VICTORIA

Victorian
Auditor-General

Audit summary of Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2009–10

Tabled in Parliament
7 October 2010

Audit summary

Background

This report informs Parliament about the results of the audit of the *Annual Financial Report of the State of Victoria, 2009–10* (AFR). Section 16A of the *Audit Act 1994* requires the Auditor-General to provide an audit opinion on the AFR, and to make a report to Parliament on each annual financial report.

Overall conclusion

The overall conclusion from this audit is that Parliament can have confidence in the AFR which was tabled in Parliament on 15 September 2010.

A clear audit opinion on the AFR was issued on 10 September 2010. A clear audit opinion indicates that the 2009–10 AFR was prepared in accordance with the requirements of the *Financial Management Act 1994* (FMA) and Australian accounting standards.

The 2009–10 net result for the state was a deficit of $5 677.7 million ($13 088.8 million deficit in 2008–09). This was largely due to an increase in the state's liability for unfunded superannuation of $1 435.8 million and a downwards revision of $4 000 million to the value of land under roads.

Findings

Results of audit

The AFR consolidates the financial results of 298 public sector entities, each of which is separately audited by the Auditor-General. Of these entities, 47 are deemed material entities because individually their financial operations are material to the consolidated finances of the state.

Our audit provides authoritative independent assurance that the Treasurer and the Minister for Finance, WorkCover and the Transport Accident Commission have prepared the AFR consistent with the provisions of the FMA and applicable accounting standards.

The accurate and timely production of the AFR is impacted by the quality and timing of information provided by public sector entities, and the production timetable and quality assurance processes adopted by the Department of Treasury and Finance (DTF).

To prepare the AFR, DTF sets key milestones and a timetable for material entities to provide draft financial statements to audit, and for financial reports to be finalised.

This timetable was not achieved with 74 per cent (83 per cent in 2008–09) of material entities not finalising their financial reports by the set milestone dates.

Financial performance of the state

The consolidated comprehensive operating statement in the AFR provides two key measures of financial performance and sustainability, the net result from transactions and the net result. The net result from transactions represents revenue less expenditure that can be directly attributed to government policy. The net result includes the net result from transactions and other economic flows such as changes in the value of assets and liabilities due to market re-measurements.

The statement also details the amount and type of state revenue and expenses.

A summary of the 2009–10 financial results for the state and the general government sector is set out below.

Figure A
2009–10 financial results for the state and the general government sector

	State of Victoria		General government sector	
	2009–10 ($mil)	**2008–09 ($mil)**	**2009–10 ($mil)**	**2008–09 ($mil)**
Net result from transactions	594.7	(123.8)	643.6	251.2
Net result	(5 677.7)	(13 088.8)	(5 413.1)	(8 372.8)

Source: Victorian Auditor-General's Office.

The 2009–10 surpluses arising from the net results from transactions in the general government sector and at the whole of state level were primarily due to increases in taxation and Commonwealth grant revenue totalling $4 861.4 million, offset by increases in employee costs, grants and other operating expenses totalling $3 972.6 million.

The net result from transactions for the general government sector exceeded the government's key financial objective of a surplus of at least $100 million.

The 2009–10 net result for the state largely reflected an increase in the state's liability for unfunded superannuation of $1 435.8 million and a downwards revision of $4 000 million to the value of land under roads.

The net result is the state's 'bottom line' and is an indicator of the state's financial sustainability and demonstrates the state's exposures to the financial markets and economic conditions.

Total expenditure of the state increased by 49.5 per cent from 2004–05 to 2009–10. This increase is greater than the increase in revenue for the same period of 45.0 per cent.

Financial position of the state

The consolidated balance sheet reports the value and composition of the state's assets and liabilities. A summary of the financial position of the state and the general government sector as at 30 June 2010 is set out below.

