

Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2016–17

Tabled 15 November 2017

VAGO

This presentation provides an overview of the Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2016–17.

Overview



- Results of audits—276 public sector entities (47 significant entities)
- Financial outcomes and performance of the State and the general government sector (GGS)
- Common internal control deficiencies



Clear audit opinion issued



State well positioned financially and continues to operate sustainably

Our report on the 2016–17 Annual Financial Report of the State of Victoria (AFR) provides Parliament with information about matters arising from our financial audit of the AFR, and our assessment of the financial sustainability of the State of Victoria at 30 June 2017.

It also provides information about the audits of the 276 public sector entities whose financial results are included in the AFR, and the common internal control deficiencies we identified at the 47 significant state-controlled entities.

We issued a clear audit opinion on the financial statements for the both State of Victoria and the general government sector (GGS) this year, which is the first clear opinion since 2013.

We concluded that the state is well positioned financially and continues to operate sustainably.

Results of audits



Clear financial report audit opinions for 47 significant state-controlled entities



Medium and above risk-rated issues reported



High-risk information technology (IT) issues



Deficiencies in payroll management and asset recognition and recording

We issued clear audit opinions on the 47 significant state-controlled entities that were material to the State's finances in 2016–17.

We identified and reported 151 internal control deficiencies at these entities in the current year that we rated a medium risk or above.

We continue to raise high-risk information technology (IT) issues in the areas of management and oversight of outsourced IT functions, password management, system updates and patches not being applied in a timely manner. Resolving these issues is particularly important given the ever-evolving sophistication around cyber attacks.

Other common issues were in payroll management, and asset recognition and recording.

Financial measures and outcomes



Net operating surplus



Net debt as a percentage of gross state product (GSP)



Fully fund superannuation liability by 2035

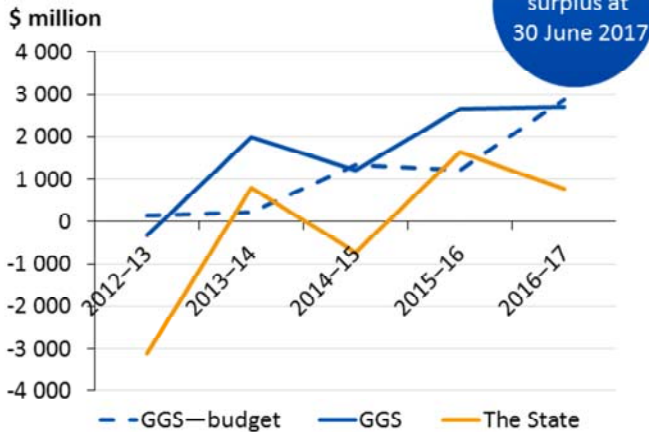
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The State Government monitors its financial sustainability against three key measures:

- net operating surplus, which is the result from transactions
- net debt as a percentage of gross state product (GSP); and
- a target to fully fund its superannuation liability by 2035.

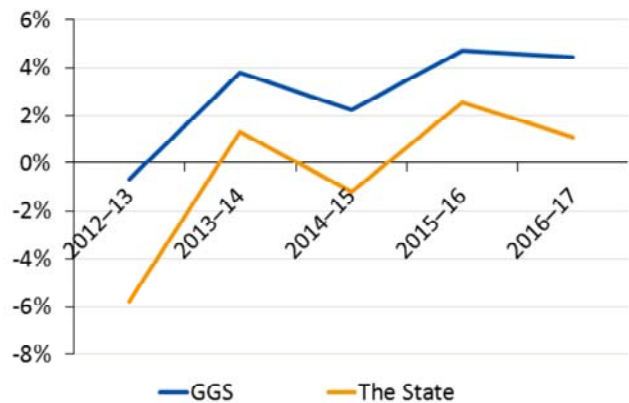
Financial sustainability—Net operating surplus

Result from transactions



Over the past five years there has been a positive upward trend in both the GGS and the State results

