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

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Victorian Auditor-General's Office

Auditing in the Public Interest

The Hon. Bruce Atkinson MLC
President
Legislative Council
Parliament House
Melbourne

The Hon. Telmo Languiller MP
Speaker
Legislative Assembly
Parliament House
Melbourne

Dear Presiding Officers

Under the provisions of section 16AB of the *Audit Act 1994*, I transmit my report *Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2014–15*.

The *Annual Financial Report of the State of Victoria 2014–15* (the AFR) was transmitted to Parliament on 4 November 2015. The AFR received a modified audit opinion containing two audit qualifications.

The audit qualifications highlight that the AFR fails to recognise the state's obligation to return $1.5 billion of Commonwealth Government funding relating to the East West Link project at 30 June 2015, and that there was insufficient appropriate evidence to support the property, plant and equipment balances at the Department of Education & Training.

This report reviews the liquidity and capital replacement ratios for the state, including the impact the East West Link project transaction had on these results. The state did not achieve its key financial measure of having a surplus from transactions for the general government sector of at least $100 million.

Yours faithfully

Dr Peter Frost
Acting Auditor-General

24 November 2015

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Auditor-General’s comments

On 4 November 2015 the Treasurer transmitted the *Annual Financial Report of the State of Victoria* (the AFR) to Parliament. This was 15 days after the date required by the *Financial Management Act 1994* and reflects a difficult and challenging year in financial reporting for the public sector.

I signed my audit opinion on the AFR on 30 October 2015. The AFR received a modified audit opinion, containing two audit qualification matters.

Firstly, the AFR failed to record the state's obligation at 30 June 2015 to return $1.5 billion in Commonwealth Government funding relating to the cancelled East West Link project.

The Commonwealth Government had requested the return of these funds prior to balance date, and can recover the funds by reducing future funding for other Victorian projects. The memorandum of understanding, and legislation under which the funding was provided, are both clear in the requirement to return funding if a project is cancelled. This obligation is therefore also required to be recognised in the state's AFR under Australian Accounting Standards. Subsequent to year end, the Commonwealth Government indicated that it would allow the state—on a without prejudice basis and under certain specified conditions—to treat the funding as a prepayment to fund the Commonwealth Government's future commitments to other projects.

Omitting the obligation to return the East West Link funding from the AFR has meant the reported results and the state's liquidity ratio are overstated. Consequently, the correct accounting treatment for this transaction reduces the net result from transactions for the general government sector. This means the state has not achieved its key financial measure of generating a net surplus from transactions of at least $100 million.

The second qualification matter relates to $16.8 billion of property, plant and equipment at the Department of Education & Training (DET) which is not supported by proper accounts and records—breaching the *Financial Management Act 1994*.

Our observations and concerns around data integrity and other issues over asset recording at DET are not new, and are a further area of concern for this office in light of our recent performance report on strategic planning at that department.

Audit team

Simone Bohan
Engagement Leader

Helen Grube
Team Leader

Engagement Quality Control Reviewer

Tim Maxfield

It is pleasing to note that DET have accepted the issues discussed in this report, and that they have made commitments to take action. My office will, within the bounds of our independence, provide the department with feedback and advice as they work through resolving these issues.

Dr Peter Frost
Acting Auditor-General

November 2015

Audit summary

This report informs Parliament about the results of our audit of the *Annual Financial Report of the State of Victoria, 2014–15* (the AFR), transmitted to Parliament by the Treasurer on 4 November 2015.

The report reviews the financial outcomes and performance of the State of Victoria (SoV), and assesses the general government sector (GGS).

The final Part of the report provides an update on four major projects, including three public private partnerships that the state was constructing at 30 June 2015. This Part also reviews the current status of the Port of Melbourne lease.

Conclusions

The 2014–15 AFR was not timely because the legislative time lines for reporting were not achieved. It was also not accurate as the audit opinion was qualified on two points.

The first audit qualification highlights that the AFR failed to record the obligation that the state government had at 30 June 2015 to repay Commonwealth Government funding relating to the cancelled East West Link (EWL) project. The state should have recognised a $1.5 billion liability and corresponding expense.

Secondly, the Department of Education & Training (DET) has failed to maintain a complete and accurate asset register to support the property, plant and equipment balance reported in their financial statements. This meant $16.8 billion of assets held by the state were not supported by proper underlying accounts and records during the 2014–15 financial year.

The state's financial results reported in the AFR showed mixed results. If the EWL project transaction is correctly accounted for, the government's key financial measure of a net result from transactions of at least a $100 million surplus has not been achieved, and the liquidity ratio for the state has fallen.

Findings

Qualified audit opinion

The AFR received a modified financial audit opinion, consisting of two audit qualifications:

- the AFR did not record an expense, and associated liability, recognising the state's obligation to return to the Commonwealth Government $1.5 billion of funding relating to the EWL project
- the property, plant and equipment balances of DET, which are included in the AFR, were not supported by proper accounts and records.

East West Link project

In 2013–14, the Commonwealth Government paid $1.5 billion to Victoria as part of a $3.0 billion contribution to the EWL project. This funding was correctly accounted for as revenue in that year in accordance with Australian Accounting Standard AASB 1004 *Contributions*. Following the state election in November 2014, the EWL project was cancelled by the state government.

The cancellation of the EWL project, and a formal request from the Commonwealth Government for repayment of the funds, pursuant to the memorandum of understanding, and the related Commonwealth legislation, means that at 30 June 2015 the state had an obligation to repay the money under AASB 1004. Importantly, the Commonwealth Government also has the ability to recover this funding by reducing future funding for other Victorian projects. The correct accounting treatment is to recognise an expense and a liability for $1.5 billion at that time.

By not recording the $1.5 billion expense and associated provision as a liability, the SoV and the GGS net result from transactions is overstated, and other provisions in the balance sheet are understated. This means that the net result from transactions for the GGS would change from a surplus of $1 214.0 million to a deficit of $286.0 million. The state's key financial measure of achieving a net surplus from transactions for the GGS of at least $100 million has therefore not been achieved.

This matter also resulted in a qualified audit opinion being issued on the financial statements for the year ending 30 June 2015 for the Department of Treasury & Finance (DTF).

As detailed in the Auditor-General's *Annual Plan 2015–16*, tabled in Parliament in June 2015, a Performance Audit of the EWL project has been undertaken. The audit reviewed the key project decisions, costs, events and related advice influencing the project's financial outcomes.

The report on this audit is scheduled to be tabled in Parliament in December 2015.

Department of Education & Training

A disclaimer audit opinion has been issued on the financial statements of DET for the year ending 30 June 2015. The disclaimer audit opinion was issued because DET was unable to provide, and therefore we were unable to obtain, sufficient appropriate audit evidence to support all the balances and/or transactions in the financial report, and those transactions and balances combined had a significant effect on the financial report.

The transactions and balances highlighted within the DET audit opinion are material to the AFR and it was determined that the following financial statement line items were materially impacted:

- land, buildings, infrastructure, plant and equipment—$16.8 billion impact
- land, buildings, infrastructure, plant and equipment revaluation surplus reserve—$7.4 billion impact.

As a result, the audit opinion for the AFR has been modified to include a qualification on these balances.

DET has failed to maintain proper accounts and records, including a complete and accurate asset register to support the property, plant and equipment balance reported in its financial statements. This is a breach of the *Financial Management Act 1994* (the FMA), and led to the Auditor-General being unable to obtain sufficient appropriate audit evidence to support a clear opinion.

The asset register issues for property, plant and equipment are not new, having been reported to DET over the past two financial years. DET have not adequately addressed these issues which has caused the audit opinion on the AFR, and DET's financial statements to be modified.

Further comment on the results of the audit of DET will be included in our *Portfolio Departments and Associated Entities: 2014–15 Audit Snapshot* report, to be tabled in Parliament in December 2015.

Resolution of prior year qualification

The Auditor-General issued a qualified audit opinion on the *Annual Financial Report of the State of Victoria, 2013–14* on 2 October 2014.

The qualified opinion was issued regarding the accounting policy applied for measuring the value of school buildings by the former Department of Education & Early Childhood Development (DEECD)—specifically, how economic obsolescence was assessed in calculating a school building's fair value.

This issue has been resolved during the 2014–15 financial year, with DEECD's successor department, DET, changing its accounting policy. An adjustment for economic obsolescence is no longer made to the valuation of school buildings still in use.

DET has made a prior year restatement in their 2014–15 financial statements, which has been incorporated into the 2014–15 AFR. As a consequence, the audit qualification relating to economic obsolescence of buildings by DET in 2013–14 has not been continued in 2014–15.

Delays to the production of the AFR

The FMA requires the AFR to be transmitted to Parliament by 15 October. This date was not met, with the AFR being transmitted by the Treasurer on 4 November 2015, and tabled in Parliament on 10 November 2015.

The timely production of the AFR requires the consolidated entities to produce complete and compliant financial reports in line with a timetable set out by DTF. For 2014–15, the timetable required 47 material entities to provide their draft financial statements to my office by 24 July 2015. Only four material entities (8.5 per cent) achieved this time line.

The financial reporting impacts of the machinery-of-government changes during 2014–15, significant and contentious financial reporting issues which arose during 2014–15, and the loss of financial knowledge and experience at some material entity finance teams in recent years all contributed to the delays in the preparation of the AFR.

Addressing prior period issues

The 2013–14 AFR audit management letter raised a number of issues relating to oversight, scrutiny, and better practice financial management which were applied to the AFR—all based on the obligations of other entities reporting under the FMA.

One important and welcome change this year is that the Treasurer has signed the certification of the AFR. However, although the FMA does not expressly prescribe who should sign the certification of the AFR, it would have been consistent with previous practice for the certification to have also been counter-signed by a chief financial officer in line with Standing Direction 4.2(c), which applies to all other reports prepared under the FMA.

DTF should seek to address our other concerns to ensure that the AFR has the same level of oversight, scrutiny and better practice financial management that is required to be applied by all public sector entities reporting under the FMA.

General government sector

The reported GGS net surplus from transactions was $1 214.0 million. Correctly accounting for the EWL project funding obligation to the Commonwealth Government would have resulted in a net deficit from transactions of $286.0 million. This means that the government has not achieved its key financial measure of a net result from transactions of at least $100 million for the GGS in 2014–15.

Included in the GGS surplus was $841.2 million in dividends received from other state entities. This was $425.1 million more than was included in the *2014–15 State Budget*. The Treasurer called upon the State Electricity Commission of Victoria for a $100 million dividend in late June when one had not been budgeted, as well as receiving an additional $31.7 million in interim dividends from three water corporations at the same time.

State of Victoria

The state's reported financial results for 2014–15 were mixed with a reported deficit of $610.7 million from operations, and the state's liquidity ratio falling from 0.97 to 0.84. The state's liquidity is measured as the proportion of current assets against current liabilities held at 30 June. If the EWL project funding obligation was correctly accounted for, this would see the deficit increase to $2 110.7 million and the liquidity ratio fall to 0.79.

There are positive results for the state's debt sustainability and capital replacement indicators. Debt sustainability remains stable because debt is growing at the same rate as the gross state product. This means the state is maintaining its ability to service the debt. Similarly, the asset replacement indicator remains strong, and suggests that the state is replacing or renewing assets at the same pace at which they are being consumed at the whole-of-government level. This does not negate, however, the asset renewal concerns in specific sectors.

Recommendations

Number	Recommendation	Page
1.	That material entities, particularly portfolio departments, 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.	12
2.	That the Department of Treasury & Finance needs to apply the same governance, oversight and better practice financial reporting principles to the Annual Financial Report of the State of Victoria that applies to public sector entities reporting under the *Financial Management Act 1994*.	12

Submissions and comments received

We have professionally engaged with agencies throughout the course of the audit. In accordance with section 16A of the *Audit Act 1994* we provided a copy of this report to the Treasurer and requested his submissions or comments. In accordance with section 16(3) of the *Audit Act 1994* we provided relevant extracts of this report to named agencies and requested their submissions or comments.

We have considered those views in reaching our audit conclusions and have represented them to the extent relevant and warranted. Their full section 16A and section 16(3) submissions and comments are included in Appendix C.

1 Context

1.1 Introduction

This report informs Parliament and the citizens of Victoria about the financial outcomes and position of the State of Victoria as at 30 June 2015. It does that by analysing and discussing the *Annual Financial Report of the State of Victoria, 2014–15* (the AFR), which was transmitted to Parliament by the Treasurer on 4 November 2015, and tabled in Parliament on 10 November 2015. Figure 1A outlines the structure and contents of this report.

Figure 1A
Report structure

Report part	Description
Part 1: Context	Details what the AFR is, and what makes up the financial statements of the state.
Part 2: 2014–15 audit opinion	Discusses the audit opinion on the AFR, including the reasons for the modified audit opinion. Reviews action taken against audit findings reported for the 2013–14 AFR.
Part 3: General government sector	Provides an analysis of the general government sector outcomes at 30 June 2015.
Part 4: State of Victoria	Provides commentary and analysis on the state's financial result at 30 June 2015. Discusses the financial position of the state at 30 June 2015.
Part 5: Major projects and significant items	Provides information on the development of significant major projects that are being delivered or planned, including current public private partnerships and the progress of the Port of Melbourne lease.

Source: Victorian Auditor-General's Office.

This report has been produced in accordance with section 16A of the *Audit Act 1994*. Pursuant to section 20(3) of the *Audit Act 1994*, unless otherwise indicated, any persons named in this report are not the subject of adverse comment or opinion.

The total cost of this report was $170 000.

1.2 What is the AFR?

1.2.1 State of Victoria

The AFR is the State of Victoria's financial statements. It is the key financial accountability document that tells Parliament and the citizens of Victoria what the state's financial position is, and how the state has performed in financial terms over the year.

The AFR consolidates the financial results and financial position of all state-controlled entities. Entities are classified into three categories as detailed in Figure 1B. Transactions between the consolidated entities are removed to avoid double counting.

Figure 1B
Categories of state government entities included in the State of Victoria financial result

Sector name	Explanation of sector	Example of entities in this sector
General government sector	Entities that provide goods and services to the community, significantly below their production cost.	Government departments Museums Board of Victoria Country Fire Authority
Public financial corporations	These entities deal with financial aspects of the state. They have the powers to borrow, accept deposits and acquire financial assets.	Treasury Corporation of Victoria Victorian Funds Management Corporation
Public non-financial corporations	The primary purpose of these entities is to provide goods and/or services in a competitive market. These services are non-regulatory and non-financial in nature.	Water corporations Alpine resort management boards Melbourne Market Authority

Source: Victorian Auditor-General's Office.

The number of entities making up the State of Victoria varies slightly from year to year, as entities are created, merged or disbanded. At 30 June 2015 there were 277 entities (279 entities at 30 June 2014) whose financial results were combined to make up the State of Victoria.

1.2.2 General government sector

As well as showing the financial results of the State of Victoria, the AFR reports on the financial position and performance of the general government sector.