Figure B
Financial position of the state and the general government sector as at 30 June 2010

	State of Victoria		General government sector	
	30 June 2010 ($mil)	30 June 2009 ($mil)	30 June 2010 ($mil)	30 June 2009 ($mil)
Total assets	203 468.8	194 254.0	164 106.5	157 528.9
Total liabilities	84 078.2	76 250.4	46 551.0	40 855.1
Net worth	**119 390.6**	**118 003.6**	**117 555.5**	**116 673.8**

Source: Victorian Auditor-General's Office.

The state's asset base continued to grow in 2009–10. Land, buildings, infrastructure, plant and equipment account for 80 per cent of the state's assets. The increase in assets was driven by:

- a $10 769.3 million revaluation of rail, road and water infrastructure, and $4 510.6 million of spending on housing, water, road, rail and schools infrastructure
- offset by $3 392.5 million of depreciation charged during the year and a downwards revaluation in the carrying value of land under roads of $4 000 million.

State liabilities increased by 10.3 per cent ($7 827.8 million) from the prior year to $84 078.2 million at 30 June 2010. The major liabilities for the state are:

- borrowings, which increased by 18.5 per cent during 2009–10 to reach $28 580.3 million at 30 June 2010
- unfunded superannuation, which increased by 8.9 per cent during 2009–10 to total $22 597.7 million as at 30 June 2010
- provisions for insurance claims, which increased by 9.3 per cent during 2009–10 to total $18 172.1 million at 30 June 2010.

Significant developments

The status and financial implications of a post balance date event and the state's more significant projects and developments undertaken in 2009–10 follows.

Post balance date event

The AFR recognised that floods, which occurred on 4 and 5 September 2010, are expected to have financial implications for the state. The cost to the state could not be estimated at the time of finalising this report (refer Note 36 of the 2009–10 AFR).

Victorian Transport Plan

The Victorian Transport Plan (VTP) outlines $38 billion of transport projects which aim to improve all modes of transport. A financial analysis is provided of the new trains, M1 upgrade, and Peninsula Link projects in the VTP which are the larger projects currently underway. As at 30 June 2010:

- nine new X'trapolis trains have been delivered out of a total of 38 on order, one less than contracted
- the state will pay an estimated $1 340 million to upgrade the M1 and will receive 50 per cent of any extra profits of Citylink that are a consequence of those works. These extra profits will be calculated, after Transurban has recovered its own construction costs of $166 million
- the state's total financial commitment to Peninsula Link, including the Lathams Road overpass, is $2 752.0 million in nominal dollars over the 25-year term of the public private partnership.

Victoria's water plan: *Our Water Our Future*

The government's long-term strategic plans for water management were detailed in *Our Water Our Future,* released in 2004, and updated and extended in 2007. The plan includes the development of a desalination plant, modernising food bowl irrigation channels, a pipeline to transfer water into Melbourne's water supply, and the northern sewerage project.

To assist in funding the cost of projects under the *Our Water Our Future* plan, Melbourne Water has increased wholesale water charges to the three metropolitan water distribution companies. These increased charges, together with other cost increases, will result in metropolitan customer water prices nearly doubling over the 5-year period to 2012–13.

Desalination Plant

The desalination plant is being delivered using a public private partnership to produce up to 150 gigalitres per annum of drinking water. Water will be transferred to Melbourne by an 84 kilometre transfer pipeline, powered using an 87 kilometre underground power supply.

The total cost to the state of preparing for, financing, designing, constructing, operating and maintaining the desalination plant and associated infrastructure for the 27.75-year operating term, is expected to be $18 080 million in nominal dollar terms, or

$5 410 million in net present value terms. This represents the total estimated project cost to the state of having a desalination plant. The cost of any water purchased will be additional to this amount. If the state purchased the maximum 150 gigalitres per year for the entire operating term the total additional cost would be $5 834 million in nominal dollar terms, or $1 260 million in net present value terms.

