

Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2014–15

Tabled 24 November 2015

The Auditor-General provides assurance to Parliament on the accountability and performance of the Victorian Public Sector. The Auditor-General conducts financial audits and performance audits, and reports on the results of these audits to Parliament.

On 24 November 2015, the Auditor-General tabled his financial audit report, *Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2014–15*.

Overview

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The Annual Financial Report of the State of Victoria 2014–15 (AFR) was neither timely or accurate:

- The AFR was transmitted to Parliament 15 days after the statutory time frame.
- The AFR received a modified audit opinion on two matters:
 - incorrect treatment of monies relating to the East West Link project (EWL) (\$1.5 billion)
 - lack of records to support assets held by the Department of Education and Training (DET) (\$16.8 billion)

The Annual Financial Report (or AFR) contains the state's financial statements and is the key accountability document for Parliament and the public on the state's financial result and position.

Our report outlines the results of our audit of the AFR.

The AFR was not timely because it did not achieve the legislative reporting date of 15 October 2015. The Acting Auditor-General issued his opinion on 30 October 2015 and the AFR was transmitted to Parliament on 4 November 2015.

The AFR was not accurate because the audit opinion was modified on two matters:

- Firstly, the failure to account for the state government's obligation at 30 June 2015 to return \$1.5 billion of Commonwealth funding for the East West Link project
- And secondly, a lack of proper accounts and records at the Department of Education and Training (or DET) meant we were unable to obtain sufficient appropriate evidence to support the \$16.8 billion of property, plant and equipment that DET holds.

Background

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The AFR:

- is a consolidation of 277 public sector entities
 - excludes universities, local government
- reports on the financial outcomes and performance at 30 June 2015 of:
 - the State of Victoria
 - the general government sector.

The AFR is prepared by consolidating the 277 public sector entities controlled by the state.

The financial transactions and balances of universities and local governments are not part of the AFR as neither of these sectors are controlled by the state.

The AFR reports at two levels:

- The general government sector—which is public entities that provide goods and/or services to the community for subsidised or at no cost
- And the State of Victoria—which is all 277 public sector entities including those in the general government sector, public financial corporations and public non-financial corporations.

The AFR was not timely

Treasurer transmitted the AFR on 4 November 2015.

- In breach of the *Financial Management Act 1994*.

The delays were caused by:

- machinery-of-government changes during 2014–15
- a loss of financial audit knowledge and experience at public sector entities
- contentious financial reporting issues in several sectors.

The AFR was transmitted to Parliament on 4 November 2015. The finalisation of the AFR report has been getting later over the past three years.

The timely preparation of the AFR is dependent on the timely finalisation of material entity financial reports. These material entities collectively make up 90 per cent of the transactions and balances in the AFR.

In 2015, only four of the 47 material entities provided draft financial statements to audit in the time frame set out by the Department of Treasury & Finance (or DTF). This had a direct impact on the delay in the AFR.

The reasons we observed for the delays were that:

- The 2014–15 Machinery-of-government changes which required a final set of financial statements to be prepared for the former departments for 31 December 2014, and a set of financial statements for the new departments to 30 June 2015,
- The former government's sustainable government initiative reduced support staff which appears to have impacted the level of financial knowledge and experience in public sector entities, and
- Contentious accounting issues arose in several sectors that took time to be resolved.

The AFR was not accurate – EWL

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- **Obligation to return EWL funds was not recognised in the AFR.**
 - State received \$1.5 billion in 2013–14 towards the construction of the EWL.
 - The new project was cancelled in November 2014.
 - State had an obligation to return the \$1.5 billion to the Commonwealth at 30 June 2015.
- **Consequently, the state did not achieve the key financial measure of a surplus from transactions of at least \$100 million.**

At 30 June 2015, the state had an obligation to repay the \$1.5 billion received in 2013–14 from the Commonwealth for the East West Link project. However, the AFR did not recognise an expense and provision for this obligation. We do not agree with this omission, and the AFR received a qualified audit opinion.