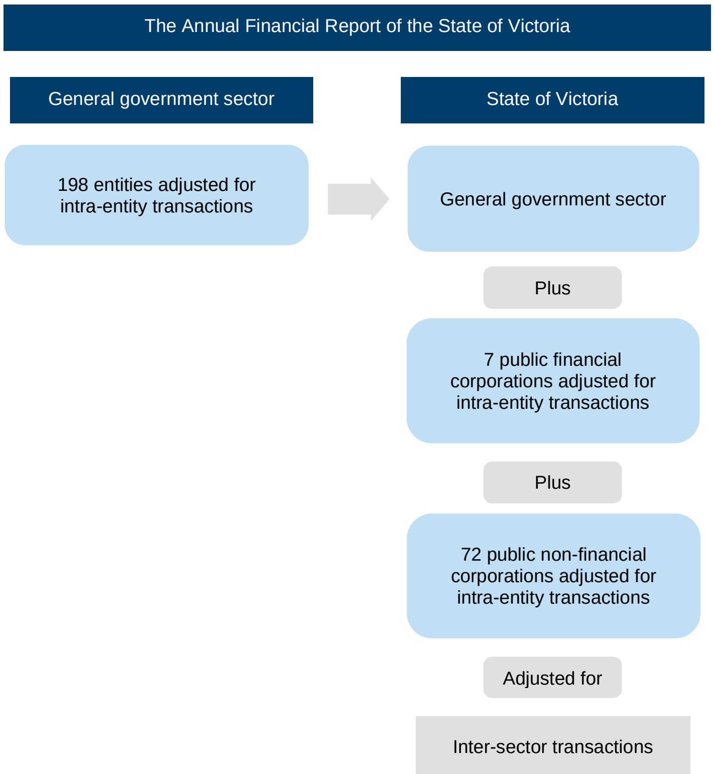
Reporting on this group of entities is important as it allows the government to demonstrate their actual results against the State Budget, published as the Estimated Financial Statements (EFS) in Budget Paper 5.

The EFS relates only to the general government sector and is reviewed (not audited) by the Auditor-General at the time of production.

How the general government sector fits into the AFR

Figure 1C shows the difference and relationship between the AFR and the general government sector.

Figure 1C
Entities included in the Annual Financial Report of the State of Victoria



Source: Victorian Auditor-General's Office.

Material entities

Of the controlled public sector entities, 47 were deemed by the Department of Treasury & Finance and my office to be 'material' entities for 2014–15 (48 in 2013–14). A public sector entity is classified as material when its individual financial operations are significant in the reporting of the consolidated finances of the state. Collectively, material entities account for more than 90 per cent of the state's assets, liabilities, revenue and expenditure.

1.2.3 Entities excluded from the AFR

The AFR only reports on state-controlled entities. Therefore, other entities which provide public services, and which may be expected to be included in the AFR, have been excluded as they are not controlled by the state for financial reporting purposes. These entities are detailed in Figure 1D.

Figure 1D
Sectors not included in the AFR

Sector	Rationale
Local government	Local government is a separate tier of government with councils elected by, and accountable to, their ratepayers.
Universities	Universities are primarily funded by the Commonwealth Government, and the state directly appoints only a minority of university council members.
Denominational hospitals	Denominational hospitals are private providers of public health services and have their own governance arrangements.
State superannuation funds	The net assets of state superannuation funds are the property of the members. However, any shortfall in the net assets related to certain defined benefit scheme entitlements of the state's superannuation funds are an obligation of the state and are reported as a liability in the AFR.

Source: Victorian Auditor-General's Office.

2 2014–15 audit opinion

At a glance

Background

The Auditor-General undertakes a financial audit of the State of Victoria's Annual Financial Report (AFR) in accordance with section 9A of the *Audit Act 1994*.

A qualified audit opinion was provided on the AFR on 30 October 2015, indicating that there are transactions and balances within the statements which the Auditor-General has determined are not accurate, and some which are not supported by sufficient appropriate evidence.

Findings

- Two qualifications were included in the modified audit opinion because:
  - the AFR did not record the state's obligation to return the East West Link project funding as an expense and corresponding liability
  - the property, plant and equipment balances at the Department of Education & Training were not supported by proper accounts and records.
- When the obligation to return the East West Link project funding is recorded, the net result from transactions becomes a loss of $286 million and consequently the government has not achieved the key financial measure of a net result from transactions of at least $100 million for the general government sector.
- Only four of the 47 material entities achieved the Department of Treasury & Finance reporting time frames for material entities to provide draft financial statements to my office. This was a major cause of the AFR missing the legislative time frame for transmitting the AFR to Parliament by 15 October.

Recommendations

- That material entities, particularly portfolio departments, 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.
- That the Department of Treasury & Finance needs to apply the same governance, oversight and better practice financial reporting principles to the Annual Financial Report of the State of Victoria that applies to public sector entities reporting under the *Financial Management Act 1994*.

2.1 Introduction

The Auditor-General undertakes a financial audit on the State of Victoria's Annual Financial Report (AFR) in accordance with section 9A of the *Audit Act 1994*.

Independent audit opinions add credibility to financial statements by providing reasonable assurance that the information reported is reliable and accurate. A clear audit opinion confirms that the financial statements present fairly the transactions and balances for the reporting period, in accordance with the requirements of relevant legislation. A qualified audit opinion is issued where a clear statement cannot be made by an auditor that financial statements are fairly presented in all material respects.

2.2 Audit opinion for year ending 30 June 2015

The Auditor-General issued a qualified audit opinion on the AFR on 30 October 2015. The qualification relates to two areas—the absence of an expense and a liability to recognise the obligation to return the East West Link (EWL) project funds, and an inability to obtain sufficient appropriate evidence for property, plant and equipment assets at the Department of Education & Training (DET). A copy of the opinion is at Appendix A.

2.2.1 East West Link project

At 30 June 2015, the state had an obligation to repay the $1.5 billion received from the Commonwealth Government for the EWL project. However, the AFR did not recognise an expense and provision for this obligation. We do not agree with this omission.

In 2013–14, the Commonwealth Government paid $1.5 billion to Victoria as part of a $3.0 billion contribution to the EWL project. This money was correctly accounted for as revenue in that year in accordance with Australian Accounting Standard AASB 1004 *Contributions*. Following the state election in November 2014, the EWL project was cancelled.

A memorandum of understanding (MoU) for the project signed by both the Commonwealth Government and the state, and the *Nation Building Program (National Land Transport) Act 2009*, under which the money was provided, both detailed what was to occur if the EWL project was cancelled. Specifically, if the project was cancelled in its entirety, any payment made on it would be repayable to the Commonwealth Government. Alternatively, the Commonwealth could withhold future funding for the state for other projects to the same amount.

On 12 May 2015, the Commonwealth Government wrote to the Minister for Public Transport and the Minister for Roads and Road Safety requesting the return of all funding previously paid to Victoria for the EWL project. In addition, the Commonwealth accounted for the return of the funding in its 2015–16 Budget.

The cancellation of the EWL project, and the formal request from the Commonwealth Government for the repayment of the funds, means that at 30 June 2015 the state had an obligation to repay the funding. The correct accounting treatment would have been to recognise an expense, and corresponding liability, for $1.5 billion at that time. Australian Accounting Standard AASB 1004 *Contributions* requires that a liability and an expense be recorded where the conditions of a grant will not be met and the funds are required to be returned. The recognition of a liability in the form of a provision for the return of the funds would also satisfy the requirements of AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*.

By not recording the $1.5 billion expense and the associated provision as a liability, the State of Victoria and the general government sector's net result from transactions is overstated, and liabilities in the balance sheet are understated. This means that the net result from transactions for the general government sector would change from a surplus to a loss of $286 million, and would see the government not achieve its key financial measure of having a net result from transactions of at least a $100 million surplus.

This issue also resulted in a qualified audit opinion being issued on the financial statements for the year ending 30 June 2015 of the Department of Treasury & Finance (DTF).

While the Treasurer has consistently stated that the money will not be returned to the Commonwealth Government, this intention does not negate the requirement under Australian Accounting Standards to recognise the obligation to return the money.

Subsequent to year end, the Commonwealth Government indicated that it would allow—on a without prejudice basis and under certain specified conditions—the state to treat the funding as a prepayment to fund the Commonwealth Government's future commitments to other projects. This does not mean an obligation to return the funds at 30 June 2015 did not exist, and withholding future funding from the state would, in substance, result in the same outcome.

DTF had previously sought legal advice which concluded that the state did not have a present obligation to return the funds—therefore there was no requirement under Australian Accounting Standard AASB 137 to recognise a liability and corresponding expense. DTF's legal advisers had also sought accounting advice in preparing their advice to DTF. It is our opinion that an expense, and corresponding liability, should be recognised; a present obligation was created when the Victorian Government discontinued the EWL project and the Commonwealth Government requested the funding to be returned, as set out in the MoU and the *Nation Building Program (National Land Transport) Act 2009*. In our view, this satisfies the broader accounting definitions of a contract and, consequently, an obligation for financial reporting purposes exists at 30 June 2015.

One of the key qualitative characteristics of financial reporting is that transactions and balances are to be accounted for based on substance over legal form. The legal view of the transaction does not override, or determine, the accounting treatment for the transaction. Our position on the correct accounting treatment for the EWL project funding has been confirmed by preeminent independent accounting experts.

As detailed in the Auditor-General's *Annual Plan 2015–16*, tabled in Parliament in June 2015, a performance audit of the EWL project has been undertaken. The audit reviewed the key project decisions, costs, events and related advice influencing the project's financial outcomes.

The report on this audit is expected to be tabled in Parliament in December 2015.

2.2.2 Department of Education & Training

A disclaimer audit opinion was issued on the financial statements of DET for the year ending 30 June 2015. The 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. These transactions and balances combined represented a substantial proportion of the financial report, and had a significant effect on the financial report.

The transactions and balances highlighted within the DET audit opinion are material to the AFR and it was determined that the following financial statement line items were materially impacted:

- land, buildings, infrastructure, plant and equipment—$16.8 billion impact
- land, buildings, infrastructure, plant and equipment revaluation surplus reserve—$7.4 billion impact.

As a result, the audit opinion for the AFR has been modified to include a qualification on these balances.

DET has failed to maintain proper accounts and records, including a complete and accurate asset register to support the property, plant and equipment balance reported in its financial statements. This is a breach of the *Financial Management Act 1994*. Consequently, we were unable to obtain sufficient appropriate audit evidence to support a clear opinion.

Issues with the integrity of data on the asset register at DET are not new, and there has been a steady elevation of these issues by the Auditor-General. In 2012–13, data integrity issues around asset records were reported to DET as a high-risk item that required immediate action. This same issue was raised again in 2013–14 when appropriate action failed to occur. In addition, two high-risk concerns around the lack of timely asset accounting and inadequate reconciliations of the assets register were raised in 2013–14.

DET had provided commitments to:

- improve the capture, store and management of asset information, and to conduct a data cleanse by November 2014
- implement new asset register software to address weaknesses, review governance controls for reconciliation approvals, and provide training to staff on reconciliations by 30 June 2015.

Notwithstanding these commitments, the fixed asset register did not sufficiently support the account balances and transactions, and therefore we could not obtain sufficient appropriate evidence to support the property, plant and equipment balances reported for 30 June 2015.

DET's inability to address areas of concern raised by my office, within a reasonable time frame was also observed in our report *Department of Education and Training: Strategic Planning* tabled in October 2015. In the instance of the asset register and data integrity issues, the Auditor-General provided DET with an opportunity to work on the issues raised during 2014. However, progress has been slow and largely ineffective, leading to a modification of the audit opinion.

As shown in Appendix C, the DET Secretary's response to this report accepts the issues discussed above, and DET have made commitments to take action to address the concerns. We will, within the bounds of our independence, provide the department with feedback and advice as they work through resolving these issues.

Further comment on the results of the audit of DET will be included in our report *Portfolio Departments and Associated Entities: 2014–15 Audit Snapshot*, to be tabled in Parliament in December 2015.

2.3 Prior year adjustments

The Auditor-General issued a qualified audit opinion on the *Annual Financial Report of the State of Victoria, 2013–14,* on 2 October 2014.

The qualified opinion was issued regarding the accounting policy applied for measuring the value of school buildings by the former Department of Education & Early Childhood Development (DEECD)—specifically, how economic obsolescence was assessed in calculating a school building’s fair value.

This issue was resolved during the 2014–15 financial year, with DEECD's successor department (DET) and the AFR, changing their accounting policy. An adjustment for economic obsolescence is no longer made to the valuation of school buildings still in use.

Additionally, DTF has issued updated guidance for the public sector on valuing assets as part of the *Financial Reporting Directions of the Minister for Finance*, promoting consistency in valuation approaches across all entities reporting under the *Financial Management Act 1994* (FMA).

DET has changed its accounting policy and made a prior year restatement in its 2014–15 financial statements, which has been incorporated into the 2014–15 AFR. As a consequence, the audit qualification relating to economic obsolescence of buildings by DET and the AFR in 2013–14 has not been continued in 2014–15.

The 2014–15 AFR has also made several adjustments to the figures reported for the 2013–14 financial year. These changes are detailed in note 37 of the AFR, and consist of:

- crown land—the state has an ongoing project to reconcile records regarding parcels of crown land, resulting in the recognition and de-recognition of assets during the financial year
- superannuation—a change in accounting policy regarding the recognition of franking credits relating to the defined benefit superannuation liability, with future franking credits and other tax offsets now recognised when they arise, rather than estimated in advance.

The overall impact of these changes was a reduction in the net result from transactions for the State of Victoria for 30 June 2014 of $7.4 million, and an increase in net assets held of $990.8 million.

2.4 Timeliness of the AFR

As per section 27(d) of the FMA, the audited AFR must be transmitted to Parliament no later than 15 October. The 2014–15 AFR missed this statutory tabling date.

Figure 2A shows that the finalisation of the AFR has been getting later over the past three years.

Figure 2A
AFR finalisation dates

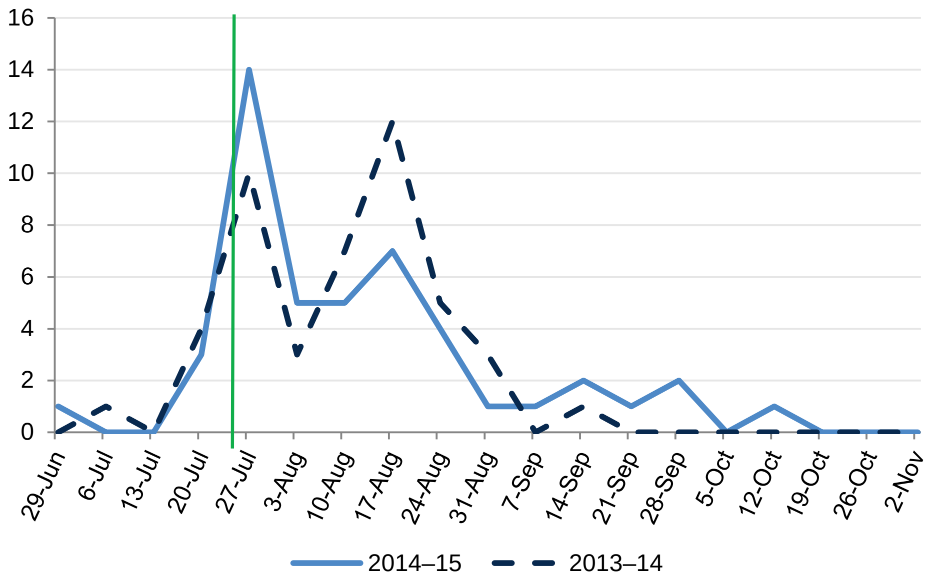
Financial year AFR	Audit opinion signing date
2010–11	10 October 2011
2011–12	5 October 2012
2012–13	27 September 2013
2013–14	2 October 2014
2014–15	30 October 2015

Source: Victorian Auditor-General's Office.

