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Ms Merran Kelsall
Chairman
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PO Box 204
Collins Street West
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Dear Ms Kelsall

CONSULTATION PAPER: ASSURANCE ENGAGEMENTS ON GENERAL PURPOSE WATER ACCOUNTING REPORTS

Thank you for the opportunity to comment on the Consultation Paper: *Assurance Engagements on General Purpose Water Accounting Reports*. The Department has considered the issues raised in the Consultation Paper and is pleased to provide comment given our long experience in water accounting. This includes producing the annual Victorian Water Accounts and participating in the pilot project program as part of the National Water Accounting Development Project.

Our responses to the questions raised in the Consultation Paper are provided in the Attachment to this letter.

Please do not hesitate to contact Roslynn McRoberts, State Water Accountant on (03) 9637 9533 or email roslynn.mcroberts@dse.vic.gov.au should you have any questions about this submission.

Yours sincerely

per Adrian Spall
Director, Water Information Management

Attachment

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**RESPONSE TO CONSULTATION PAPER: ASSURANCE ENGAGEMENTS
ON GENERAL PURPOSE WATER ACCOUNTING REPORTS**

Introduction

This document sets out the Department of Sustainability and Environment's response to the Consultation Paper: Assurance Engagements on General Purpose Water Accounting Reports.

The response has been developed in consultation with the Victorian Water Industry Association.

The response is based on the proposed approach to implementing Exposure Draft of Australian Water Accounting Standard 1 set out in the Department's response to the Draft Standard provided to the Water Accounting Standards Board in July 2011. The Department's proposed approach would involve the Department preparing water accounting reports for water controlled by the Crown in Victoria. Under this approach, water corporations and other data providers would gather and provide water accounting data to the Department, which would process it and prepare water accounting reports. The Department and the water corporations would review the results and the Department would revise the reports as required before publication.

It is these reports that would be subject to independent assurance.

This approach does not preclude water corporations producing their own general purpose water accounting reports; however as the producers of these reports, the relevant water corporations would be responsible for seeking independent assurance on their reports.

Relationship of a standard for assurance engagements on GPWAR to existing auditing and assurance standards

Q1. Which of the three alternatives do you prefer for a standard on assurance engagements on General Purpose Water Accounting Reports (GPWAR)? Please provide reasons to support your view.

The Department prefers alternative 3, which would involve developing a new assurance standard that incorporates references to existing Auditing and Assurance Standards Board (AUASB) standards. This alternative is preferred as it would:

- reference relevant guidance and requirements from existing relevant AUASB standards likely to be applicable to undertaking an assurance engagement on GPWARs, in particular Standard on Assurance Engagements ASAE 3000 *Assurance Engagements Other than Audits or Reviews of Historical Financial Information* (ASAE 3000); and
- provide water specific concepts and focus on requirements and guidance related specifically to providing assurance on GPWARs. Water specific concepts should include unit of account, nature of the water report

entity (these are more likely to be geographical regions and/or physical systems than organisations with water resources management responsibilities) and the distinction between water report unit and report preparer. Specific requirements and guidance should include such matters as the subsequent events, using the work of experts, internal auditors, external auditors and component assurance practitioners, content of assurance reports and types of assurance conclusions.

The proposed standard should expand on how ASAE 3000 is to be applied through water specific concepts, requirements and guidance.

Who should perform assurance engagements on GPWAR?

Q2. Do you agree that the qualifications' requirements in the proposed assurance standard should be principles-based and not prescriptive? Please provide reasons for your view.

We agree that a principles based approach is preferable as it is uncomplicated by registration requirements for assurance practitioners and the need to establish associated administrative and governance arrangements.

Q3. If you answered 'yes' to Question 2, are the suggested qualifications' requirements and guidance in paragraphs 23-24 appropriate?

Q4. Are there any other qualifications' requirements and guidance that should be included in the assurance standard?

As the subject matter of the proposed standard is general purpose water accounting reports, the lead assurance practitioner should have competencies in water accounting, that is, quantifying and reporting water volumes, and assurance. The lead practitioner would be required to meet appropriate ethical requirements (refer response to Q7 and Q8.)

Assurance engagements on GPWARs would be undertaken by a multidisciplinary team with experts in the quantification and reporting of water volumes and assurance specialists. An assurance team of accountants, engineers, scientists/hydrologists and professionals in water management may collectively hold these competencies.