In 2014–15 and following a change in government, the East West Link project was cancelled and in accordance with the funding agreement under which the money was provided, and the *Nation Building Program (National Land Transport) Act 2009*, the money was required to be returned, which the Commonwealth requested in writing.

Alternatively, the Commonwealth has the right to withhold money from future projects to settle the obligation.

Subsequent to 30 June 2015, the Commonwealth has indicated that they may allow the funding to be used for other future projects subject to conditions which have not been met. This does not mean that there was no obligation at 30 June and withholding future funding from the state would result in the same outcome.

Had the obligation been correctly recognised, the net result from transactions would have been a deficit of \$286 million, which means the state did not achieve its key financial measure of a net surplus from transactions of at least \$100 million.

The AFR was not accurate – Education assets

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- DET failed to maintain proper accounts and records to support their property, plant and equipment balances.
 - \$16.8 billion of assets impacted at 30 June 2015.
 - DET did not have an asset register, breaching the *Financial Management Act 1994*.
 - A qualified audit opinion was issued on the AFR as the balance impacted was material to the state.

A disclaimer audit opinion was issued on the financial statements of the DET for the year ending 30 June 2015. A disclaimer audit opinion was issued because we were unable to obtain sufficient appropriate audit evidence to support all the balances and/or transactions in the financial report relating to fixed assets and certain school-based financial information.

It was determined that the \$16.8 billion of property, plant and equipment transactions and balances were material to the AFR, so a qualification was provided on the AFR.

DET breached the Financial Management Act 1994 by failing to maintain proper accounts and records. This led to us being unable to obtain sufficient appropriate audit evidence to support a clear opinion.

DET have, in their response to this report, accepted the issues and made commitments to take action to address them. We will do what we can, within the bounds of our independence, to provide the department with feedback and direction as they work through resolving these issues.

Update on prior year management letter issues

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In 2013–14, Auditor-General recommended :

- increased scrutiny and oversight of the AFR—**not actioned**
- AFR be signed by the Treasurer—**actioned**
 - However, 2014–15 AFR not signed by a chief financial officer.

In our 2013–14 audit of the AFR, we raised three issues with DTF regarding the preparation and oversight of the AFR. These issues were also reported to Parliament in our Portfolio Departments and Associated Entities: Results of 2013–14 Audits report tabled in February 2015.

Two of the issues raised remain unresolved and have therefore been raised again in this report. These are:

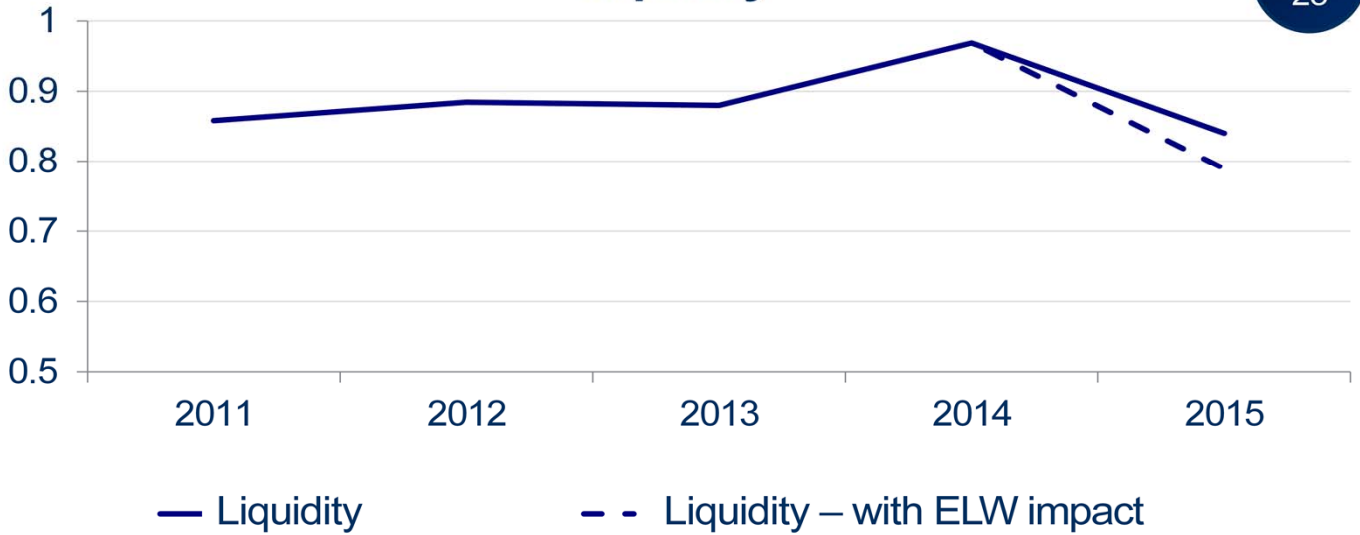
- The lack of independent governance and oversight of the AFR, and that
- The AFR does not adopt the principles in the Standing Directions of the Minister for Finance and the Financial Reporting Directions that all other public sector agencies apply.