To meet the statutory date, the preparation and audit of the AFR depends on material entities meeting the timetable set by DTF for the collation of information, and the early identification and resolution of significant accounting and disclosure issues. On 4 August 2015, the former Auditor-General wrote to the Secretary, DTF (and other secretaries) and advised that there were risks to the timely preparation of departmental financial statements that would ultimately have a flow-on effect to the AFR.

Those risks lead to the eventual delay in finalising the 2014–15 AFR with only four (8.5 per cent) of the 47 material entities providing their draft financial statements to my office by the DTF deadline of 24 July 2015. Figure 2B summarises when complete draft financial statements were provided to audit teams over the 2013–14 and 2014–15 financial years.

Figure 2B
Draft financial statements provided to audit by material entities, 2013–14 and 2014–15 financial years



Note: Vertical (green) line shows the date DTF expected material entities to have provided their draft statements to their auditors.
Source: Victorian Auditor-General's Office.

The material entity delays were caused by a number of concurrent issues, including:

- machinery-of-government changes during the 2014–15 financial year which, among other things, required the preparation of a final set of financial statements for the former departments to 31 December 2014, and amalgamated statements for the new departments for 30 June 2015
- contentious financial reporting issues in several sectors and the AFR
- a loss of financial knowledge and experience across certain finance teams following the reduction in staff through voluntary departures under the Sustainable Government Initiative, and machinery-of-government changes.

2.5 Unresolved prior period issues

The financial audit of the 2013–14 AFR raised three governance and oversight issues that were bought to DTF's attention and raised in our report *Portfolio Departments and Associated Entities: Results of 2013–14 Audits* (tabled in February 2015). Figure 2C provides an update on these issues as at September 2015.

Figure 2C
Update on 2013–14 management letter issues

Issue relating to 2013–14 AFR	Update for 2014–15 AFR
There is a lack of independent governance and oversight of the AFR as the DTF audit committee has no role on whole-of-government matters—including reports.	Unresolved
The AFR is not bound to comply with the *Standing Directions of the Minister for Finance* or the *Financial Reporting Directions*—although entities included in the AFR are. This means that the AFR does not disclose some information required by other financial reports—for example, related parties & executive remuneration.	Unresolved
The Treasurer does not sign the AFR, nor does the AFR note that the signatories are signing the document on his behalf.	The 2014–15 AFR was signed by the Treasurer and the Secretary, DTF. The AFR was not signed by a chief financial officer. This is inconsistent with other entities reporting under the FMA.

Source: Victorian Auditor-General's Office.

DTF has yet to address two of the issues raised in the audit of the 2013–14 AFR, and consequently the same level of oversight, scrutiny and better practice financial management that is required to be applied by all public sector entities reporting under the FMA has not been applied to the AFR.

In addition, while the Treasurer and Secretary, DTF, signed the 2014–15 AFR, the chief financial officer did not. This is not consistent with previous practice and with the standards set by the FMA for applicable public sector entities when preparing financial reports.

Recommendations

1. That material entities, particularly portfolio departments, 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. That the Department of Treasury & Finance needs to apply the same governance, oversight and better practice financial reporting principles to the Annual Financial Report of the State of Victoria that applies to public sector entities reporting under the *Financial Management Act 1994*.

3 General government sector

At a glance

Background

This Part reviews the financial position and performance of the general government sector for the financial year ending 30 June 2015, and provides a comparison of these results against the *2014–15 State Budget* for the same period.

Conclusion

The Annual Financial Report (AFR) reported that the general government sector generated a net surplus from operations of $1 214.0 million in 2014–15. If the AFR had correctly recognised the state's obligation to return $1.5 billion funding to the Commonwealth Government relating to the East West Link project at 30 June 2015, the state would not have achieved its key financial measure of at least a $100 million net surplus from transactions for the general government sector.

Findings

- The general government sector reported net surplus from transactions at 30 June 2015 excludes recognition of the $1.5 billion required to be returned to the Commonwealth Government for the East West Link project. If this was correctly accounted for the net result from transactions would have been a deficit of $286.0 million.
- Based on its reported result, the state did not meet its budget target of a $1 326.7 million net result from transactions.
- The state collected $841.2 million in dividends from certain entities outside of the general government sector. This was $425.1 million more than budgeted.

3.1 Introduction

Entities in the general government sector (GGS) provide goods and services to the community, often at no or low cost to users. These goods and services are the core public services provided by the state—therefore measurement of financial performance and outcomes at this level provides information about how economically they have been delivered.

The state prepares its annual budget at this GGS level. In this Part we review and make comment on the financial position and performance of the GGS for the financial year ending 30 June 2015 including an assessment against the published budget.

3.2 Conclusion

The Annual Financial Report (AFR) reported a GGS net surplus from transactions of $1 214.0 million in 2014–15, against a budgeted outcome of $1 326.7 million.

This result excludes recognition of the $1.5 billion Commonwealth Government funding for the East West Link (EWL) project, which the state had an obligation to return at 30 June 2015. If this was correctly accounted for the net result from transactions would have been a deficit of $286.0 million. As a result, it has not achieved its key financial measure of at least a $100 million net surplus from transactions for the GGS.

3.3 Budget to actual

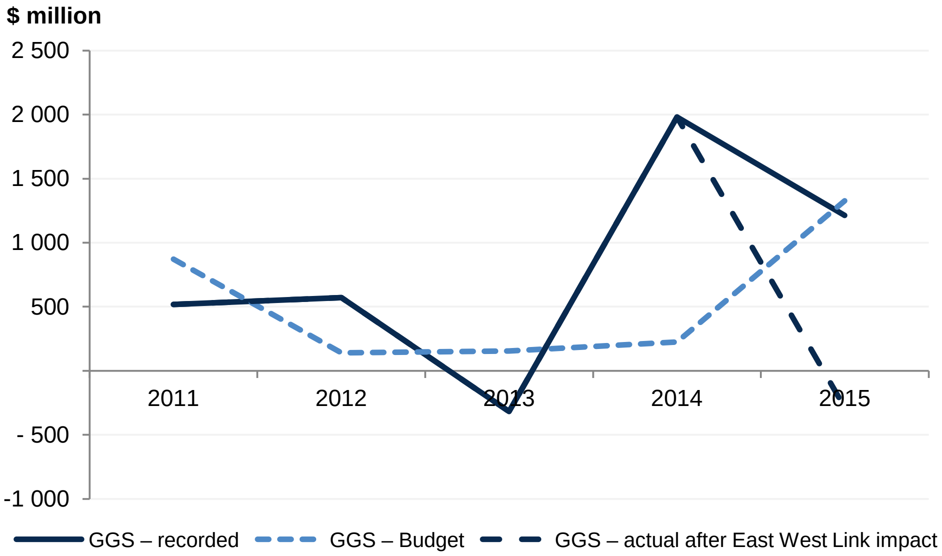
The estimated financial statements (EFS) are part of the State Budget and they set out the expected financial result and position for the GGS for the next financial year, as well as providing forward financial estimates for the outward three years. The EFS is a budget for the GGS sector, not the State of Victoria.

The EFS is reviewed, but not audited, by the Auditor-General, and a review conclusion is published as part of the Budget document. A clear review report was issued by the Auditor-General on the 2014–15 EFS.

Figure 3A shows a comparison between the actual and budgeted net result from transactions for the GGS for 2014–15 and the previous four financial years. It shows that the actual result for the GGS has varied from the predicted result in most financial years.

In 2014–15, the GGS reported a net result from transactions of $1 214.0 million, against a budgeted result of $1 326.7 million. However to provide context to these results, the total revenue from transactions for the GGS for 2014–15 was $53.8 billion and the budgeted net result from transactions was 2.5 per cent of revenue and the actual net result from transactions was 2.3 per cent of revenue.

Figure 3A
Net result from transactions for the financial year ending 30 June for the general government sector



Source: Victorian Auditor-General's Office.

The net result from transactions of $1 214.0 million was achieved by omitting the recognition of an expense for the requirement to return the EWL project funding to the Commonwealth Government. Figure 3A shows that the net result from transactions is a deficit if the expense had been correctly recognised as is required by Australian Accounting Standards. A deficit would mean that the government had not achieved its key financial measure of at least a $100 million net result from transactions surplus for 2014–15.

The net result from transactions, as published, shows the 2014–15 result also did not achieve the budgeted outcome of $1 326.7 million, falling short by $112.7 million.

3.3.1 Dividends

In 2014–15, the GGS received $841.2 million in dividends from other state entities outside the GGS. This $841.2 million is more than double the $416.1 million that was budgeted to be received. Details of the budget and actual dividends received by the GGS from other state entities are shown in Figure 3B.

Figure 3B
Dividends paid to the GGS in the 2014–15 financial year – budget to actual

	2014–15 Budget ($mil)	2014–15 Actual ($mil)	Variance ($mil)	Variance Percentage
Public Financial Corporations				
Worksafe Victoria	109.8	241.7	131.9	120.1
Transport Accident Commission	189.0	253.2	64.2	34.0
Treasury Corporation Victoria	42.6	50.6	8.0	18.9
Rural Finance Corporation of Victoria	0.0	17.5	17.5	100.0
State Trustees Ltd	0.8	1.6	0.8	100.0
Victorian Funds Management Corporation	2.7	1.7	–1.0	–37.0
Total Public Financial Corporations Dividends	**344.9**	**566.3**	221.4	64.2
Public Non-Financial Corporations				
Melbourne Water Corporation	16.7	21.5	4.8	28.7
City West Water Corporation	6.3	15.6	9.3	147.6
South East Water Corporation	16.0	52.0	36.0	225.0
Yarra Valley Water Corporation	5.2	31.7	26.5	509.6
State Electricity Commission of Victoria	0.0	100.0	100.0	100.0
Victorian Regional Channels Authority	0.7	0.0	–0.7	–100.0
Port of Melbourne Corporation	24.2	33.0	8.8	36.4
Other	0.0	2.2	2.2	100.0
Total Public Non-Financial Corporations Dividends	**69.1**	**256.0**	186.9	270.5
Non-government entities				
Other	2.1	18.9	16.8	800.0
Total non-government entities	**2.1**	**18.9**	16.8	800.0
Total dividends to the GGS	**416.1**	**841.2**	425.1	102.1

Source: Victorian Auditor-General's Office based on *Victorian Budget 2014–15* and *Annual Financial Report of the State of Victoria, 2014–15,* Department of Treasury & Finance.

The extra revenue received as dividends by the GGS was largely due to:

- interim dividends declared in 2013–14 by the Treasurer—from the Transport Accident Commission and WorkSafe Victoria—had been previously deferred, but were paid in 2014–15
- an unbudgeted interim dividend paid by the State Electricity Commission of Victoria of $100 million, determined by the Treasurer on 22 June 2015, for payment by 30 June 2015
- an additional $31.7 million in interim dividends relating to the 2014–15 financial year from three water corporations determined by the Treasurer in late June 2015 and paid on 29 June 2015.

The payment of dividends is determined by the Treasurer, in consultation with the entities impacted. Without the additional $425.1 million of dividends received in the year, the 30 June 2015 reported net result from transactions for the GGS would have been $789.0 million, 40 per cent less than the budgeted result.

4 State of Victoria

At a glance

Background

This Part reviews the financial position and performance of the State of Victoria for the financial year ending 30 June 2015.

Conclusion

The state's financial statements had mixed results for 2014–15. On the positive side, the state's ability to service debt remained stable and spending on new assets and asset renewal appears to be keeping pace with the consumption of assets at the state level. However, the state reported a net deficit from transactions of $610.7 million and has a declining liquidity ratio.

Findings

- The state generated a net deficit of $610.7 million from operations in 2014–15 ($787.6 million surplus in 2013–14). The deficit increases to $2 110.7 million when the obligation to return the East West Link project funding to the Commonwealth Government is correctly accounted for as an expense.
- Liquidity, that is the ratio of current assets over current liabilities, has fallen significantly from 0.97 at 30 June 2014 to 0.84 at 30 June 2015. Recognition of the obligation to repay the Commonwealth Government the East West Link project funding would see it fall further to 0.79. This indicates the state had more short-term liabilities than short-term assets to meet those obligations at 30 June 2015.
- The capital replacement indicator remains above one which indicates that more is being spent on new assets and asset renewal than is being consumed at the total level. However, this may not be representative across all sectors with our reports flagging concern in the hospital and water sectors, and for some state entities.

4.1 Introduction

This Part reviews the financial position and performance of the State of Victoria for the financial year ending 30 June 2015.

4.2 Conclusion

The state's financial statements had mixed results for 2014–15, generating a net deficit from transactions of $610.7 million. While we observed positive indicators for the level of asset renewal and debt sustainability, if the state correctly accounted for the $1.5 billion East West Link (EWL) project obligation at 30 June 2015, there would have been a significant decline in its liquidity position and net result.

On the positive side, although borrowings had a small increase, the state's ability to service this debt has remained stable. Spending on new assets and asset renewal also appears to be keeping pace with the consumption of assets at the state level. This is notwithstanding our sector-based reports flagging asset replacement risks at individual public hospitals, water entities and other state entities.

4.3 Financial performance of the state

To get a complete picture of how the state has performed financially in 2014–15 requires consideration of key measures on both the comprehensive operating statement and balance sheet. Figure 4A provides a summary of key measures in both main statements and a calculation of liquidity. It includes the numbers reported in the *Annual Financial Report of the State of Victoria 2014–15* (AFR) and demonstrates the impact on the financial results and financial position of the state if the correct accounting treatment had been adopted for the return of the EWL project funding to the Commonwealth.

Figure 4A
Key balances for the State of Victoria for the financial year ending 30 June ($ million)

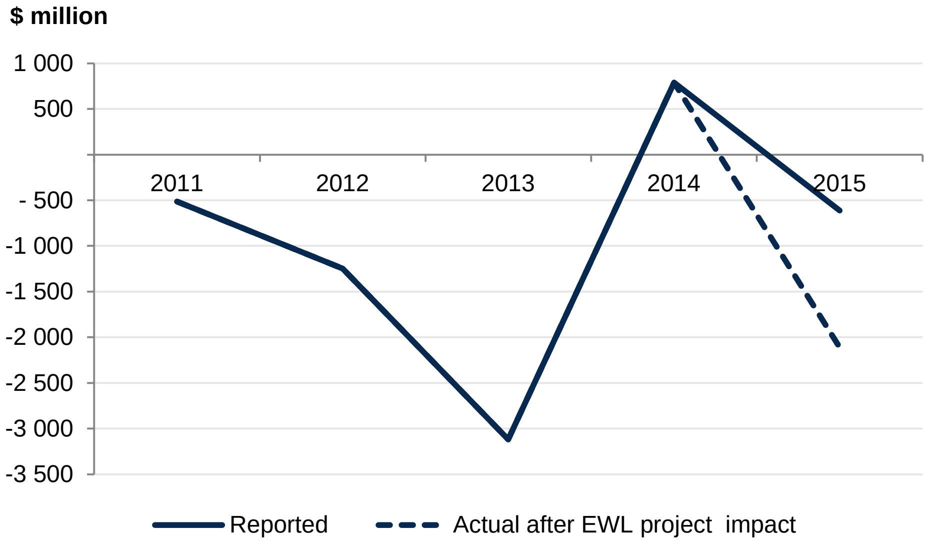
Year ending 30 June	Revenue from transactions	Expenditure from transactions	Net result from transactions —surplus (deficit)	Net result—surplus (deficit)	Net assets	Liquidity
2015 – as per AFR	61 054.0	61 664.7	(610.7)	50.7	139 909.2	0.84
2015 – accounting for EWL funding return	61 054.0	63 164.7	(2 110.7)	(1 449.3)	138 409.2	0.79
2014 – as per AFR	60 273.8	59 486.2	787.6	1 651.9	132 083.2	0.97

Source: Victorian Auditor-General's Office.