On this basis, the qualifications requirements and guidance on necessary professional competencies in paragraphs 23 and 24 seem appropriate.

Q5. Do you think that the standard should be available for application by anyone with appropriate skills and who can meet appropriate ethical and quality control requirements, or do you believe it should be restricted to only those persons with particular accreditation from certain bodies?

We consider that persons or organisations with appropriate skills in the provision of assurance and water quantification and reporting, and who can

meet the ethical and quality control requirements set out in ASAE 3000, should be able to apply the proposed standard to undertake assurance engagements on GPWARs.

- Q6. Please provide details of regulators that may be appropriate to set accreditation requirements for assurance practitioners performing engagements on GPWAR.**

We don't think accreditation is necessary. Qualifications and competencies should be dealt with through principles and guidelines for practitioners undertaking assurance engagements.

Ethical requirements, including independence

- Q7. Do you agree that the proposed assurance standard should include a requirement relating to compliance with relevant ethical principles, including independence?**

Yes. We consider that independence is fundamental to the principles of integrity and objectivity included at paragraph 31(a) of the Consultation Paper.

- Q8. Would a requirement such as that in paragraph 38, with additional guidance such as that in paragraph 39, cover assurance practitioners from a range of backgrounds?**

Given that the proposed standard may be used by persons and organisations from a broad range of backgrounds, we believe it should be drafted to provide a benchmark for ethics requirements to be applied by all practitioners undertaking assurance engagements for GPWARs.

On that basis, we consider that the requirement suggested in paragraph 38 regarding compliance with ethical requirements would cover assurance practitioners from a range of backgrounds. We concur with the material proposed in paragraph 39 clarifying ethical requirements.

- Q9. Do you believe that appropriate safeguards relating to threats to independence can be put in place to ensure the integrity of the assurance process? If so, please list some of those safeguards?**

Yes. See our response to Q10 below.

- Q10. Please provide details of codes of ethics or conduct, or other professional requirements, or laws and regulations, covering other professional groups that may be involved in assurance engagements on GPWAR, which contain similar ethical requirements to those contained in the *Code of Ethics for Professional Accountants*.**

Yes. The conceptual framework approach provided in *APES 110 Code of Ethics for Professional Accountants* (APES 110) could be used by assurance

practitioners undertaking assurance engagements on GPWARs to assist them to achieve and maintain independence so that the assurance process is not compromised. APES 110 describes potential threats and the types of safeguards that may eliminate the threats or reduce them to an acceptable level, and identify situations where safeguards are not available to reduce the threats to an acceptable level.

The use of this framework approach to identifying, evaluating and addressing threats to independence recognises that it is not possible to identify every situation that would create a threat to independence and specify an appropriate safeguard to eliminate or reduce the threat. It enables the assurance practitioner to exercise professional judgement in the particular circumstances.

Requiring independence in relation to external experts could create problems. It may be difficult to find experts to work on an assurance team who have not been involved in any way with water accounting in an organisation that is responsible for preparing and presenting a GPWAR or for managing the water assets and water liabilities of the water report entity in respect of which the GPWAR has been prepared. It would be more appropriate for the assurance practitioner to evaluate the external expert for objectivity rather than independence.

We are not aware of codes, professional requirements or laws and regulations that contain ethical requirements similar to those in APES 110.

What is the subject matter information upon which assurance is to be provided?

Q11. Should assurance be provided on the GPWAR as a whole, taking into account each component of the GPWAR: the Contextual Statement, water accounting statements, note disclosures and the Accountability Statement?

No. We consider that the provision of assurance should be limited to the water accounting statements, note disclosures (excluding the note on future prospects) and the element of the accountability statement concerned with whether the GPWAR has been prepared and presented in accordance with Australian Water Accounting Standards (AWAS).

In providing assurance on a GPWAR, the assurance practitioner should consider the information in the contextual statement to identify material inconsistencies with the water accounting statements and note disclosures, as any inconsistency identified may raise doubts about the assurance conclusion. However, the assurance practitioner should not provide assurance on the contextual statement.

Q12. Should assurance be provided on the Contextual Statement in a GPWAR?

No. As stated in our response to Q11, the contextual statement should be read and considered by the assurance practitioner to identify material inconsistencies with the water accounting statements and note disclosures. The credibility of the water accounting statements and notes disclosures may be compromised or diminished by any inconsistencies between these elements and the contextual statement.

