

VAGO

Victorian Auditor-General's Office



Results of 2017 Audits: Universities

May 2018

Independent assurance report to Parliament
2017–18: 20



Results of 2017 Audits: Universities

Ordered to be published

VICTORIAN GOVERNMENT PRINTER

May 2018

PP no 395, Session 2014–18

This report is printed on Monza Recycled paper. Monza Recycled is certified Carbon Neutral by The Carbon Reduction Institute (CRI) in accordance with the global Greenhouse Gas Protocol and ISO 14040 framework. The Lifecycle Analysis for Monza Recycled is cradle to grave including Scopes 1, 2 and 3. It has FSC Mix Certification combined with 55% recycled content.

ISBN 978 1 925678 18 5



The Hon Bruce Atkinson MLC
President
Legislative Council
Parliament House
Melbourne

The Hon Colin Brooks 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 *Results of 2017 Audits: Universities*.

Yours faithfully

A handwritten signature in black ink, appearing to read "Andrew Greaves", is written over a faint, light blue circular stamp. The signature is fluid and cursive.

Andrew Greaves
Auditor-General

23 May 2018

Contents

Report overview	7
Conclusion	7
Findings	7
Recommendation	11
Responses to recommendation	11
1 Context	13
1.1 Legislative and reporting framework	15
1.2 Report structure	16
2 Results of audits	17
2.1 Financial report audit opinions	17
2.2 Key audit themes	19
2.3 Quality of financial reporting in the sector	20
2.4 Upcoming changes to Australian Accounting Standards	25
3 Internal controls	27
3.1 Internal control observations	27
3.2 Status of internal control issues raised in previous audits	30
4 Financial outcomes and sustainability	33
4.1 Conclusion	33
4.2 Financial results	34
4.3 A sustainable Victorian university sector	36
4.4 Sustainable resource management	44
4.5 Asset maintenance	48
Appendix A. <i>Audit Act 1994</i> section 16—submissions and comments	57
Appendix B. Audit opinions	63
Appendix C. Financial reporting better practice elements	65
Appendix D. Control issues risk ratings	67
Appendix E. Financial sustainability risk indicators	69
Appendix F. Glossary	75

Acronyms

AASB	Australian Accounting Standards Board
ANAM	Australian National Academy of Music
DET	Department of Education and Training
EFTSL	Total equivalent full-time student load
FMA	<i>Financial Management Act 1994</i>
HESA Act	<i>Higher Education Support Act 2003</i>
TEQSA Act	<i>Tertiary Education Quality and Standards Agency Act 2011</i>
VAGO	Victorian Auditor-General's Office

Report overview

In Victoria, there are eight public universities, which control a further 50 entities that we audit. Each year, we conduct the financial audits of these 58 entities. This report outlines the results of these financial audits and our observations for the year ended 31 December 2017. We also discuss asset maintenance and management, and comment on the financial sustainability of the sector.

Conclusion

Overall, the university sector's financial reports are reliable, except for those of Deakin University and the University of Melbourne. The sector overall continues to be financially and operationally sustainable, and its assets are being managed well to meet future demand.

In contrast to the rest of the sector, Victoria University and Federation University Australia have had declining financial results and student numbers. Federation University Australia should still be sustainable in the medium term, as it has significant financial assets and relatively low liabilities. Victoria University needs to address its short-term liquidity. Both universities should review key aspects of their operations to ensure their viability in the long term.

Findings

Audit opinions

For the financial year ended 31 December 2017, we issued clear audit opinions to six of the eight universities (six in 2016) and 41 of the 50 controlled entities that we audit (50 of 51 in 2016).

At the date of this report, the audits of nine controlled entities had not been finalised, as these entities had not yet signed their financial reports. This delay is related to the small size of these entities, which can mean that the universities' attention had been focused on completing their financial reports and those of their larger consolidated entities. This led to delays in commencing the preparation of the smaller entities' financial reports.

Revenue recognition

We qualified the audit opinions for the financial reports of two entities (three in 2016) because, in our opinion, the entities' recognition of Australian, state and local government financial assistance did not conform with Australian Accounting Standards. This has caused a material misstatement in the financial reports of:

- Deakin University
- the University of Melbourne.

In 2016, we qualified the financial reports of a third entity, the Australian National Academy of Music (ANAM), for the same reason. Our audit of ANAM's financial report for 2017 was still in progress at the date of this report.

Controlled entities are entities that the universities receive benefits from, and are able to influence the extent of those benefits through any rights they have to direct the activities of those entities.

A **qualified audit opinion** is issued when the auditor concludes that a clear opinion cannot be expressed because of a conflict with the applicable reporting framework or a limitation of scope.