The net result from transactions shows the surplus or deficit the state has made from its operational revenue and expenditure for the year. This includes revenue and expenditure attributable to government policy, but excludes changes in values of assets and liabilities due to market fair value re-measurements—such as financial investments and non-financial fixed assets.

For 2014–15, the state reported a deficit from transactions of $610.7 million. This is a significant change from 2013–14 when the state achieved a net result from transactions of a surplus of $787.6 million. Figure 4B shows the net result from transactions for the state over the past five financial years, and it demonstrates that the surplus in 2013–14 was an unusual occurrence.

Figure 4B
Net result from transactions for the financial year ending 30 June for the State of Victoria

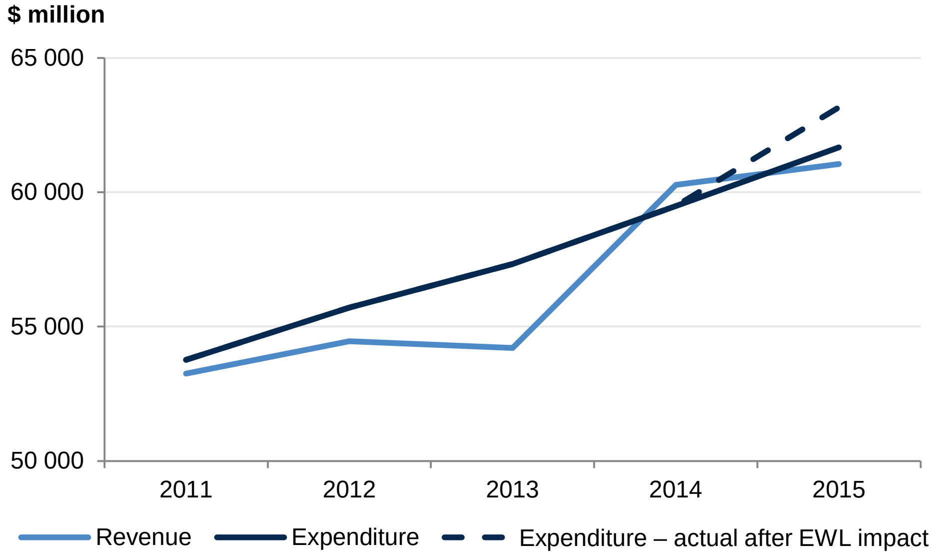


Source: Victorian Auditor-General's Office.

The accounting for the EWL project funding has had a significant impact on the state's finances in the current and previous year. The surplus in 2013–14 was achieved because $1.5 billion in grant funding for the EWL project was provided by the Commonwealth Government during June 2014, $1 billion more than the state was expecting in that year. Conversely, in 2014–15 the broken line in Figure 4B demonstrates the impact on the net result from transactions if the correct accounting treatment had been adopted for the EWL project funding. The net result from transactions would have been a deficit of $2.1 billion.

Underpinning the net result from transactions is the fluctuation in revenues the state generates and expenditures that are incurred. Figure 4C illustrates the trends in revenue and expenditure transactions for the state over the past five years.

Figure 4C
Revenue and expenditure transactions for the financial year ending 30 June for the State of Victoria



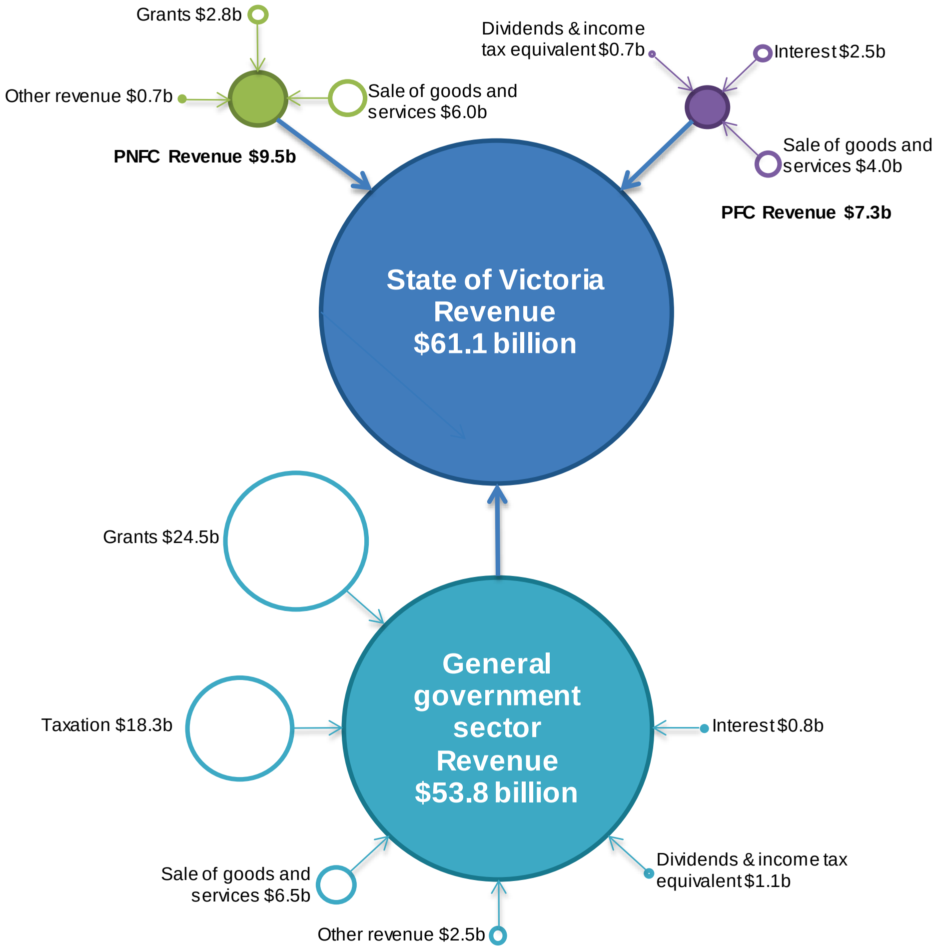
Source: Victorian Auditor-General's Office.

Figure 4C shows that revenue fluctuates year to year compared to expenditure which has had a steady growth over the past five years. The revenue fluctuations are mainly caused by receipt of Commonwealth Government grants, which are generally significant in amount, but the timing is largely outside of the state's control. Large amounts of Commonwealth Government funding can be provided for capital projects and this fluctuates depending on what projects the state is delivering.

4.3.1 Sources of revenue for the State of Victoria

In 2014–15, the state received $61.1 billion in revenue from transactions ($60.3 billion in 2013–14). As shown in Figure 4D, the largest components of the state's revenue are Commonwealth grants and state taxation.

Figure 4D
Composition of revenue from transactions received by the State of Victoria in 2014–15



Note: Inter-sector transactions of $9.5 billion (in 2014–15) eliminated from consolidation to State of Victoria.
PNFC = Public Non-Financial Corporation; PFC = Public Financial Corporation.
Source: Victorian Auditor-General's Office.

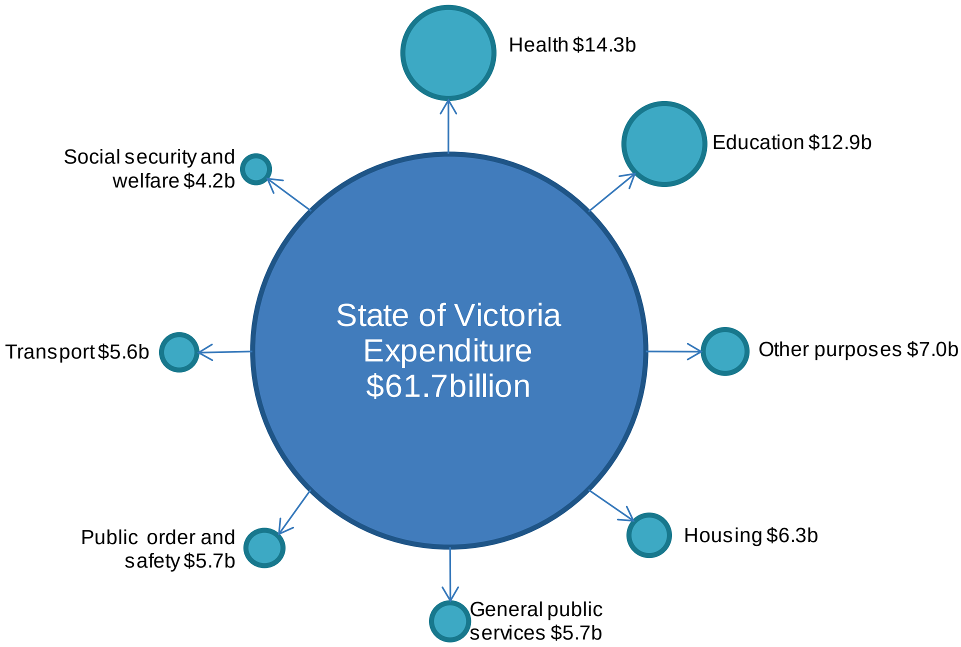
Grants from the Commonwealth Government accounted for 39.9 per cent of the revenue that the state received in 2014–15 (41.5 per cent in 2013–14), and is the state's largest source of revenue. Taxation made up 29.4 per cent of revenue (27.3 per cent in 2013–14).

4.3.2 Expenditure reported by the State of Victoria

As reported in the AFR, in 2014–15 the state incurred expenditure of $61.7 billion ($59.5 billion in 2013–14) primarily on the delivery of services to, and maintenance of infrastructure for, the Victorian public (expenditure from transactions).

Almost half of the state's reported spending was on health and education as shown in Figure 4E which depicts the services on which the state is spending its money.

Figure 4E
Composition of expenditure from transactions reported by the State of Victoria in 2014–15



Source: Victorian Auditor-General's Office.

To deliver services, the principal costs that the state incurs are employee expenses and the purchase of goods and services. A further $4 453.7 million of expenditure is depreciation ($4 334.1 million in 2013–14) which approximates the level of assets consumed in the financial year to deliver the state's goods and services.

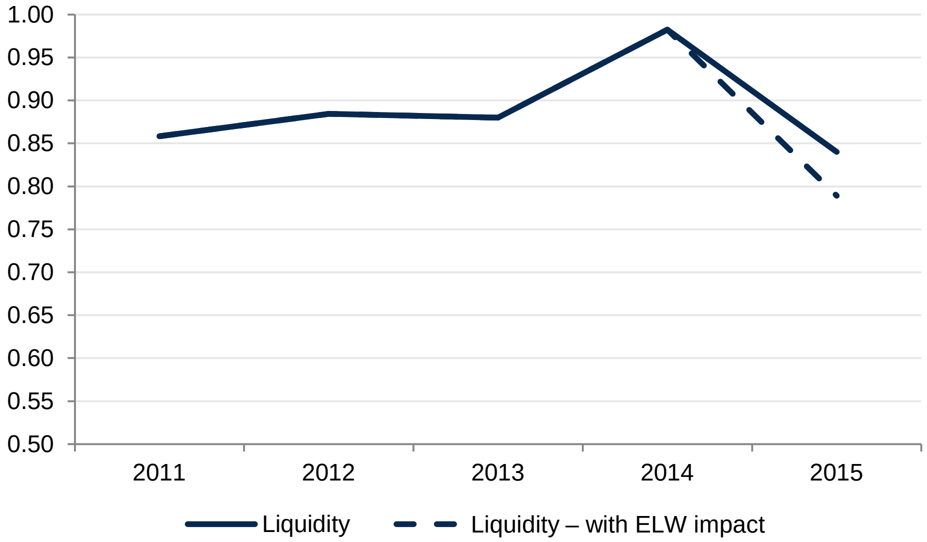
4.4 Financial position

4.4.1 Liquidity

An internationally accepted indicator of short-term financial health is the ability to pay all short-term financial obligations as they become due. Liquidity is measured by comparing the state’s current assets against current liabilities. A ratio of more than one indicates a low risk in meeting short-term obligations as there are more cash and liquid assets than short-term liabilities. The stronger the ratio the better able you are to meet ongoing and unexpected costs.

The state's liquidity was less than one at 30 June 2015. Figure 4F graphs the state’s ratio of current assets over current liabilities over the past five years, and shows that liquidity has always been below one and it has significantly declined from 2014 to 2015.

Figure 4F
Liquidity ratio as at 30 June for the State of Victoria



Source: Victorian Auditor-General’s Office.

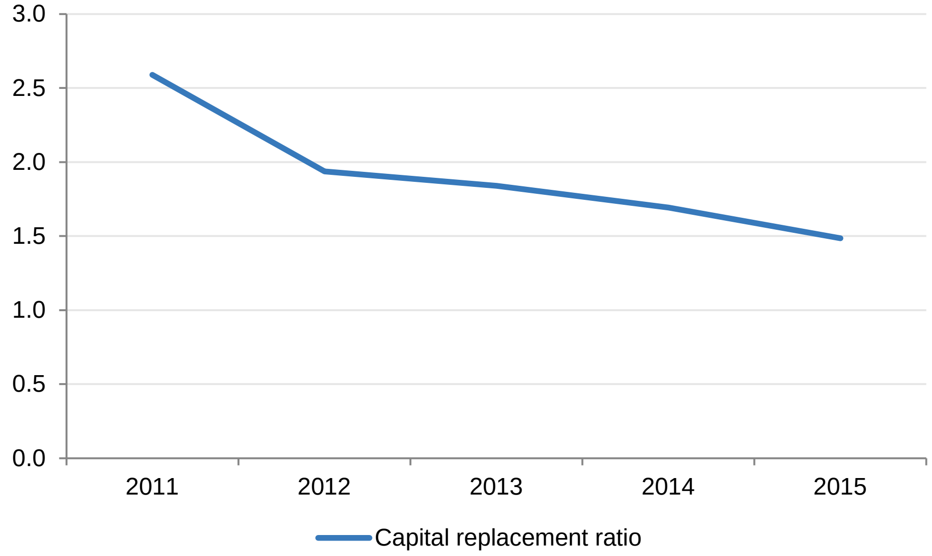
The decline in liquidity from 0.97 at 30 June 2014 to 0.84 at 30 June 2015 is driven by an increase in current borrowings of $1.4 billion; which has been moved from longer-term borrowings by the state's financial entity, Treasury Corporation of Victoria. The change in the composition of the state's borrowings has been undertaken to take advantage of low interest rates for shorter-term borrowings.