The AFR, at Note 33, separately highlights the state's commitments to the consortium for the construction, operation and maintenance of the plant totalling $15 808 in nominal dollar terms, or $4 590 million in net present value terms. The balance of $2 272 million in nominal terms or $820 million in net present value terms includes capital, operating and maintenance commitments to the consortium associated with an underground power supply and plant refurbishment during the period of operation, and other related financial commitments of the Department of Sustainability and Environment.

With two reconciling items, this is consistent with the Partnerships Victoria project summary titled *Victorian Desalination Project*, dated November 2009. This project summary set out the cost of the plant as $5 720 million in net present value terms, based on estimated payments to the consortium over the total operating term. The reconciling items are:

- other related estimated costs of the state comprising project development and management costs, environmental assessments, land acquisition and compensation payments, totalling $308 million in net present value terms
- the impact of DSE using a different discount rate and time period over which the calculation is made for valuing the financial commitments to the consortium for financial reporting purposes under the Australian accounting standards, totalling $642 million in net present value terms.

This $5 720 million estimate includes the cost of purchasing the maximum volume of water, $1 260 million in net present value terms.

Food Bowl Modernisation

The $2 billion food bowl modernisation irrigation system aims to provide the Goulburn Murray Irrigation District with an irrigation delivery system that will reduce water losses and assist with the region's economic viability. The project is being delivered in two stages. Stage 1 is aiming to recover approximately 225 gigalitres of water per annum, and stage 2, 200 gigalitres of water per annum, as a long-term average. Water to be recovered relates to water that is currently lost to the system through leakage, seepage, unplanned spills or releases, evaporation and inaccurate metering.

Stage 1 of the project commenced in 2008 and is scheduled to be finished by 31 December 2012, at a cost of $1 004.5 million. As at 30 June 2010, $274.9 million had been spent on stage 1.

The metropolitan water distribution companies will have access to the water savings from the project which will be transferred to Melbourne via the 70 kilometre Sugarloaf Pipeline.

Sugarloaf Pipeline

The Sugarloaf Pipeline was commissioned in February 2010 at an estimated cost of $692.2 million. It is expected to transfer up to 75 000 megalitres per annum of water savings to Melbourne. As at 16 August 2010, 17 980 megalitres had been delivered by the pipeline.

The water savings are metered at the Goulburn River Pump Station, and are managed by Goulburn-Murray Rural Water Corporation and accessed by Melbourne Water for supply to the metropolitan water distribution companies. Water savings will be confirmed by an annual audit organised by the Department of Sustainability and Environment, pursuant to the Water Savings Supply and Transfer Agreement.

Northern Sewerage Project

The project commenced in August 2007 and is ahead of schedule. Works undertaken by Melbourne Water are now expected to be completed and commissioned by October 2011 and Yarra Valley Water Limited by February 2012. The original target date for the project was mid 2012.

Substantial project savings of $134 million (21 per cent) have been realised during the construction stage due to design reviews, construction risk management, and adverse ground conditions not being encountered.

Building the Education Revolution

The Commonwealth Government's *Building the Education Revolution* program will provide new facilities and refurbishments in Australian schools, including a funding allocation to Victoria of $3.8 billion over three years.

The Department of Education and Early Childhood Development's (DEECD) delivery of the program is behind schedule. All projects were originally to be completed by 30 June 2011 and the New Science and Language Centres for the 21st Century were to be fast tracked and completed by 30 June 2010. DEECD had spent $1 010 million at 30 June 2010, $412 million or 29 per cent less than budgeted, and none of the planned 70 science and language centres were complete. Consequently, DEECD advised the Commonwealth Department of Education, Employment and Workplace Relations of the delays, as it wanted to achieve best value for money through its procurement practices, and transfer of project funding into 2011–12 has been agreed.

Victorian Schools Plan

The Victorian Schools Plan is the government's 10-year, $1 934 million plan to transform schools by rebuilding, renovating or extending all government schools by 2016.

At 30 June 2010, DEECD had spent a total of $1 108 million on projects under the *Victorian Schools Plan*, compared to a total cumulative budget of $1 270 million.