Q13. Do you consider that assurance can be provided on each of the three aspects covered in the Accountability Statement? Please provide reasons to support your views.

We believe that assurance can only be provided on the aspect dealing with compliance with AWAS. Our reasons for this conclusion follow.

Whether the GPWAR has been prepared and presented in accordance with AWAS.

The AWAS constitutes the water reporting framework used to prepare and present a GPWAR and assurance can be provided as to whether the GPWAR has been prepared and presented in accordance with the applicable water reporting framework.

Whether externally-imposed requirements relevant to managing the water assets and water liabilities of the water report entity have been complied with.

We strongly believe that assurance should not be provided on this element because it blurs the distinction between accounting for water resources and managing the resources. It removes the focus of the assurance process from the accounts to compliance related matters that are dealt with in other reports or instruments. In Victoria, these include the annual reports of water corporations and the annual performance reporting requirements of the Essential Services Commission. We believe that duplication of these accountabilities is unwarranted and must be avoided.

Whether best practices for managing water assets and water liabilities have been applied.

We do not believe it is possible to provide assurance on this element. "Best practices" is an open-ended concept and difficult to define. It raises questions about what is best practice in relation to managing water assets and water liabilities and who determines this.

Q14. Would the assurance practitioner need to perform any specific or additional procedures in relation to the unaccounted-for difference?

Given that the unaccounted-for difference item is effectively a balancing item, we don't believe there is a need to develop and perform specific procedures in relation to this item. The hydrological nature of water management and assessment means that the use of a balancing item is an important mechanism in water accounting. Undertaking assurance procedures on the volumes of water assets and water liabilities as at the reporting date and the items that explain the differences in these elements (e.g. physical flows and allocation announcements & adjustments) should be sufficient to assess the risk of misstatement of the unaccounted-for difference.

Q15. Are there any other items or elements within the components of a GPWAR that present complexities in terms of assurance?

We have concerns with the future prospects note being subject to assurance. Please refer to our responses to Q38 and Q39. It is anticipated that environmental disclosures will raise assurance complexities.

Levels of assurance

Q16. Should the proposed assurance standard allow for both reasonable and limited assurance?

We believe the proposed standard should provide a framework to allow for both reasonable and limited assurance, based on the particular requirements of the system or water report entity in question. Conceptually the higher level of assurance provided by reasonable assurance is preferable, as it would improve the credibility of the GPWAR/water accounting statements and associated notes. However, this assumes that potential users of a GPWAR understand the differences between the two assurance levels and are seeking a high level of assurance, or that the higher level of assurance is necessary for a GPWAR.

In this regard, further work with stakeholders, including potential GPWAR users and preparers of GPWARs, is required to establish whether a reasonable level of assurance for GPWARs is necessary given the nature of this type of reporting. This work could include consideration of the relative costs and benefits of limited and reasonable assurance levels.

Q17. If you consider that limited assurance should be covered in the proposed standard for assurance engagements on GPWAR, please identify the circumstances in which limited assurance might be appropriate.

Limited assurance may be sought by organisations doing voluntary reporting under Exposure Draft of Australian Water Accounting Standard 1 and in the context of the significance of a water report entity within a jurisdiction.

For instance, limited assurance would be relevant for water report entities (for example, surface water/river systems, groundwater systems, distribution systems, rural or urban water systems) that are not considered to be significant in a statewide or regional sense. In this context, *significant* may relate to the contribution a particular water system, or series of systems, makes to the economic, environmental or social fabric of a state or region, or the volume of water taken from the system relative to the volume of water available particularly where there is a trend of resource over-allocation.

Q18. Do you agree that single-layered assurance reports are preferable for GPWAR? Please provide reasons to support your views.

In the interests of simplicity and cost, we consider that single layered assurance reports are preferable to multi layered assurance reports. We agree that obtaining multi layered assurance may confuse some users of the GPWAR about the level of assurance being provided, may complicate the drafting of the terms of the engagement and the conduct of the engagement, and may be more costly.

Rather than have multi layered assurance engagements, it is preferable to specify which components of the GPWAR are not subject to assurance and engage an assurance practitioner to provide either a reasonable or limited assurance report (single level) on the components of the GPWAR that are subject to assurance. This is arguably less confusing than a multi-layered assurance approach.

Content of the assurance report

Q19. Do you agree that the proposed standard for assurance engagements on GPWAR should include requirements and guidance relating to the content of the assurance report to promote consistency in assurance reporting?