When the correct accounting treatment is applied to recognise a liability for the return of the EWL project funding, the broken line in Figure 4F shows liquidity would decline further to 0.79.

4.4.2 Capital replacement

Maintaining existing infrastructure, and providing new infrastructure, to enable the state to continue to provide services to the community is a significant challenge for the government. An indicator of how well the state is renewing or replacing assets is to compare the spend on assets in the financial year to the depreciation expense. This is illustrated in Figure 4G.

Figure 4G
Capital replacement ratio for the State of Victoria at 30 June



Source: Victorian Auditor-General's Office.

In 2014–15, the state spent $6.6 billion on new and replacement assets, against a budgeted spend of $6 971.5 million on capital projects.

Figure 4G indicates the state is renewing and/or replacing assets at a good rate against their use—as measured through depreciation. However, it should be noted that this ratio can be distorted by large projects for new assets—such as the completion of the Peninsula Link.

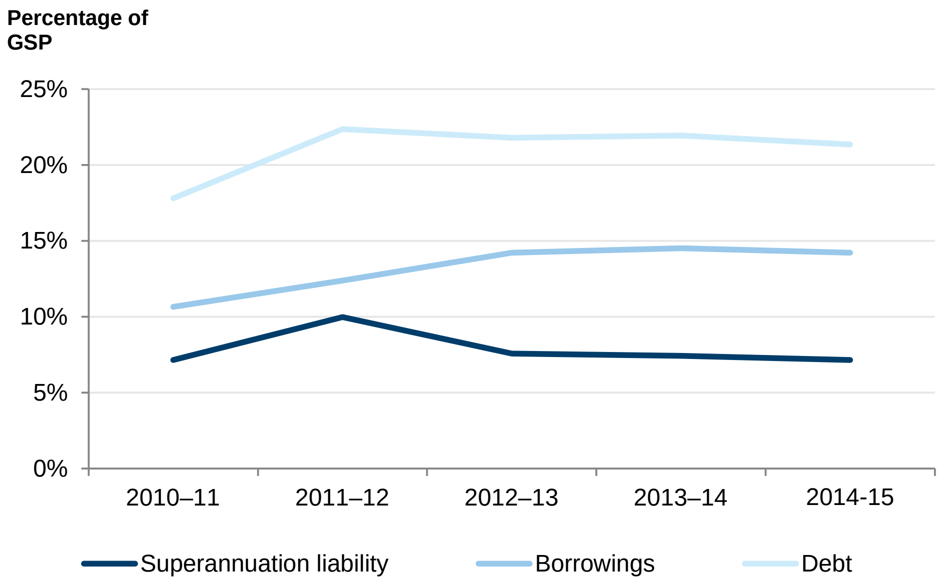
It is important to make sure that the state also continues to maintain existing assets, so that services to the Victorian public are not compromised through a lack of appropriate facilities. Analysis included in our sector-specific Audit Snapshot reports over the past financial years has continually indicated that spending on hospital, water and other state assets has not kept pace with their usage.

4.4.3 Debt sustainability

In purely financial terms, sustainable debt is the level of debt that can be repaid while balancing factors such as economic growth, interest rates, and the state's capacity to generate surpluses in the future.

The value of borrowings as a percentage of gross state product (GSP) is an indicator of debt sustainability. A low percentage indicates that the state is better able to service its debt obligations.

Figure 4H
Debt sustainability ratio for the State of Victoria at 30 June

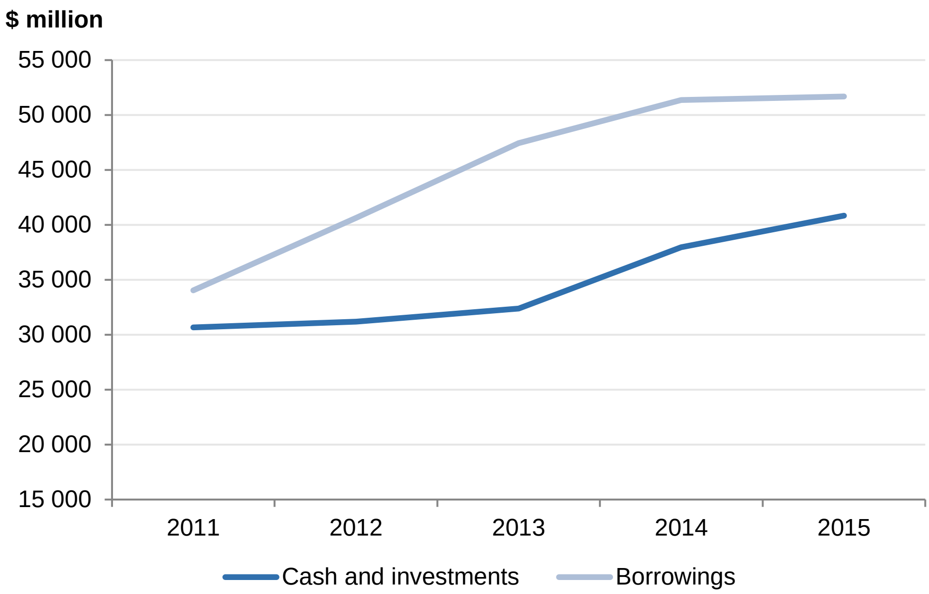


GSP = Gross state product.
Source: Victorian Auditor-General's Office.

Figure 4H indicates that the state's ability to service debt is relatively unchanged from the prior year because total debt is growing at the same pace as GSP meaning the state is not making gains in this area. However, debt sustainability has improved compared to recent years when there was a sharp decline that coincided with a sharp increase in borrowings.

Total borrowings, as depicted in Figure 4I have stagnated this year coming after four years of consistent growth.

Figure 4I
Cash and interest bearing liabilities balances at 30 June for the State of Victoria



Source: Victorian Auditor-General's Office.

The increasing levels of borrowings indicate that the state has been funding large capital projects from borrowings and other sources—such as public private partnerships—rather than through cash. However, the ability to service this debt has not been flagged as a concern.

5 Major projects and significant items

At a glance

Background

This Part provides an update at 30 June 2015 on the following five major projects or significant transactions that impact Victoria—Bendigo Hospital, Victorian Comprehensive Cancer Centre, Regional Rail Link, Ravenhall Prison and the Port of Melbourne lease.

Findings

- The 2014–15 State Budget details around $72 billion worth of projects that were either underway or to be started in the 2014–15 financial year. The state government spent $6.6 billion on purchases of new and replacement assets in this period.
- The Regional Rail Link project was substantially completed at 30 June 2015, and the three other major projects were progressing on time and budget.
- On 5 May 2014, the Treasurer of Victoria and the Minister for Ports confirmed the state's intent to lease the commercial operations of the Port of Melbourne to help fund the government's infrastructure program. Legislation for the lease, the *Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015*, was introduced to Parliament in May 2015. In August 2015, it was referred to a Select Committee Inquiry by the Legislative Council for review.

5.1 Introduction

The 2014–15 State Budget provided details of public sector capital projects that were either underway or starting in the 2014–15 financial year. The total value of these projects is around $72 billion.

In 2014–15, the state government spent $6.6 billion on purchases of new and replacement assets.

In the Budget Papers, the government identified 36 of these projects as ‘high value, high risk’ (HVHR) major projects. These are projects with a budget of more than $100 million, and/or which are considered to have a higher risk profile than normal. As a result, they are subject to increased oversight, particularly from the central agencies such as the Department of Treasury & Finance (DTF), throughout their planning and development phase.

We have previously reviewed the high value, high risk system in our report *Impact of Increased Scrutiny of High Value High Risk Projects*, tabled in Parliament in June 2014. This report found that the increased scrutiny applied through the HVHR process has improved the quality of the business cases and procurements underpinning government's infrastructure investments. However, these improved practices are yet to ensure that project development and implementation consistently and comprehensively meets DTF's better practice guidelines. This means government is still exposed to the risk that projects fail to deliver intended benefits on time and within approved budgets. A robust HVHR process is critical to effectively managing this risk.

Our subsequent report *Applying the High Value High Risk Process to Unsolicited Proposals*, tabled in Parliament in August 2015, highlighted that DTF has not consistently applied the HVHR process to unsolicited proposals. DTF’s guidance falls short of providing the transparency needed to enable affected stakeholders and the wider community to understand the full impacts of these projects.

Section 5.4 provides an update on another significant project impacting the State of Victoria—the proposed Port of Melbourne lease. This item is discussed as a subsequent event in note 38 of the 2014–15 *Annual Financial Report of the State of Victoria* (the AFR), but does not impact the financial transactions reported in the AFR. It was included in the 2015–16 State Budget, and may impact assets held by the state in the future.

5.2 Different types of major projects

Of the 34 projects identified by the government as high value, high risk, some are delivered by the government, while others are being delivered using a public private partnership (PPP).

The 19 PPPs for which the state government had outstanding commitments at 30 June 2015 are detailed in note 34(b) of the 2014–15 AFR. Of these, three PPPs are not yet commissioned, meaning that their construction has not been completed. This Part provides an update on these PPPs as at 30 June 2015. They are:

- Bendigo Hospital
- Victorian Comprehensive Cancer Centre (VCCC)
- Ravenhall Prison.

This Part also details the status of the Regional Rail Link—a major project—as at the same date.

What are public private partnerships?

A PPP is a long-term contract between the public and private sectors generally covering the design, construction, maintenance, management and financing of an infrastructure asset. Common characteristics of a PPP are:

- the private entity funds the design and construction of the asset
- the private entity manages the asset for an extended period—usually over 20 years—and usually leases it to a public sector entity
- the public sector uses the asset to deliver services and usually makes a regular payment to the private entity for leasing and maintaining the asset
- after the lease period, the asset is returned to public sector ownership, which can then continue to use, or dispose of, the asset as required.

Auditing PPP arrangements

Due to the complex nature of PPP arrangements, and the high level of public money that will be spent on these arrangements over the life of the contract, it is important that these arrangements are subject to the same scrutiny as other public spending.

However, as the state has increasingly sought partnerships, alliances or other service delivery models involving the private sector, the provisions of the *Audit Act 1994* have failed to keep pace with these developments. As a result, the Auditor-General's mandate to review public expenditure on large projects has diminished. This means that PPPs cannot be held to the same level of transparency or accountability as other areas of public spending.

5.3 Analysis of selected major projects

5.3.1 Bendigo Hospital Redevelopment PPP

The Bendigo Hospital development involves the construction of a new hospital on a site adjacent to the existing hospital. The project is being delivered in the following stages:

- **stage 1**—development of a new hospital, an integrated cancer centre, 372 inpatient beds and an 80 bed integrated mental health facility
- **stage 2**—development of a multi-storey car park and helipad.

The Department of Health & Human Services (DHHS), in consultation with Bendigo Health, is responsible for delivering the project.

In May 2013, the state entered into a PPP with a private sector consortium to design, finance, build and maintain the new hospital for 25 years, before transferring ownership to the state.

Construction of stage 1 commenced in June 2013 and is scheduled to be completed in December 2016. At 30 June 2015, the concrete structure had been completed and the building façade was progressing.

Construction of stage 2 is scheduled to commence in January 2017 and be completed in June 2018.

Cost to the state

Figure 5A details the state's financial commitments to the consortium and other costs it expects to incur over the life of the PPP.

At 30 June 2015, the PPP is progressing on time and on budget. The completed leased asset and liability will be reported in Bendigo Health's financial statements on completion which is expected to occur in December 2016.

Figure 5A
Bendigo Hospital and associated infrastructure: estimated cost of construction and operation, as at 30 June 2015

Item	Nominal value ($mil)	Net present value ($mil)
State's financial commitments to the consortium		
Design and construction of the hospital, which will lead to the recognition of a leased asset and liability of the state upon completion of construction—inclusive of GST	1 367	949
Quarterly service payments for operation and maintenance over the 25-year term—inclusive of GST[(a)]	1 594	603
Total including GST	**2 961**	**1 552**
Less GST recoverable from the Australian Taxation Office	(269)	(141)
Total excluding GST	**2 692**	**1 411**
Other estimated costs of the state		
Other project costs—exclusive of GST[(b)]	46	46
Total estimated cost—exclusive of GST	**2 738**	**1 457**

(a) Discount rate of 8.06 per cent and 8.07 per cent used to calculate the net present value of the interest portion of stage 1 and stage 2 costs, respectively. Discount rate of 7.18 per cent used to calculate the net present value of all other operating costs.

(b) Direct costs associated with establishing the contractual and lease arrangements, critical infrastructure work, fire services upgrade, demolition, enabling work, and relocation and building of five new ambulance stations around Bendigo.

Source: Victorian Auditor-General's Office.

The expected value of the asset will include construction costs which will be funded by a $566.0 million state contribution, payable to the consortium upon commercial acceptance of stage 1 work. As at 30 June 2015, the state had incurred $79.8 million of expenditure relating to this project.

5.3.2 Victorian Comprehensive Cancer Centre PPP

The VCCC is intended to be a world-class cancer centre. Scheduled to be operational by June 2016, the facility will:

- house the relocated Peter MacCallum Cancer Centre
- provide new cancer research and clinical care facilities for Melbourne Health
- provide cancer research space for The University of Melbourne.

VCCC will consist of a north and south facility. In December 2011, the state entered into a PPP with a private sector consortium to design, finance and construct the south facility. The consortium will maintain the south facility for a 25-year period after which ownership will revert to the state. The consortium will also complete the north facility, however, these works do not form part of the PPP and are being delivered under a traditional procurement approach.

At the north facility, four new floors will be constructed on top of an existing Royal Melbourne Hospital building.

At the south facility, a new 13 floor building will be constructed on the site formerly known as the Royal Dental Hospital.

The north and south facilities will be connected by enclosed bridge links crossing Grattan Street, Carlton.

As at 30 June 2015, construction was progressing to schedule.

Construction of the four additional floors is near completion, with internal building fit-out well progressed. The three new clinical floors were handed over to Melbourne Health (the hospital operator) in October 2015. The north facility is scheduled to be completed and available for service delivery in late 2015.

Construction is underway for the south facility, with the building's façade being substantially complete and the internal fit-out progressing. Commercial acceptance of the south facility is scheduled for June 2016.

Cost to the state

North facility

A breakdown of budget, actual and committed expenditure, and the expected completion date for the north facility as at 30 June 2015 is provided in Figure 5B.

Figure 5B
VCCC north facility: budget, actual and committed expenditure, and expected completion date, as at 30 June 2015

Project component	Initial Budget ($mil)	Revised Budget ($mil)	2013–14 Budget ($mil)	2014–15 Budget ($mil)	Expenditure to date ($mil)	Committed expenditure ($mil)	Expected completion
Construction costs	93.8	103.7	129	132	104	28	2015

Source: Victorian Auditor-General's Office.

As at 30 June 2015, costs of $104.0 million had been incurred by the state for the north facility. Upon completion, the state will be responsible for the ongoing operation and maintenance of the north facility.