The third issue we raised was that the Treasurer should sign the AFR as the responsible person for its preparation. While the Treasurer did sign the 2014–15 AFR, a chief financial officer did not. This was a fundamental change from prior years, which puts the AFR at odds with the requirements for all other public sector entities and previous practice for the AFR.

State of Victoria financial performance at 30 June ⁸

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Liquidity

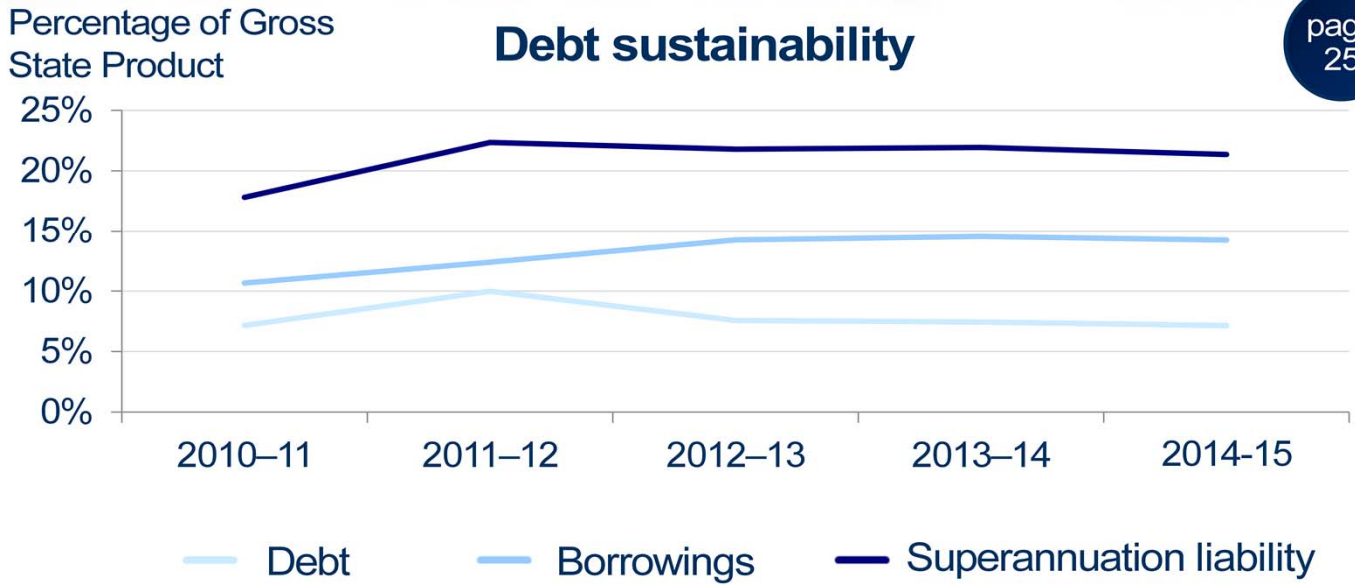


The financial results for the State of Victoria for 2014–15 were mixed.

The state reported a net deficit from operations of \$610 million.

In addition, liquidity, which is the measure of current assets to current liabilities, declined from 0.97 to 0.84. Liquidity would have declined further to 0.79 if the East West Link project funding return had been correctly accounted for.