Yes. See our response to Q20 below.

Q20. Do you consider that illustrative assurance reports would be helpful and should be included in the proposed assurance standard?

We agree that requirements and guidance regarding the content of the assurance report, and illustrative assurance reports, should be included in the proposed standard.

The assurance practitioner's conclusion

Q21. Should the proposed assurance standard include requirements and guidance on the different types of assurance conclusions that may be included in an assurance report on a GPWAR?

We agree that the proposed standard should include requirements and guidance on the different types of assurance conclusions that may be included in a GPWAR assurance report.

Q22. Are the types of assurance conclusions discussed in this consultation paper relevant to assurance engagements on GPWAR?

The various assurance conclusions appear relevant to GPWAR assurance engagements.

Emphasis of matter and other matter paragraphs in the assurance report

Q23. Should the proposed assurance standard include requirements and guidance on Emphasis of Matter and Other Matter paragraphs in the assurance report?

Q24. Please provide examples of matters that may be included in an Emphasis of Matter paragraph in an assurance report on a GPWAR.

Q25. Please provide examples of matters that may be included in an Other Matter paragraph in an assurance report on a GPWAR.

The proposed standard should include requirements for an assurance practitioner to include Emphasis of Matter and Other Matter paragraphs. The necessity of including such a paragraph would depend on the particular circumstances of the assurance engagement and be a judgement call of the assurance practitioner.

Guidance on these items should be included in the proposed standard.

We have no specific examples of matters that may be included in these paragraphs.

Materiality

Q26. Do you agree that it is appropriate to use a principles-based approach, rather than prescribing a numeric level for materiality in the proposed standard for assurance engagements on GPWAR?

Yes. A principles based approach recognises the importance of an assurance practitioner exercising professional judgement about materiality. Judgements are made in view of the particular circumstances of the assurance engagement and are affected by quantitative and qualitative factors.

Assurance procedures

Q27. Are there any specific considerations necessary in the application of 'traditional' assurance procedures to assurance engagements on GPWAR?

Q28. Are there any other procedures that have not been identified that you consider would be applicable to assurance engagements on GPWAR?

Based on the discussion in the Consultation Paper, the alternative assurance procedures of inquiry, analytical review and observation seem to us to be appropriate for obtaining evidence to reach an assurance conclusion. We have no further comments on these questions.

Using the work of experts

Q29. Should the proposed assurance standard include requirements and guidance relating to using the work of assurance practitioners' experts?

Q30. Are there any special considerations that are required when the assurance practitioner uses the work of an assurance practitioner's expert in an assurance engagement of GPWAR?

We consider that the proposed standard should include requirements and guidance related to using the work of assurance practitioners' experts.

Having established the need for an expert, the assurance practitioner should evaluate the general competence, capability and objectivity of the expert, including being able to provide reliable, objective information/evidence to support the assurance conclusion. In the case of an external expert, the assurance practitioner should evaluate for objectivity. This should include obtaining a written conflicts of interest statement from the proposed external expert about any interests or relationships with the entity that prepared the GPWAR the expert is aware of, and whether the expert believes these relationships would prohibit the expert from being involved in the assurance engagement.

Q31. Should the proposed assurance standard include requirements and guidance relating to using the work of management's experts?

Q32. Are there any special considerations that are required when the assurance practitioner uses the work of a management's expert in an assurance engagement on GPWAR?

We consider that the proposed standard should include requirements and guidance relating to using the work of management's experts.

The assurance practitioner should evaluate the general competence, capability and objectivity of a management's expert, including being able to provide

reliable, objective information/evidence to support the assurance conclusion. The management's expert should be evaluated for objectivity.

Given that water accounting is a specialised area, there may be circumstances where a proposed assurance practitioner's expert has provided expertise to management of the organisation that produced the GPWAR. In those circumstances, the assurance practitioner's evaluation of objectivity should include enquiring about interests and relationships the expert has with the entity that prepared the GPWAR and discussing any applicable safeguards with the expert and the adequacy of these to reduce threats to an acceptable level.

Using the work of internal audit

Q33. Are you aware of any internal audit functions that perform work related to the water accounting function of a management group likely to be a GPWAR preparer and, if so, should the assurance standard provide for the use of the work of internal audit by the assurance practitioner?