South facility

Figure 5C details the state's financial commitments to the consortium and other costs it expects to incur on the south facility. As at 30 June 2015, costs of $310.4 million had been incurred by the state for the south facility.

Figure 5C
Victorian Comprehensive Cancer Centre south facility: estimated cost of construction and operation, as at 30 June 2015

Item	Nominal value ($mil)	Net present value ($mil)
State's financial commitments to the consortium		
Design and construction of the VCCC south facility, which will lead to the recognition of a leased asset and liability of the state upon completion of construction (inclusive of GST)(a)(b)(c)	2 312	1 155
Quarterly service payments for the operation and maintenance over the 25-year term subsequent to construction completion (inclusive of GST) (d)	888	281
Total including GST	**3 200**	**1 436**
Less GST recoverable from the Australian Taxation Office	(291)	(131)
Total excluding GST	**2 909**	**1 305**
Other estimated costs to the state		
Other project costs (exclusive of GST)(e)	98	98
Total estimated cost (exclusive of GST)	**3 007**	**1 403**

(a) The leased asset and liability will be recognised on commissioning of the new south facility which is expected to occur in June 2016. The finance leased asset and liability will be reported in the Peter MacCallum Cancer Centre financial statements in 2015–16.
(b) Includes $300 million that the state will contribute towards the design and construction of the VCCC south facility during the construction phase.
(c) Discount rate of 9.17 per cent used to calculate net present value.
(d) Discount rate of 8.33 per cent used to calculate net present value.
(e) Management of project development, state delivered works, ICT, enabling works and relocation allowance.
Source: Victorian Auditor-General's Office.

5.3.3 Ravenhall Prison PPP

On 15 September 2014, the state contracted a private company to design, build, finance, operate and maintain a new medium-security prison to be located at Ravenhall in Melbourne's West. The project will be located on Department of Justice & Regulation land at Ravenhall, adjacent to Riding Boundary Road and the Deer Park Bypass.

Ravenhall Prison will initially accommodate 1 000 prisoners with a capacity for 1 300 prisoners should this be required in future. The new prison will include a mix of low-rise accommodation, administration, programs, health and mental health facilities, industries and recreation buildings surrounded by a solid perimeter wall. The facility will include:

- accommodation for mainstream and protection prisoners
- 75 inpatient forensic mental health beds
- a 25 bed 'close supervision unit' for a small but highly complex group of prisoners with particularly challenging behaviours
- a self-contained 25 bed unit that can be adapted to cater for prisoners with particular needs, initially providing a residential drug treatment program for younger prisoners.

The private operator will operate and maintain the facility for 25 years.

Project costs

The net present cost of the consortium's proposal is $2.5 billion, based on a discount rate of 5.5 per cent per annum. This includes design, construction, operating and maintenance costs for the term of the PPP, and forms part of the total estimated cost of the project to the state of $3.1 billion (excluding GST).

To date, no payments have been made by the state to the consortium. The first payment will be due on commercial acceptance of the prison. The total estimated commitment as of 30 June 2015 is $6.8 billion (nominal cost excluding GST).

The project's key milestones and current status are set out in Figure 5D.

Figure 5D
Key milestones of Ravenhall Prison PPP

Milestone	Planned date of achievement	Update as at 30 June 2015
Commencement of construction of the prison	Early 2015	Construction started in February 2015
Commercial acceptance (construction complete and can be used)	31 October 2017	Expectations are that the building will completed on time.
Prison will start to be used	Late 2017/Early 2018	–
End of PPP contract	2042	–

Source: Victorian Auditor-General's Office.

5.3.4 Regional Rail Link

The Regional Rail Link project was substantively complete in June 2015. The first passenger train service along the new dedicated regional tracks through Melbourne's west occurred on 14 June 2015, and the final section of the project through Tarneit and Wyndham Vale opened to commuters on 21 June 2015.

The project provided:

- approximately 50 kilometres of dual track and 40 kilometres of single track between Southern Cross Station and West Werribee, via Sunshine
- five new or upgraded train stations
- two new platforms at Southern Cross Station
- thirteen grade separations
- two level crossing removals.

The project was delivered in a number of works packages.

Project expenditure

A breakdown of budget, actual and committed expenditure for each works package, as at 30 June 2015, is provided in Figure 5E.

The total expected cost of the project is $3.65 billion, which is consistent with the revised 2015 budget. The Commonwealth Government provided $2.7 billion for the project, with the state providing the remaining funding.

Approximately $100 million of expenditure is expected to be incurred after 30 June 2015 to complete the project, of which $72 million was contractually committed at 30 June 2015. Future costs relate to land settlements, post completion activities and some construction costs.

Figure 5E
Regional Rail Link project: budget, actual and committed expenditure, as at 30 June 2015

Works package	Original budget ($mil)	Revised budget ($mil) 2011	2013	2014	2015	Expenditure to date 2015 ($mil)	Committed expenditure ($mil)
Preparatory works and project management	369	608	695	557	508	466	11
Southern Cross works	244	315	342	228	235	229	–
City to Maribyrnong works	632	929	952	729	663	648	33
Footscray to Deer Park works	955	1 437	1 281	1 157	1 056	1 046	6
Sunshine to Deer Park West works	393	48	n/a(a)	n/a	n/a	n/a	n/a
Deer Park to West Werribee Junction works	1 343	1 295	963	863	864	844	–
West Werribee Junction works	136	149	146	55	52	52	–
Anderson Road level crossing works	n/a	180	n/a(a)	n/a	n/a	n/a	n/a
Rail systems works	245	230	428	311	272	264	22
St Albans level crossing works	–	–	–	202	n/a(b)	n/a	n/a
Central contingency	–	377	–	–	–	–	–
Total	**4 317**	**5 568**	**4 807**	**4 102**	**3 650**	**2 549**	**72**

(a) These two works packages are now included as part of the Footscray to Deer Park works package.
(b) This works package is now being delivered through the government's Level Crossing Removal program.
Source: Victorian Auditor-General's Office.

Due to a number of amendments to the Regional Rail Link project plan throughout its life, the project budget was subject to several revisions during construction. The reason for budget revisions are summarised in Figure 5F.

Figure 5F
Regional Rail Link project: Budget revisions

Budget	Amount ($mil)	Detail
Original budget	4 317	
Revised budget 2011	5 568	The original project budget of $4 317 million was revised in March 2011 to $5 568 million to include additional contingency provisions, signalling equipment, land acquisition, and the removal of level crossings at Anderson Road, Sunshine.
Revised budget 2013	4 807	A further amendment reducing the project budget to $4 807 million was approved in January 2013. The decrease was attributed to improved scope certainty, construction efficiencies and innovation, and removal of contingency provisions.
Revised budget 2014	4 102	The 2014–15 State Budget announced another amendment to the project budget, further reducing it to $4 102 million based on delivery progress, while also including $202 million of level crossing works at Main Road, St Albans within the project.
Revised budget 2015	3 650	The 2015–16 State Budget announced another amendment to the project budget, further reducing it to $3 650 million based on a reduction in risk provisioning of $200 million, reduction in expenditure forecasts of $50 million, and the removal of $202 million of level crossing works at Main Road, St Albans from within the scope of the project.

Source: Victorian Auditor-General's Office.

5.4 Analysis of proposed transaction

5.4.1 Port of Melbourne lease

The Port of Melbourne is Australia's largest maritime hub for shipping containers and automotive cargo. With over 3 000 commercial ships visiting the port each year, the Port of Melbourne handles over 2.5 million '20-foot equivalent units' (TEU) and 350 000 new motor vehicles annually.

Established on 1 July 2003 to provide for the strategic management and development of the Port of Melbourne, the Port of Melbourne Corporation (PoMC) manage the port under the provisions of the *Transport Integration Act 2010*, *Port Management Act 1995* and other relevant legislation.

In addition to the shipping channels within the port, PoMC owns and manages around 510 hectares of port land with 36 commercial berths contributing to a total berth length of nearly seven kilometres. In 2014–15, PoMC generated a profit before income tax of $51.3 million ($102.3 million in 2013–14) and at 30 June 2015 reported net assets of $3.4 billion ($1.7 billion at 30 June 2014).

The lease transaction

On 5 May 2014, the Treasurer of Victoria and the Minister for Ports confirmed the state's intent to lease the commercial operations of the Port of Melbourne to help fund the government's infrastructure program.

The transaction involves leasing the port’s commercial operations for 50 years, with the state having the ability to grant an additional term of up to 20 years to the leaseholder. The state will retain ownership of the freehold title to the land, and at the end of the lease term the port will return to the state’s control. During the lease, the Victorian and Commonwealth governments retain responsibility for regulating the port’s safety, security and environmental functions. The leaseholder will be required to comply with these regulations.

The financial impact of the proposed lease on the state's balance sheet was reflected in the 2014–15 State Budget, however, to preserve the state's commercial interests ahead of a leasing process, the specific expected results were not separately identifiable.

In its 2014–15 Budget, the Commonwealth Government announced its Asset Recycling Initiative (ARI). Under the ARI, the Commonwealth Government offers financial incentives to the states and territories to privatise mature government-owned assets and reinvest the returns into new, productivity-enhancing infrastructure. The state and territory governments are responsible for managing asset sales and delivering the new infrastructure projects. The sale must be completed, and new assets commenced, before 30 June 2019 to be eligible for the funding.

The state may be eligible for a 15 per cent payment on the net proceeds of the port lease through the ARI.

Legislation

The government introduced the *Delivering Victorian Infrastructure (Port of Melbourne Lease Transaction) Bill 2015* (the Bill) into the Legislative Assembly in May 2015. If passed, the Bill facilitates the transaction and modifies current legislative frameworks to allow assets and functions to be separated between the state and the leaseholder. The Bill:

- authorises the transfer of PoMC's assets and liabilities to the leaseholder
- authorises a 50-year lease and, under regulation, the ability to grant an additional term of up to 20 years to a leaseholder
- authorises and facilitates an efficient and timely restructure of PoMC's assets and liabilities and the transfer of the commercial port operations to the private sector
- authorises a strengthened economic regulatory regime to provide enhanced protection for port users for the 50-year lease term
- enables the transfer of employees, preserves employee entitlements and provides a two-year employment guarantee for permanent non-executive employees.

The Bill establishes the Victorian Transport Fund (VTF) and directs proceeds of the lease, which are to be paid up front, into the VTF. The Bill requires the proceeds in the VTF to be used for the Level Crossing Removal Program and other infrastructure projects.

The Legislative Assembly passed the Bill in June 2015. It was then debated in the Legislative Council in August 2015, where it was referred to a Select Committee Inquiry for consideration of items such as:

- the structure and duration of the proposed lease
- the potential impacts of the proposed lease on the development of a second container port in Victoria
- how the proposed lease balances the short-term objective of maximising the proceeds of the lease with the longer-term objective of maximising the economic benefits to Victoria of container trade
- any other relevant matters.

The reporting date for this inquiry is 30 November 2015.

Items impacting on the potential value of the lease

Port Capacity Project

The $1.6 billion Port Capacity Project, announced in April 2012, aims to expand the Port of Melbourne's container and automotive terminal capacity. Its centrepiece is the redevelopment of Webb Dock and the construction of a new international container terminal capable of handling at least one million standard containers per year. The project also includes the consolidation of Victoria's car and automotive trade at a new facility to be built at Webb Dock. The new facilities are expected to become progressively operational from late 2015. At 30 June 2015, the project remains on schedule to be completed within approved milestones and under budget.

PoMC is currently responsible for funding and delivering the base infrastructure for the project, at a budgeted cost of $921 million. Base infrastructure includes site preparation, roads and services works, and maritime works including the delivery of a new 920 metre wharf at Webb Dock West and berth works at Webb Dock East. Delivery of uncompleted base infrastructure will become the responsibility of the new leaseholder at the commencement of the lease.

Private sector participants are responsible, among other things, for financing, delivering, and operating the new international terminal at Webb Dock East, the automotive terminal, and a pre-delivery inspection hub. PoMC or the leaseholder will not contribute to the construction or operating costs of these components during the lease term.

A breakdown of the budget, actual and committed expenditure—and expected completion dates for each component of the base infrastructure works as at 30 June 2015 is provided in Figure 5G.

Figure 5G
Port capacity project: base infrastructure: budget, actual and committed expenditure, and expected completion dates as at 30 June 2015

Project component	Original budget ($mil)	Expenditure to date ($mil)	Future committed expenditure ($mil)	Expected completion
Site preparation and other early works	6	5	–	Completed
Roads and services works	98	83	9	2016
Maritime works	584	238	158	2017
Swanson Dock works	20	1	–	2017
Other—project overheads, risk event allowance and land works[(a)]	213	79	18	2017
Total	**921**	**406**	**185**	

(a) Other expenditure supports the delivery of the base infrastructure works packages. It includes a risk event allowance to be utilised if identified risks eventuate at any stage during the project.
Source: Victorian Auditor-General's Office.

Total expenditure of $405.8 million had been incurred to 30 June 2015. This includes $376.2 million of capital expenditure and $29.6 million of other operating expenditure. Future contractual commitments of $185 million were reported by PoMC at 30 June 2015.

Revaluation of property, plant and equipment

In accordance with the requirements of Australian Accounting Standard AASB 116 *Property, Plant and Equipment* and Financial Reporting Direction 103F *Non-financial Physical Assets* issued by the Minister for Finance, PoMC is required to value its property, plant and equipment at fair value. Fair value is defined under Australian Accounting Standard AASB 13 *Fair Value Measurement* as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

The value of property, plant and equipment at the Port of Melbourne increased by $1.43 billion in 2014–15, as a result of a formal independent revaluation. This was fairly presented for financial reporting purposes. Figure 5H shows the increase in value for each class of asset.

Figure 5H
Increase in value of property, plant and equipment, 2014–15

Class of asset	Revaluation increment ($mil)
Land	867.8
Channels	369.5
Infrastructure	179.8
Plant and equipment	8.3
Total	**1 425.4**

Source: Victorian Auditor-General's Office from Port of Melbourne Corporation's financial statements for the year ended 30 June 2015.

The increase in the value of land in 2014–15 reflects new lease agreements being signed for previously vacant sites. Land currently under development as part of the Port Capacity Project has been valued on the basis that it will be fully developed in future years.

Repayment of debt

On 15 May 2015, the Minister for Ports, at the request and with the approval of the Treasurer, directed PoMC to repay all its borrowings on or before 30 June 2015 in order to prepare the commercial operations to be leased to a new operator on a debt free basis.

A cash contribution to PoMC of $652.3 million from the Department of Treasury & Finance enabled this repayment to occur on 25 June 2015. $579.5 million was paid to the loan provider—Treasury Corporation Victoria—consisting of $538.9 million of outstanding borrowings and $40.6 million of 'break costs' incurred due to early repayment. Residual monies not paid to Treasury Corporation Victoria will be used by PoMC in 2015–16 for working capital purposes.

Port growth regime

It is proposed that a Port Growth Regime, which guarantees container capacity up to a certain level, will be incorporated into bids for the Port of Melbourne lease.

The Port Growth Regime is designed to reduce the leaseholders risk exposure to a second container port being developed by the state during the lease term. It also provides for compensation to be paid to the leaseholder if a second port is developed by the state during the lease term that takes international container trade away from the Port of Melbourne, although there are circumstances in which this will not be paid.