Net operating result ratio 2012-13 to 2016-17



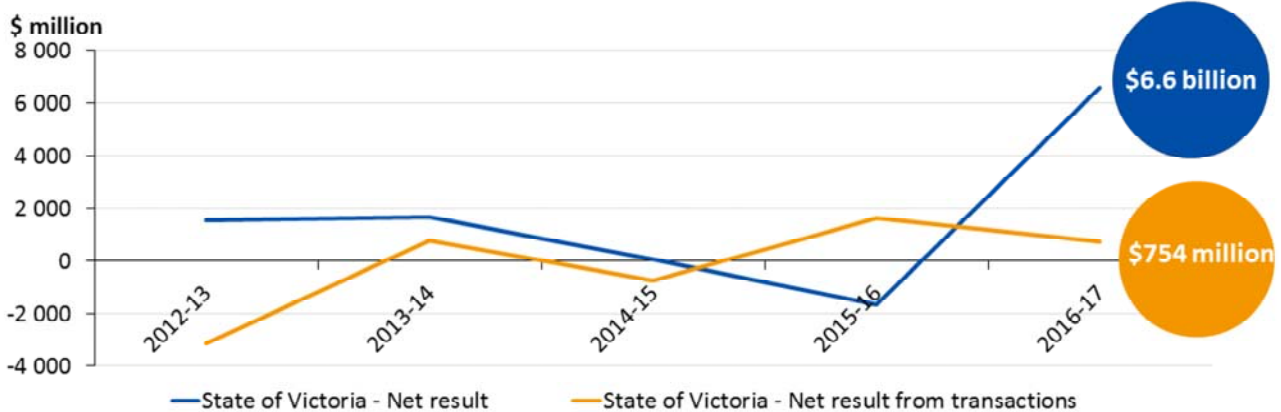
In 2016-17, state expenditure grew at a rate faster than its revenue.

The GGS generated a net operating surplus of \$2.7 billion in 2016-17, which is comparable to the prior year. As the graph on the left illustrates, over the past five years we have seen a positive upward trend in both the GGS and the State results. It also shows that the GGS, which is made up largely of budget reliant entities that generate little or no income themselves, typically exceeds expectations.

We also compared the net operating surplus in terms of its size against turnover—that is, as a proportion of revenue. This ratio shows how much of each dollar collected by the State translates into net operating surplus. The graph on the right illustrates that while the net operating result grew in absolute terms compared to the prior year, it declined marginally in relative terms. This was because, in 2016-17, state expenditure grew at a rate faster than its revenue.

Financial sustainability—Net result—‘two bottom lines’

Net result from transactions represents the surplus or deficit from revenues and expenses



Stronger bottom line result is due to the strong performance of financial markets and a positive change in the economic assumptions that underpin the valuation of insurance claims provisions

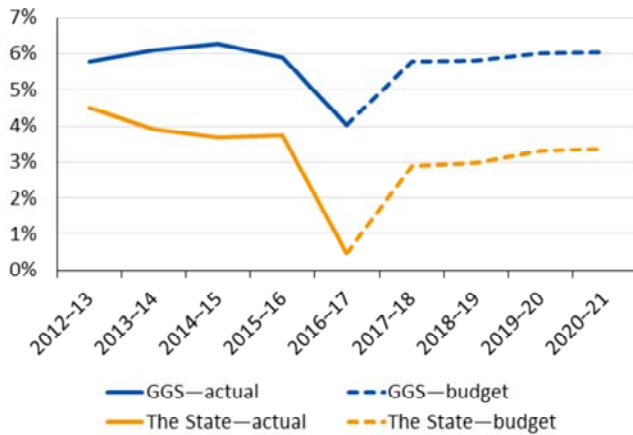
The net result from transactions represents the surplus or deficit from revenues and expenses and is a measure of financial performance for the period related to the day-to-day operations of the government.

The net result, or what we term the bottom line result, is also a measure of financial performance for the period. It includes the result from operations, and changes in the value of assets and liabilities that result from market re-measurements—such as financial investments.

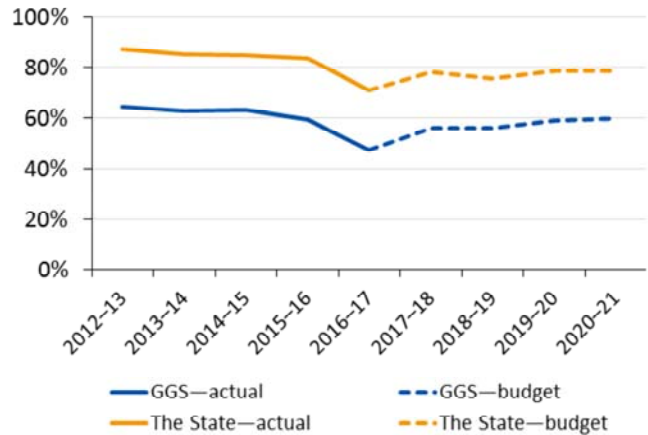
As shown in the graph on this slide, in 2016–17, the State generated a bottom line result of \$6.6 billion compared to an operating surplus of \$754 million. The stronger bottom line result is due to the strong performance of financial markets and a positive change in the economic assumptions that underpin the valuation of insurance claims provisions. These factors also contributed to the State returning to a positive bottom line result when compared to the prior year, when a deficit of \$1.6 billion was reported.