Where possible, the assurance practitioner should take advantage of any internal audit functions that may assist in undertaking the assurance engagement. This would involve determining the adequacy of relevant work of the internal auditors for the assurance practitioner's purposes.

Quality assurance and quality control

Q34. Are you aware of any QA/QC, or peer review, functions undertaken that are related to the water accounting function of a management group likely to be a GPWAR preparer?

Where possible, the assurance practitioner should take advantage of any QA/QC or peer review functions related to the management group's water accounting function that may assist in undertaking the assurance engagement. This would involve determining the adequacy of relevant work from these functions for the assurance practitioner's purposes.

Q35. What impact, if any, will the existence of QA/QC, or peer review, functions have on assurance engagements on GPWAR?

It is expected that this would depend on the reliance the assurance practitioner could expect to place on these functions. This is about deciding if the controls for these functions are relevant and effective.

Using the work of component assurance practitioners

Q36. Are you aware of any group water report entities involving more than one component entity or of a water report entity involving a number of components of a water system? If so, please provide details.

In Victoria, water can be reported by various entities including river basins, groundwater management units and distribution systems involving multiple parties. Information in relation to these individual entities or components may be aggregated to produce a 'group' water accounting report if necessary.

Q37. Should the proposed standard for assurance engagements on GPWAR provide requirements and guidance for group assurance practitioners when using the work of component assurance practitioners?

Yes.

Future prospects

Q38. What should be the assurance practitioner's responsibilities regarding information included in the Future Prospects note in a GPWAR?

We have grave concerns about the utility and reliability of information included in the future prospects note and consider this should be excluded from the GPWAR and therefore not be subject to an assurance conclusion. For these reasons if it were to be included, we believe the assurance practitioner would be unable to give meaningful assurance due to the process of determining these values.

Q39. Does the information in the Future Prospects note in a GPWAR present any challenges for assurance practitioners? If so, please provide details.

Information in the future prospects note is presented at a particular point in time – the end of the reporting period – and is intended to provide information about the extent to which water assets at that date will be available to settle water liabilities and future water commitments within 12 months of the reporting date. The future prospects note is proposed to include estimates of future inflows of water.

Management of the water corporation responsible for managing water resources within its operational area would assess future prospects for water availability on an ongoing basis. It is likely that information provided at the end of the reporting period would quickly be overtaken by emerging seasonal conditions and for this reason we do not consider it appropriate for assurance to be provided on prospective information.

Subsequent events

Q40. Should the proposed assurance standard for GPWAR include requirements regarding subsequent events?

Yes. Requirements and guidance regarding subsequent events should be included in the proposed assurance standard.

Q41. Please provide examples of *adjusting events after the reporting period*, as defined in ED AWAS 1, together with any assurance implications arising from them.

We have no specific examples of adjusting events after reporting period.

Frequency of assurance

Q42. Are there any circumstances that would warrant the provision of assurance less frequently than the frequency of the preparation of the GPWAR?

Q43. What are the implications for the usefulness of an assurance report where a limited assurance engagement is undertaken in one period, followed by reasonable assurance in the next period, if the assurance conclusion must be modified as a result?

To provide credibility to the GPWAR, assurance should be provided at least annually (to align with reporting frequency).

In the interests of consistency in the level of assurance across reporting periods and keeping the costs of assurance reasonable, it would be better to adopt a limited level of assurance in consecutive reporting periods. Varying the level of assurance from year to year may confuse report users and preparers and diminish report credibility.

Other comments

Other comments not covered in the questions above

- Consideration should be given to the costs versus the benefits of the proposed assurance levels. This relates to the context of what are the GPWARs likely to be used for. Matters for consideration include:
 - To what extent are the GPWARs likely to inform or influence decision makers, given that users of the reports are likely to include regulators, policy makers, academics, environmental interest groups and potential investors?
 - What level of assurance are the potential users of GPWARs seeking to meet their needs?

- What is the relative cost/benefit of a reasonable assurance level compared to a limited level of assurance?
- Assurance processes need to be flexible given that volumes will include high levels of estimation and modelling with various associated timing differences.
- Concern has been raised by several water corporations in Victoria that in the absence of standards for quantifying values in the GPWARs, assurance practitioners may collect evidence to support a standard of 'best practice' rather than 'fit for purpose', which may force the water industry to use 'best practice' as proposed by assurance practitioners.
- Assurance engagements should be concerned with providing assurance on the values reported in the GPWAR, not the methods used to quantify items.