Myki

Myki is the new ticketing system that will replace the Metcard and V/Line ticketing systems, and paper tickets on regional buses.

Control weaknesses in the new myki ticketing system meant that it was not possible to form an opinion on the completeness and accuracy of myki revenue for the year ending 30 June 2010. Accordingly, a qualified audit opinion was issued on the 2009–10 financial report of the Transport Ticketing Authority.

Public transport franchise contracts

On 31 August 2009 the state completed contracts with private sector providers to operate and maintain Melbourne's passenger train and tram networks.

During the myki start up period up to 30 June 2012 the state decided to accept the risk associated with the introduction of the new ticketing system and has guaranteed fare box revenue payments to the train and tram operators. The state will therefore fund any shortfall between the guaranteed fare box, which is based on projected fare box revenue, and the actual fare box revenue. The contract however does not provide for adjustments to the guaranteed revenue for variations not attributable to the new ticketing system.

In 2009–10, the state paid a total of $22.4 million above the actual amount of fare box revenue collected. This was an additional cost to the state borne by the Department of Transport primarily due to lower patronage growth on trains and buses, and a decline in tram patronage. Further additional costs may also arise in 2010–11 and 2011–12 if there is a shortfall between the fare box revenue collected and the guaranteed fare box payable to the operators in those years. Therefore, in addition to any adverse revenue implications associated with the new ticketing system, the state will also bear the cost of these impacts and any further adverse patronage movements.

Under the contract with the train operator, it is estimated that the state will pay $2.31 for each train passenger boarding in the 2010–11 financial year, the first full year of operation of the new contract. This is an 18 per cent increase when compared to the cost per boarding of $1.95 in 2008–09 and is due to higher maintenance payments by the state in the new contracts. The same analysis for trams shows a 21 per cent increase which will be offset by the state retaining 10 per cent more fare box revenue under the new contracts.

A performance bonus of $0.74 million was paid to the tram operator for the period 1 December 2009 to 30 June 2010, and performance penalties were levied on the train operator of $4.8 million for the same period. The capping of performance bonuses and penalties under the new franchise arrangements has reduced the financial bonuses that the state paid by $1.16 million and the financial penalties that it received by $10.6 million. The introduction of capping was designed to influence the bids from the franchisees who may have otherwise sought higher franchise payments.

Channel deepening

On 25 November 2009, the Port of Melbourne Corporation announced that the channel deepening project was complete, one month ahead of schedule. The estimated total cost of the project was $721 million, calculated on 31 May 2010 when most of the project expenditure had been paid. The project finished $248 million under budget assuming no payments are made on a $100 million guarantee issued by the Minister for Roads and Ports to remediate certain environmental related impacts of the project.

Victorian Bushfires Appeal Fund

Over 78 towns and communities across Victoria were devastated by the bushfires of February 2009. On 8 February 2009, the 2009 Victorian Bushfire Appeal Trust Fund was established.

Since the appeal fund's inception, $391.6 million has been received, including $8.5 million of interest revenue. The appeal fund has distributed $267.6 million to individuals and communities, leaving a balance in the fund of $124.0 million as at 31 August 2010. Of the $124 million remaining, 87 per cent has been committed for future disbursement.

Recommendation

Number	Recommendation	Page
1.	The Department of Treasury and Finance should develop strategies so that agreed AFR milestones are generally met by material entities.	11

Submissions and comments received

In addition to progressive engagement during the course of the audit, in accordance with section 16A and 16(3) of the *Audit Act 1994* a copy of this report, or relevant extracts from the report, was provided to the Treasurer and all relevant agencies with a request for submissions or comments.

The Treasurer's and agency views have been considered in reaching our audit conclusions and are represented to the extent relevant and warranted in preparing this report. Their full section 16(3) submissions and comments, however, are included in Appendix D.

Audit conduct

The audit of the AFR was conducted in accordance with Australian Auditing Standards.

The total cost of preparing and printing this report was $172 000.