Financial sustainability—Debt

Net debt as a percentage of GSP



Gross debt as a percentage of operating revenue, 30 June 2013 to 30 June 2021



- State well positioned to service its debt
- Over next four years both ratios estimated to trend upwards as state increases borrowings

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The value of borrowings held by the State decreased by \$5.2 billion in 2016–17 to \$48.8 billion at 30 June. The decrease is largely a result of the State using the proceeds of the Port of Melbourne lease to repay debt.

The government assesses how manageable the State's debt is by comparing net debt to the State's economy, indicated by gross state product. A stable or declining ratio is regarded as a sustainable position. Over the past four financial years, the rate of growth in net debt for the State has been below economic growth, as indicated in the graph on the left.

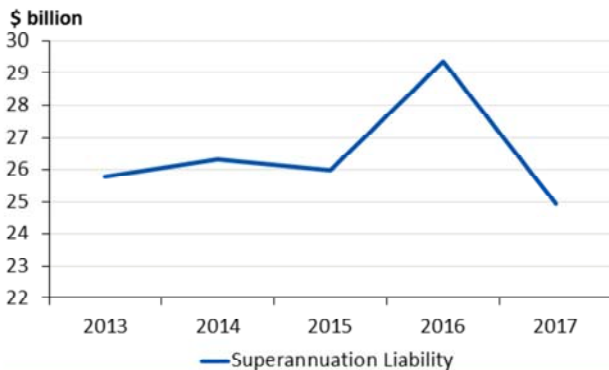
We also compared gross debt to public sector revenue in our assessment of debt sustainability. Again, a stable or declining trend is a positive outcome. Over the past four financial years, gross debt for the State has grown at a slower rate than revenue, as illustrated in the graph on the right.

The downward trend in both measures indicates the state is well positioned to service its debt as it becomes payable, and there is presently a relative low risk to the State from increasing debt in the short term. Over the next four financial years, both ratios are estimated to trend upwards as the state increases its borrowings to fund capital projects and public services.

Financial sustainability—Superannuation

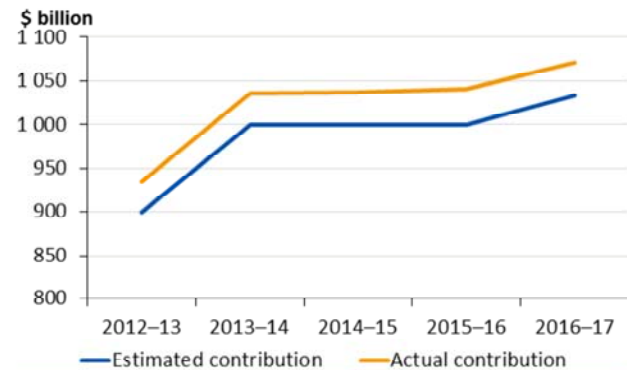
Superannuation liability—the gap between the future amounts the funds will be required to pay to their members, and the value of the assets held by the funds to meet these payments

Superannuation liability held by the State



At 30 June 2017, the State owed \$24.9 billion (a decrease of \$4.4 billion compared to the prior year)

Payments by the State to reduce the superannuation liability



State has been meeting payment plan over the past five years

The superannuation liability represents the gap between the future amounts the funds will be required to pay to their members, and the value of the assets held by the funds to meet these payments.

At 30 June 2017, the State owed \$24.9 billion to four superannuation funds, which is a decrease of \$4.4 billion compared to the prior year. The key drivers for the decrease were the actual investment returns of the superannuation funds being greater than expected, together with an increase in the discount rate used to value the liability.

Every year the State engages actuaries to provide a payment plan to meet its zero target by 2035. As the graph on the right illustrates, the State has been meeting these payments over the past five years.

For further information, please view the full report on our website:
www.audit.vic.gov.au

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