Revenue recognition is a longstanding issue in the sector. Deakin University and the University of Melbourne have received this qualification for over 10 consecutive years. Within the next two years, new accounting standards on revenue will become applicable. Now is the time for universities to review and realign their accounting policies to ensure they comply with the new standards, as this will require a significant amount of work.

Key audit themes

A related-party relationship exists when a person or entity is linked to the entity preparing their financial report.

This year, AASB 124 *Related Party Disclosures* applied to the sector for the first time. As a result, all universities needed to disclose information about related-party relationships and transactions if they were material. Overall, we found that the universities' processes for capturing and reporting the required information were appropriate. Across the universities, most disclosures under this standard related to relationships and transactions between the university and private non-government entities.

With no other significant changes to accounting standards applicable during the year, all eight universities took the opportunity to partially or fully streamline and simplify their financial reports. Their financial reports were more concise and easier to understand. We encourage the sector to continue to improve and enhance the relevance of financial reports to users.

Quality of financial reporting in the sector

Financial statements refers to an entity's comprehensive income statement, balance sheet, cash flow statement, and statement of changes in equity.

We assessed the quality of the sector's financial reporting by looking at the timeliness of their financial reports, and the number and value of errors in draft financial reports we identified during our audits. Overall, the sector continues to produce quality financial reports, but there are areas for improvement.

Seven of the eight universities met the statutory deadline for finalising their financial report (eight in 2016). Victoria University did not sign its 2017 financial report until 19 April 2018 because more work was needed to assess the assumptions and methodology the university and the valuer used to value the university's physical assets. This complex issue delayed Victoria University's financial report due to the material impact on its overall asset balances.

A financial report is a document that reports the financial outcome and position of an entity for a financial year. It comprises an entity's financial statements, explanatory notes and a certification by the entity's governing body.

Across the sector, we identified a low error rate in the universities' draft financial reports, with university management correcting 70 per cent of the errors found before the audit opinion was signed. The remaining errors were immaterial, apart from the two resulting in the qualified opinions for Deakin University and the University of Melbourne.

The processes used by most universities for compiling and preparing their financial reports for audit were sound. However, all universities could improve their processes by implementing more rigorous quality control and assurance procedures, especially by:

- reviewing complex accounting matters early and ensuring that the appropriate disclosures have been included in the draft financial report
- reviewing large and unusual transactions earlier in the reporting process
- reviewing key supporting documentation to check that it supports the information in the draft financial report.

Internal controls

To the extent that we tested them, we found overall that the universities had adequate internal controls to ensure reliable financial reporting. Consistent with the previous years, the most significant area for improvement across the sector remains its IT control environments. Universities rely heavily on their IT systems and controls, and weaknesses in these systems increase the risk of undetected fraud or errors. Additionally, entities with weaker IT control environments face an increased risk of cyber-security issues.

University management is taking corrective action on the issues we report—two-thirds of the issues we raised in prior years had been resolved during 2017.

Three high-risk issues relating to the IT control environment at Deakin University and Swinburne University of Technology remain unresolved more than 12 months after we first identified them. While we acknowledge the actions the universities have taken to fix these control weaknesses, failure to do so in a timely manner reduces the effectiveness of the internal control environment at these entities.

Financial outcomes and sustainability

The sector generally remains financially sound, generating a combined net result of \$664 million for 2017 (\$537 million in 2016). This positive outcome is driven largely by student enrolments, which have increased by 17 per cent over the past five years.

The growth in student numbers has allowed the sector to diversify its revenue. While government grants continue to account for almost half of the sector's revenue, when compared to the national average, Victorian universities are beginning to rely less on Commonwealth funding and more on fees from international students. This diversification may assist these universities in mitigating the possible impact from any potential changes to the Commonwealth funding model.

While the overall sustainability of the sector continues to be strong, the indicators for Victoria University and Federation University Australia are starting to show that they may face financial sustainability issues in the longer term. In a period of student growth and positive results for the sector, both universities:

- experienced a fall in student numbers over the past five years
- generated net result deficits in 2017
- had weaker employee benefit ratios when compared to the rest of the sector.

It would be prudent for these two universities to assess the relevance and financial sustainability of their current course offerings, as well as their staff profile. This may help them address any issues early.

Asset maintenance and management

To deliver its services, the sector held \$15.1 billion of property, plant and equipment assets at 31 December 2017 (\$13.9 billion in 2016). It is important that universities keep these assets in good condition and, when required, replace them or add new assets.

Our review of asset indicators found that the sector is building or acquiring new assets or replacing existing assets at a greater rate than the depreciation of its existing assets, continuing a positive trend from 2016. The universities are managing existing assets to make sure they continue to be fit for use.