Strengthened economic regulatory regime

The strengthened economic regulatory regime proposed in the Bill will see Victoria's independent economic regulator, the Essential Services Commission, overseeing the pricing structure for port users. The government is seeking to ensure port users and Victorian consumers are safeguarded from unexpected price increases by:

- providing independent oversight over more prescribed services
- ensuring prices reflect underlying efficient costs
- capping price increases at the Consumer Price Index for 15 years.

At the end of the 15-year period the leaseholder would be able to set prices based on a range of pricing and cost allocation principles developed in a Pricing Order.

The strengthened economic regulatory regime will provide the leaseholder with some certainty by limiting the scope for re-regulation.

Appendix A.

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

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INDEPENDENT AUDITOR'S REPORT

To the Treasurer

The Financial Report

The accompanying financial report for the year ended 30 June 2015 of the State of Victoria (the State) and the Victorian General Government Sector has been audited. The Annual Financial Report comprises a consolidated comprehensive operating statement, consolidated balance sheet, consolidated cash flow statement, consolidated statement of changes in equity, notes comprising a summary of significant accounting policies and other explanatory information contained in Chapter 4 of the Annual Financial Report, and the certification by the Treasurer and the Department of Treasury and Finance. The financial report is the consolidated financial statements of the State, comprising the State of Victoria and the Victorian General Government Sector and the entities they controlled at the year's end or from time to time during the financial year as disclosed in Note 42 to the consolidated financial statements.

The original General Government Sector budget estimates disclosed in Note 32 were subject to a review by my office as required by Section 16B of the *Audit Act 1994* upon which I issued an unqualified review report on 1 May 2015.

The Treasurer's Responsibility

The Treasurer of Victoria is responsible for the preparation and fair presentation of the financial report in accordance with Australian Accounting Standards, and the manner and form of the financial statements determined by the Treasurer of Victoria as required by the *Financial Management Act 1994*, and for such internal control as the Treasurer determines is necessary to enable the preparation and fair presentation of the financial report that is free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

As required by the *Audit Act 1994*, my responsibility is to express an opinion on the financial report based on the audit, which has been conducted in accordance with Australian Auditing Standards. Those standards require compliance with relevant ethical requirements relating to audit engagements and that the audit be planned and performed to obtain reasonable assurance about whether the financial report is free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial report. The audit procedures selected depend on judgement, including the assessment of the risks of material misstatement of the financial report, whether due to fraud or error. In making those risk assessments, consideration is given to the internal control relevant to the entities' preparation and fair presentation of the financial report in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the consolidated entites' internal control. An audit also includes evaluating the appropriateness of the accounting policies used and the reasonableness of accounting estimates made by the Treasurer of Victoria, as well as evaluating the overall presentation of the financial report.

Auditing in the Public Interest

Independent Auditor's Report (continued)

I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my qualified audit opinion.

Independence

The Auditor-General's independence is established by the *Constitution Act 1975*. The Auditor-General is not subject to direction by any person about the way in which his powers and responsibilities are to be exercised. In conducting the audit, the Auditor-General, his staff and delegates complied with all applicable independence requirements of the Australian accounting profession.

Basis for Qualified Opinion – East West Link project funding

As set out in Note 1(B) and the Certification by the Treasurer and Department of Treasury and Finance, the State has not recognised a liability for the return of the funding associated with the East West Link project.

During May 2015, after the cancellation of the East West Link project by the State Government, the Commonwealth Government formally requested the return of these funds, consistent with the provisions of the relevant Memorandum of Understanding for the Project and the *Nation Building Program (National Land Transport) Act 2009*. The Commonwealth Government can also reduce future funding to Victoria for other projects to recover these funds, should they not be repaid.

The State has not recorded a liability in the consolidated balance sheet or an expense in the consolidated comprehensive operating statement to account for the requirement to return the funds. This is a departure from *AASB 1004 Contributions*, which requires that a liability and an expense be recognised because the conditions of the grant will not be met and the funds are required to be returned, and consequently a departure from *AASB 137 Provisions, Contingent Liabilities and Contingent Assets*.

The failure to recognise a liability and an expense means that:

- expenses from transactions in the consolidated comprehensive operating statement are understated for the State of Victoria and the Victorian General Government Sector by $1 500 million
- the net results from transactions in the consolidated comprehensive operating statement are overstated for the State of Victoria and the Victorian General Government Sector by $1 500 million. The comprehensive results are also overstated by the same amount
- other provisions and total liabilities are both understated for the State of Victoria and the Victorian General Government Sector by $1 500 million and
- the accumulated surplus and net assets for the State of Victoria and the Victorian General Government Sector are overstated by $1 500 million.

Consequently, the government's key financial measure of a net result from transactions for the Victorian General Government Sector of a net operating surplus of at least $100 million has not been achieved. The net result from transactions for the Victorian General Government Sector, after adjustment for this matter, is a deficit of $286 million.

Independent Auditor's Report (continued)

Basis for Qualified Opinion – Property, plant and equipment at the Department of Education and Training

Land, buildings, infrastructure, plant and equipment includes $16 832 million reported by the Department of Education and Training as at 30 June 2015. This Department has not maintained proper accounts and records to support its property, plant and equipment balance as well as related financial statement line items, which is a breach of the *Financial Management Act 1994*. Consequently this has prevented me from obtaining sufficient appropriate audit evidence. As a result, I am unable to determine whether any adjustments may have been necessary to the following financial statement line items:

- Land, buildings, infrastructure, plant and equipment of $16 832 million out of a total of $107 586 million for the General Government Sector and $206 972 million for the State of Victoria
- Reserves of $7 382 million out of a total of $90 496 million for the General Government Sector and $78 630 million for the State of Victoria.

The inability to obtain sufficient appropriate audit evidence for the Department of Education and Training's property, plant and equipment balances also means I am unable to determine whether any other adjustments to the consolidated comprehensive operating statement, consolidated balance sheet, consolidated statement of changes in equity and the consolidated cash flow statement were necessary.

Qualified Opinion

In my opinion, except for the effect on the financial report of the matters described in the Basis for Qualified Opinion paragraphs above, the financial report presents fairly, in all material respects, the consolidated financial positions of the State of Victoria and the General Government Sector as at 30 June 2015 and their consolidated financial performance and their consolidated cash flows for the year then ended in accordance with applicable Australian Accounting Standards, and the manner and form of the financial statements determined by the Treasurer of Victoria in accordance with the *Financial Management Act 1994*.

MELBOURNE
30 October 2015

Dr Peter Frost
Acting Auditor-General

Appendix B.
Glossary

Accountability

Responsibility of public sector entities to achieve their objectives, with regard to reliability of financial reporting, effectiveness and efficiency of operations, compliance with applicable laws, and reporting to interested parties.

Acquisition

Establishing control of an asset, undertaking the risks, and receiving the rights to future benefits, as would be conferred with ownership, in exchange for the cost of acquisition.

Asset

A resource controlled by an entity as a result of past events, and from which future economic benefits are expected to flow to the entity.

Audit Act 1994

An Act of the State of Victoria that establishes the:

- operating powers and responsibilities of the Auditor-General
- the operation of his office—the Victorian Auditor-General's Office (VAGO)
- nature and scope of audits conducted by VAGO
- relationship of the Auditor-General with the Public Accounts and Estimates Committee as the representative body of Parliament
- Auditor-General's accountability to Parliament for discharge of the position's responsibilities.

Audit risk

The risk of an inappropriate audit opinion being expressed when the financial report is materially misstated.

Capital commitment

A contractual agreement to undertake capital expenditure at some set time in the future which has not yet become a liability.

Clear audit opinion – financial report

A positive written expression provided when the financial report has been prepared and presents fairly the transactions and balances for the reporting period in accordance with the requirements of the relevant legislation and Australian accounting standards.

Also referred to as an **unqualified or an unmodified audit opinion**.

Consumer Price Index

A measure of changes, over time, in retail prices of a constant 'basket' of goods and services representative of consumption expenditure.

Credit risk

The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

Deficit

Total expenditure exceeds total revenue resulting in a loss.

Depreciated replacement cost

The cost to replace an asset with an equivalent current service capacity. It is calculated as the cost of an asset after applying depreciation and consideration of economic obsolescence.

Depreciation

The systematic allocation of a fixed asset’s capital value as an expense over its expected useful life to take account of normal usage, obsolescence, or the passage of time.

Disclaimer audit opinion

A disclaimer is issued when the auditor is unable to obtain sufficient appropriate audit evidence to enable them to form an opinion on all or part of the financial statements. The lack of evidence is material and pervasive to the financial report.

Also referred to as a **modified audit opinion**.

East West Link project

The East West Link project was a proposed 18 kilometre cross city road in Melbourne, connecting the Eastern Freeway at Hoddle Street to CityLink, and the Port of Melbourne precinct and the Western Ring Road at Sunshine West.

Economic obsolescence

The loss in value of an asset caused by factors which are external to the asset itself. Such factors often relate to the economics of the industry in which the business operates or the business in which the asset is employed.

Eliminations

Removing the effect of inter-entity transactions for the preparation of consolidated financial statements.

Entity

A body, whether corporate or unincorporated, that has a public function to exercise on behalf of the state or is wholly owned by the state, including—departments, statutory authorities, statutory corporations and government business enterprises.

Equity or net assets

Residual interest in the assets of an entity after deduction of its liabilities.

Expense

Outflows or other depletions of economic benefits in the form of incurrence of liabilities or depletion of assets of the entity, other than those relating to contributions by owners, that results in a decrease in equity during the reporting period.

Financial instrument

Any contract that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

Financial Management Act 1994

An Act of the State of Victoria that establishes the financial administration and accountability of the public sector, as well as annual reporting to the Parliament by all departments and public sector entities.

Financial report

Structured representation of the financial information, which usually includes accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time or the changes therein for a period in accordance with a financial reporting framework.

Financial sustainability

An entity's ability to manage financial resources so it can meet spending commitments, both at present and into the future.

Financial year

The period of 12 months for which a financial report (and performance report) is prepared.

Fiscal targets

Targets set by the government in order to meet short and medium term economic objectives.

General government sector

The general government sector comprises all government departments, offices and other bodies engaged in providing services free of charge or at prices significantly below their cost of production. General government services include those which are mainly non-market in nature, those which are largely for collective consumption by the community, and those which involve the transfer or redistribution of income. These services are financed mainly through taxes, other compulsory levies and user charges.

Governance

The control arrangements in place at an entity that are used to govern and monitor its activities, in order to achieve its strategic and operational goals—it includes the oversight role of the board of management at public hospitals.

Inherent risk

The susceptibility of a balance or disclosure in the financial report being misstated before consideration of any related controls.

Investment

The expenditure of funds intended to result in medium- to long-term service and/or financial benefits arising from the development and/or use of infrastructure assets by either the public or private sectors.

Legislative framework

Sets out the legal functions and powers of the state government entities as detailed in the relevant legislation.

Liability

A present obligation of an entity arising from past events, the settlement of which is expected to result in an outflow of resources from the entity.

Liquidity risk

The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

Machinery-of-government changes

Changes made to the administrative structure of government.

Management letter

A written report issued to management which communicates significant matters relating to or arising from the financial audit of an entity.

Material entity

Those entities that are collectively deemed to have a significant effect on the transactions and balances reported in the state's annual financial report.

The selection of these entities follows a detailed analysis of the financial operations of all controlled entities of the state and takes into account any major risk factors that are attached to specific entities or portfolios.

Materiality

Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial report. Materiality depends on the size or nature of the item or error judged in the particular circumstances of its omission or misstatement.

Modified audit opinion

A modified audit opinion means that a clear audit opinion cannot be issued on the financial statements. The two types of modified audit opinion referred to in this report are:

- a **disclaimer audit opinion**
- a **qualified audit opinion**.

Net result

Calculated by subtracting an entity's total expenses from its total revenue, to show what the entity has earned or lost in a given period of time.

Professional scepticism

An attitude that includes a questioning mind, being alert to conditions which may indicate possible misstatement due to error or fraud, and a critical assessment of audit evidence.

Public financial corporation

A subsector comprising public sector corporations which are engaged in providing financial intermediation services or auxiliary financial services. Central borrowing authorities of state governments are included in this subsector.

Public non-financial corporation

A subsector comprising public sector corporations which are mainly engaged in providing market non-financial goods and services. Includes corporations which aim at covering most of their expenses from revenue.

Public private partnerships (PPP)

An infrastructure procurement method used by the state government. The aim of a PPP is to deliver improved services and better value for money primarily through appropriate risk transfer, encouraging innovation, greater asset utilisation and an integrated whole-of-life management, underpinned by private financing.

Qualified audit opinion

A qualification is issued when the auditor concludes that an unqualified opinion cannot be expressed due to one of the following reasons:

- disagreement with those charged with governance
- conflict between applicable financial reporting frameworks
- limitation of scope.

A qualified opinion is expressed as being except for the effects of the matter to which the qualification relates.

Also referred to as a **modified audit opinion**.

Revaluation

Recognising a reassessment of values for non-current assets at a particular point in time.

Revenue

Inflows of funds, or other enhancements or savings in outflows of service potential, or future economic benefits in the form of increases in assets or reductions in liabilities of the entity, other than those relating to contributions by owners which result in an increase in equity during the reporting period.

Risk

The chance of a negative impact on the objectives, outputs or outcomes of the entity.

State controlled entity

A public body which is classified as a general government sector entity as defined and listed in the Annual Financial Report of the State of Victoria.

Surplus

Total revenue exceeds total expenditure resulting in a profit.

Sustainable government initiative

The reduction of the number of public sector employees in non-service delivery and back office roles by approximately 3 600 workers.

Third balance sheet

A financial statement required to be presented if an entity makes adjustments which have a material effect on information in the balance sheet at the beginning of the comparative period. Adjustments can result from retrospective application of an accounting policy, restatement or reclassification of items.

Triple-A credit rating

The highest possible rating assigned to the bonds of an issuer by credit rating agencies. An issuer that is rated AAA has an exceptional degree of creditworthiness and can easily meet its financial commitments.

Unqualified (or unmodified) audit opinion

See ‘**clear audit opinion’**.

Appendix C.

Audit Act 1994 section 16—submissions and comments

Introduction

In accordance with section 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 submissions and comments provided are not subject to audit nor the evidentiary standards required to reach an audit conclusion. Responsibility for the accuracy, fairness and balance of those comments rests solely with the agency head.

Responses were received as follows:

RESPONSE provided by the Treasurer

Treasurer of Victoria

1 Treasury Place
GPO Box 4379
Melbourne Victoria 3001
Telephone: 03 9651 5201
Facsimile: 03 9651 0759
DX 210759

RECEIVED
19 NOV 2015
VICTORIAN AUDITOR-GENERAL'S OFFICE

Dr Peter Frost
Acting Auditor-General
Victorian Auditor-General's Office
Level 24, 35 Collins Street
MELBOURNE VIC 3000

Dear Dr Frost

RESPONSE TO THE AUDITOR-GENERAL'S REPORT ON THE ANNUAL FINANCIAL REPORT OF THE STATE OF VICTORIA, 2014-15

Thank you for your letter of 5 November 2015 inviting a response to your Report on the Annual Financial Report of the State of Victoria, 2014-15 (the Report) prior to its finalisation and transmission to Parliament.