State of Victoria financial performance at 30 June ⁹

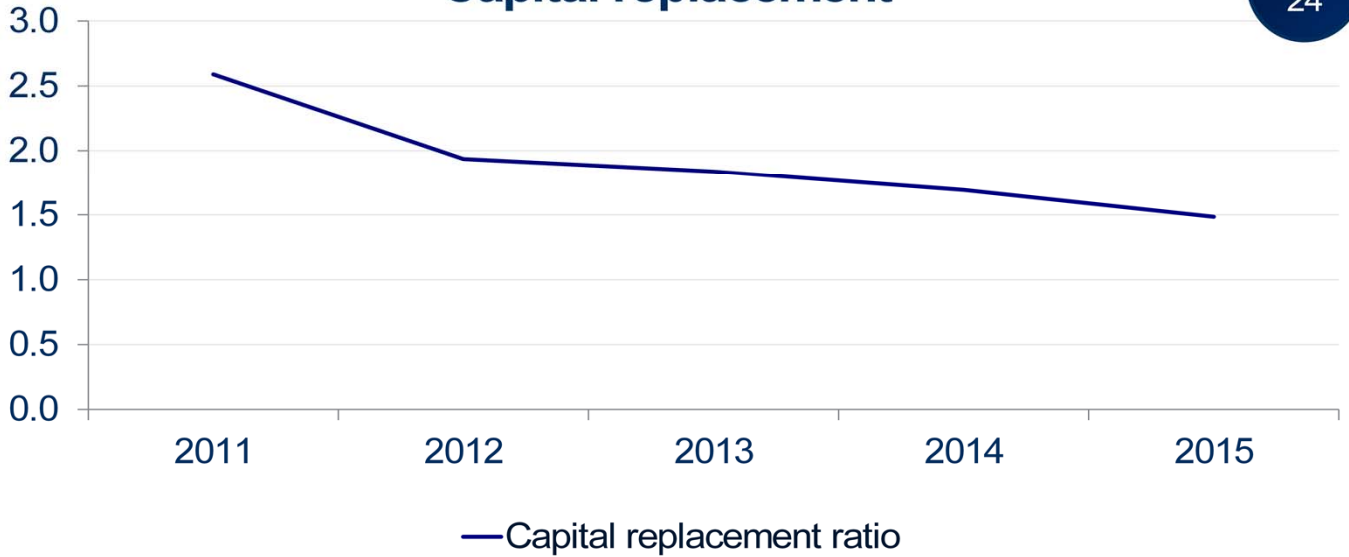


The positives in the AFR were the state's debt sustainability and capital replacement indicators. Debt sustainability remained stable. While debt has grown it has been at the same pace as gross state product has grown therefore the state has maintained its capacity to service this debt.

State of Victoria financial performance at 30 June 10

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Capital replacement



Our capital replacement indicator, which looks at the spending on new assets and asset renewal compared to the consumption of assets as measured by depreciation, shows no concern with the indicator staying above one.

Recommendations

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		Accept
1.	Material entities, particularly portfolio departments, should review the resources and capability of their finance teams and ensure they have the skills and experience to produce accurate and compliant financial statements in a timely manner.	✓
2.	DTF needs to apply the same governance, oversight and better practice financial reporting principles to the AFR that applies to public sector entities reporting under the <i>Financial Management Act 1994</i> .	×

The report makes two recommendations.

In his response to this report, the Treasurer accepted the recommendation for material entities to review the resources and capabilities of their finance teams.

The Treasurer did not accept our recommendation that the AFR apply the same governance, oversight and better practice financial reporting principles as all other public sector entities are required to adopt under the *Financial Management Act 1994*.

Overall message

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The AFR was neither timely nor accurate:

- received a modified audit opinion
- transmitted outside of timelines required by *Financial Management Act 1994*.

In summary, the AFR was neither timely nor accurate:

- received a modified audit opinion, and
- it was transmitted outside of timelines required by *Financial Management Act 1994*.

Contact us

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For further information on this presentation please contact:

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