I note the Report comments on the audit qualification issued on the AFR relating to a technical accounting disagreement about the treatment of the Commonwealth Government's previous request to return the $1.5 billion funding provided for the former East West Link (EWL) project. As set-out in the AFR, specialised legal and technical accounting advice provided to the Department of Treasury and Finance concluded that no liability or expense was required to be recognised as the State had no obligation to return the funding previously paid to Victoria for EWL. On this basis, the State did not record a liability or expense in relation to this item.

The Report also comments on the additional audit qualification on the AFR related to the reporting of land and building asset balances, and associated reserves, in the Department of Education and Training's (DET) financial statements. This audit qualification was issued as your Office considered it was not able to obtain sufficient audit evidence to support DET's underlying asset accounts and records. While the Department had begun considerable work to improve its processes and record keeping during the year, there is general agreement that more work is needed and that work is underway.

Beyond these issues, your Report provides a high-level analysis of certain aspects of the State's finances, for example, liquidity, dividends, capital replacement and debt sustainability, and draws certain conclusions on the basis of the analysis presented. As commented by the former Victorian Treasurer in response to last year's Report, particular care needs to be taken in interpreting this analysis as the ratios used in isolation have limited relevance in the public sector environment and the analysis lacks

VICTORIA State Government

RESPONSE provided by the Treasurer – continued

sufficient context upon which to base informed conclusions. The Report also presents observations on matters including the "management certification " of the AFR; the timeliness of the AFR; and several prior period issues. My comments on each of these aspects are detailed below.

Liquidity

The maintenance of a strong liquidity position with strong access to financial markets and lines of funding, are particular strengths of the State of Victoria, as acknowledged by the leading credit ratings agencies, reflected in the State's triple-A credit rating.

It is important to note that the analysis presented in the Report is based on a generic liquidity ratio (current assets divided by current liabilities) which, while it has a general purpose use as a high level indicator of liquidity, can be misleading if used as a sole indicator to form conclusions of an entity's liquidity. It is, at best, a rule of thumb, but has limited relevance to the general government sector and the State as a consolidated reporting entity with the diverse range of entities and operations being consolidated, and the complex funding and cash management arrangements in place between entities and sectors.

The Treasury Corporation of Victoria (TCV) has final operational responsibility for ensuring that the State's liquidity requirements are met at all times, and TCV itself operates with a high level of liquidity as disclosed in the AFR. Note 33(j) of the AFR shows that "as at 30 June 2015, the whole of Victorian government liquidity ratio stood at 125 per cent". This high level of State liquidity is one of the key considerations supporting the State's triple-A credit rating by the two rating agencies. In Standard and Poor's (S&P) rating report of 1 September 2015 on the State of Victoria, S&P stated "We consider Victoria's liquidity to be exceptional" and noted Victoria's ''prudent approach to liquidity management". This strong liquidity position supports the State's triple-A credit rating.

This centralised approach to funding State entities and managing liquidity takes advantage of the State's excellent access to funding. Under this funding framework, general government sector entities are primarily funded centrally to meet their obligations as they fall due. This minimises debt and cost to the taxpayer by ensuring that money is not dispersed until it is needed. It also ensures that, backed by appropriate letters of support if requested, entities would not be required to sacrifice long-term assets or to incur interest penalties in the unlikely event that their short term obligations became due at the one time.

More specifically, the State's capital adequacy and prudential supervision framework for TCV largely mirrors the APRA framework for financial institutions. I consider this a more sophisticated, useful and appropriate tool to manage the State's liquidity risk.

Dividends

The Report draws particular attention to the level of dividends received from government-owned businesses in 2014-15 and notes that without the higher level of dividends, the 30 June 2015 general government sector net result from transactions would have been less than the budgeted result.

2

RESPONSE provided by the Treasurer – continued

It needs to be recognised that dividends from government-owned businesses are one of the many sources of government revenue. Subsequent to the initial budget estimates, dividends may be adjusted in relation to the timing of payments and ability to pay, in the context of the government managing a broad range of competing budget priorities.

Dividends are determined by the Treasurer after consultation with the Board of Directors of each entity and the portfolio Minister as required by legislation, and following careful consideration of the relevant commercial parameters pertaining to each government entity. These considerations include reported profit and operating cash flow, gearing and interest cover, liquidity and working capital requirements, and planned capital expenditure.

Performance of the State of Victoria

I note particular reference and focus in the Report, at a whole of State level, to the net result from transactions. As you may be aware, each of the key State Budget and AFR publications for many years have highlighted that care needs to be taken when using this as a lead indicator of financial performance at the consolidated State level. This is because at this level, there is significant Public Financial Corporation (PFC) activity occurring 'below the line' . For example, this measure excludes significant parts of income from the investment portfolios of the insurance agencies, which for accounting purposes form part of "other economic flows", and only incorporated in the "net result", which represents the more comprehensive result for the State.

I note that the State achieved a positive net result of $51 million for 2014-15.

Delay to the completion and release of the AFR

The report notes that 2014-15 was a particularly challenging year with the financial audit cycle impacted by an unusually large number of factors causing delay in the completion of year-end reporting by departments and public sector entities. More specifically, the delay was caused by the unprecedented number of significant issues at an entity level subject to more extensive audit examination, which converged with the transitional reporting challenges of certain recently restructured departments to cause delay in the finalisation of the respective entity audited financial statements for 2014-15 and, in turn, the 2014-15 audited AFR by two weeks.

In the context of this experience, I support the recommendation for material entities, particularly portfolio departments, to review the resources and capability of their finance teams to ensure they have the required skills and experience to produce accurate and compliant financial statements in a timely manner for future periods.
I also ask your Office to continue to consider the impact of unusual circumstances and issues challenging reporting timelines on their planning and allocation of audit resources, with the view to achieving the mutual objective of assuring quality and timely public sector reporting.

3

RESPONSE provided by the Treasurer – continued

Management certification of AFR

The *Financial Management Act 1994* (the FMA) requires me, the Treasurer, to annually prepare and transmit the AFR to parliament. Since the enactment of the FMA and up to 2013-14, the management certification of the AFR had been signed-off by the Secretary and other senior officers of DTF. Since 2010, this was supported by a formal ongoing Treasurer delegation to the department under the provisions of the FMA.

In 2013-14, the Victorian Auditor-General's Office recommended through its management letter that that the Treasurer sign the AFR certification. Subsequently, in the February 2015 *Portfolio Departments and Associated Entities: Results of the 2013-14 Audits* Report, the Auditor-General recommended that the broader FMA Reporting Directions be applicable to the AFR. In seeking to address these recommendations, I signed the 2014-15 AFR certification. In addition, the Secretary of my department also signed the AFR to provide additional assurance, which is above and beyond the requirements of the FMA. I note, it is also additional to that of the comparable consolidated financial report prepared by the Commonwealth of Australia.

The Report notes this as an "important and welcome change". The current certification exceeds the requirements of the FMA for the AFR and is comparable to other jurisdictions such as the Commonwealth of Australia.

Prior period issues

Finally, the Report again raises two issues previously not accepted by the former Treasurers and DTF. They relate to establishing a new, or extending the ambit of the DTF audit committee, to also oversee the AFR; and to consider extending the scope of all Financial Reporting Directions (FRD's) to the AFR.

I do not accept these recommendations, as there are already extensive and robust governance and control processes over the AFR; and the purpose of the FRD's remains to drive consistent reporting and accounting practices across the public sector to help ensure entities are well placed to comply with accounting standards and, where standards provide choices, to limit the choices so there is consistency across the sector to support whole of government reporting. Where the Government considers there is merit in extending the scope of any one Direction to the AFR, this is considered accordingly.

I trust this information is of assistance.

Yours sincerely

TIM PALLAS MP
Treasurer
19/11 /2015

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Acting Auditor-General's response to the Treasurer of Victoria

The Treasurer has noted that the audit qualification on the *Annual Financial Report of the State, 2014–15* (AFR) relating to the AFR's failure to recognise the state's obligation to return the East West Link project funds is a technical accounting disagreement. This is not correct. The requirements of the state's memorandum of understanding with the Commonwealth Government, the relevant Commonwealth legislation, related correspondence from the Commonwealth Government and Australian Accounting Standard AASB1004 *Contributions* are all clear and straightforward in this regard.

Further, as also set out in this report, we note that the Department of Treasury & Finance obtained legal advice on this matter, and that their legal advisers had sought some accounting advice in preparing their advice. One of the key qualitative characteristics of financial reporting is that transactions are accounted for based on substance over legal form. The legal view of a transaction does not override, or determine, the accounting treatment for a transaction. Lastly, our position on the correct accounting treatment for the state's obligation at 30 June 2015 to return the East West Link project funds has been confirmed by pre-eminent independent accounting experts.

Consequently, this is not a technical accounting disagreement.

It is also important to note, that while the Commonwealth Government had requested the return of the East West Link project funds prior to 30 June 2015, it can also recover those funds by reducing future funding for other Victorian projects. The Commonwealth has subsequently indicated that it may take this later course of action by allowing the state to treat the funding as a prepayment, under certain specified conditions. Whichever course is ultimately chosen by the Commonwealth, the impact on the state remains the same in substance.

Liquidity

The Treasurer has stated that the liquidity ratio adopted in this report can be misleading and has little relevance to the public sector. I maintain our position of last year on this matter. That is these comments are incorrect and inappropriate. The liquidity ratio used in this report is accepted around the world as a valid indicator of liquidity for reporting entities.

I note that the Treasurer references another liquidity ratio reported in Note 33(j) of the AFR. However this ratio is not a complete indicator of the state's ability to pay all existing short-term debt and interest obligations as it does not consider all short-term financial obligations of the state, such as payables. Refer to page 23 of this report. Therefore this ratio is not sufficiently indicative of the state's position.

Delay to the completion and release of the AFR

The Treasurer acknowledges the unprecedented number of significant issues at an entity level subject to more extensive audit examination which had converged with the machinery-of-government impacts to delay the finalisation of financial reports, as highlighted in this report. To be clear, I am required by the Australian Auditing and Assurance Standards to adopt appropriate audit procedures in response to significant and contentious matters that arise during the preparation and audit of a financial report. The level of audit work undertaken is determined after assessing the risks and controls in place at each entity, and this is assessed during both the planning and execution phases of an audit.

In section 2.4 of this report, we outline that only four of the 47 material entities provided complete draft financial statements to audit on time. My office cannot audit what we have not received. It is a credit to my financial audit practice that they were able to reschedule and change the composition of audit teams as unprecedented and contentious issues arose during the preparation and audit of often late draft financial reports. These extended to the AFR itself.

I acknowledge the Treasurer's support for our related recommendations in this regard.

Management certification of the AFR and Prior Period Issues

It is an important and welcome change that the Treasurer signed the certification of the 2014–15 AFR. However, contrary to previous practice, a chief financial officer did not sign the certification of the AFR this year. Page 12 of this report specifically highlights that the absence of a chief financial officer signing the AFR is inconsistent with the standards required of all public sector entities reporting under the *Financial Management Act 1994* (FMA) and is a change of practice for the AFR. The AFR is prepared pursuant to the FMA, however, the FMA does not expressly prescribe who should sign the certification of the AFR.

Further, having the Treasurer and Secretary sign the certification is not over and above what is required for public sector entities reporting under the FMA. However, not having a chief financial officer sign the certification is less than that required of public sector entities reporting under the FMA.

RESPONSE provided by the Secretary, Department of Education & Training

Department of
Education & Training
Office of the Secretary

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Telephone: +613 9637 2000
DX210083

RECEIVED
18 NOV 2015
VICTORIAN AUDITOR-GENERAL'S OFFICE

COR013204

Dr Peter Frost
Acting Auditor-General
Victorian Auditor-General's Office
Level 24, 35 Collins Street
MELBOURNE VIC 3000

Dear Dr Frost

RE: Audit Act 1994*, s16(3) – Proposed Audit Report *Auditor-General's Report on the Annual Financial Report of the State of Victoria 2014-15

Thank you for your letter dated 5 November, 2015 which included extracts pertaining to the Department of Education and Training for the proposed *Auditor-General's Report on the Annual Financial Report of the State of Victoria 2014-15*.

I appreciate the invitation to provide submissions or comments from the Department and have taken the opportunity to enclose a response for inclusion in the report (refer **Attachment A** of this letter).

Should you require any further information please do not hesitate to contact Jenny Atta, Acting Deputy Secretary, Infrastructure and Finance Services Group on (03) 9637 3202.

Yours sincerely

Gill Callister
Secretary

12/11/2015

VICTORIA State Government

RESPONSE provided by the Secretary, Department of Education & Training – continued

ATTACHMENT A

Response to issues raised by the *Auditor-General's Report on the Annual Financial Report of the State of Victoria 2014-15*

Schools are a vital and integral part of our community. Victoria has more than 1500 government school with buildings and land worth more than $16.8 billion – which is 22 percent of the State's asset base. The Department of Education and Training acknowledges that it is essential that the Department's record keeping is robust and reliable.

An important program of work has commenced to improve the Department's financial management and reporting processes, systems and controls. A key priority is to continue, and finalise, the work underway to ensure a complete and accurate asset register to support the property, plant and equipment balance reported in the financial statements.

The Department is implementing an improved asset management system and will work closely with the Auditor General's office in delivering the necessary improvements. When concerns were raised in the prior year around asset evidence, the Department committed to:

- improve the capture, store and management of asset information, and to conduct a data cleanse by November 2014
- implement new asset register software to address weaknesses, review governance controls for reconciliation approvals, and provide training to staff on reconciliation by 30 June 2015

These commitments were progressed through the implementation of a new asset management system (software) in December 2014. This included a data cleanse pre-implementation. Additionally, governance controls have been reviewed and staff training provided by both internal staff, as well as an external accounting firm. However, while the Department has undertaken considerable work to improve its processes and record keeping, the matters identified are not yet fully resolved. Further work is being progressed to fully reconcile all assets data, review asset management processes and ensure property, plant and equipment balances are supported by proper accounts and records.

2

Auditor-General’s reports

Reports tabled during 2015–16

Report title	Date tabled
Follow up of Collections Management in Cultural Agencies (2015–16:1)	August 2015
Follow up of Managing Major Project (2015–16:2)	August 2015
Follow up of Management of Staff Occupational Health and Safety in Public Schools (2015–16:3)	August 2015
Biosecurity: Livestock (2015–16:4)	August 2015
Applying the High Value High Risk Process to Unsolicited Proposals (2015–16:5)	August 2015
Unconventional Gas: Managing Risks and Impacts (2015–16:6)	August 2015
Regional Growth Fund: Outcomes and Learnings (2015–16:7)	September 2015
Realising the Benefits of Smart Meters (2015–16:8)	September 2015
Delivering Services to Citizens and Consumers via Devices of Personal Choice: Phase 2 (2015–16:9)	October 2015
Financial Systems Controls Report: Information Technology 2014–15 (2015–16:10)	October 2015
Department of Education and Training: Strategic Planning (2015–16:11)	October 2015
Public Hospitals: 2014–15 Audit Snapshot (2015–16:12)	November 2015

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