A key part of ensuring that assets are maintained to appropriate standards is to have a strong asset maintenance framework in place. We conducted a review of the asset maintenance framework at each university and observed that most universities have developed a framework that includes most of the better practice elements we would expect to see. However, the frameworks at Federation University Australia and Victoria University were relatively less well developed. Weak frameworks reduce the entity's ability to plan and manage its maintenance expenditure, and increase the risk that assets may not allow the university to deliver the required services.

We acknowledge that Victoria University is currently developing an asset management framework that is intended to comply with ISO 55001:2014 *Asset Management*.

Overall, the sector has an asset maintenance and refurbishment backlog of \$1.13 billion at 31 December 2017 (\$1.15 billion in 2016). However, when we assess this backlog against the value of assets that need to be maintained, we have established that, in general, the universities are keeping up with their maintenance requirements.

One university, RMIT University, had all the elements of a better practice asset maintenance framework in place. The asset life cycle model that RMIT University uses to manage its asset portfolio allows it to better manage the risks relating to its physical assets, and improves the effectiveness of and accountability for its capital expenditure.

Recommendation

We recommend that universities:

1. strengthen their asset maintenance frameworks by, where necessary:
 - documenting and regularly reviewing their asset maintenance policy to give effect to their asset maintenance strategies and plans
 - including in their asset maintenance policies funding requirements for maintenance
 - using life cycle modelling as a basis for managing their asset portfolios (see Section 4.5).

Responses to recommendation

We have consulted with the Department of Education and Training (DET) and the eight public universities in Victoria, and we considered their views when reaching our audit conclusions. As required by section 16(3) of the *Audit Act 1994*, we gave a draft copy of this report, or relevant extracts, to those agencies and asked for their submissions or comments. We also provided a copy of the report to the Department of Premier and Cabinet.

The following is a summary of those responses. The full responses are included in Appendix A.

We received three submissions from the sector and a response from DET.

DET supports our recommendation.

Deakin University does not agree with our interpretation of the nature of its revenue that resulted in us issuing a qualified audit opinion on its financial report—this is discussed further in Part 2.

Deakin University has provided details of its plan to address the high-risk IT issue we discuss in Part 3.

Federation University Australia has accepted our findings. It has provided details about how it intends to address the findings on the accuracy of its financial report, its long-term financial sustainability and its asset maintenance policies and procedures.

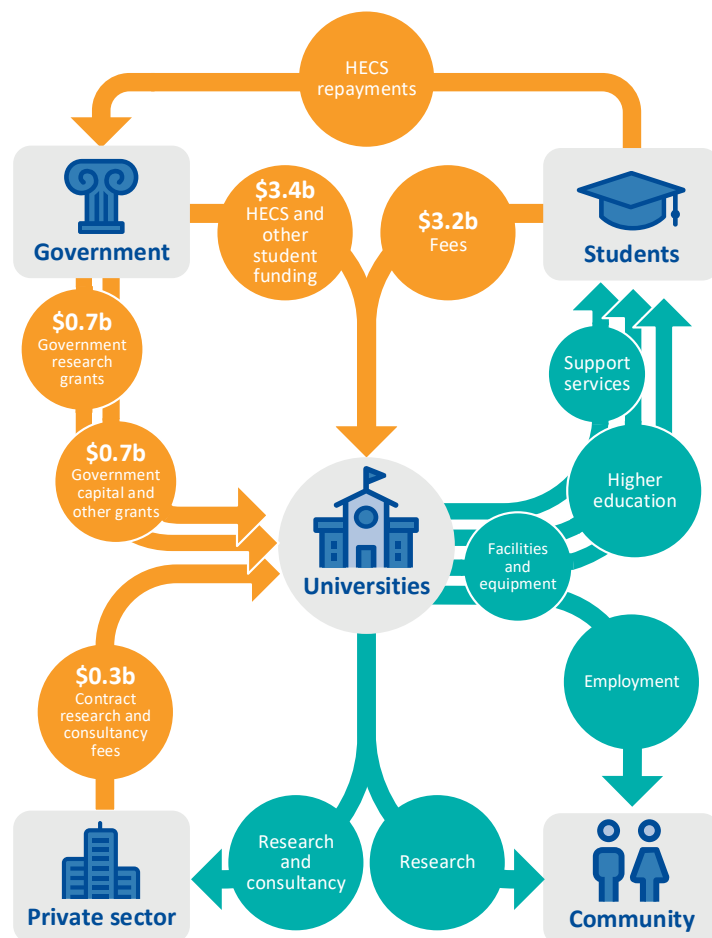
Victoria University has provided details of how it plans to address its long-term financial sustainability risks.

1

Context

Eight universities and their 50 controlled entities make up the public university sector in Victoria. Their principal activities are providing higher education and conducting research. Figure 1A summarises the income sources and outputs of the sector.

Figure 1A
Victorian universities' funding sources and key outputs



Note: HECS = Higher Education Contribution Scheme.
Source: VAGO.

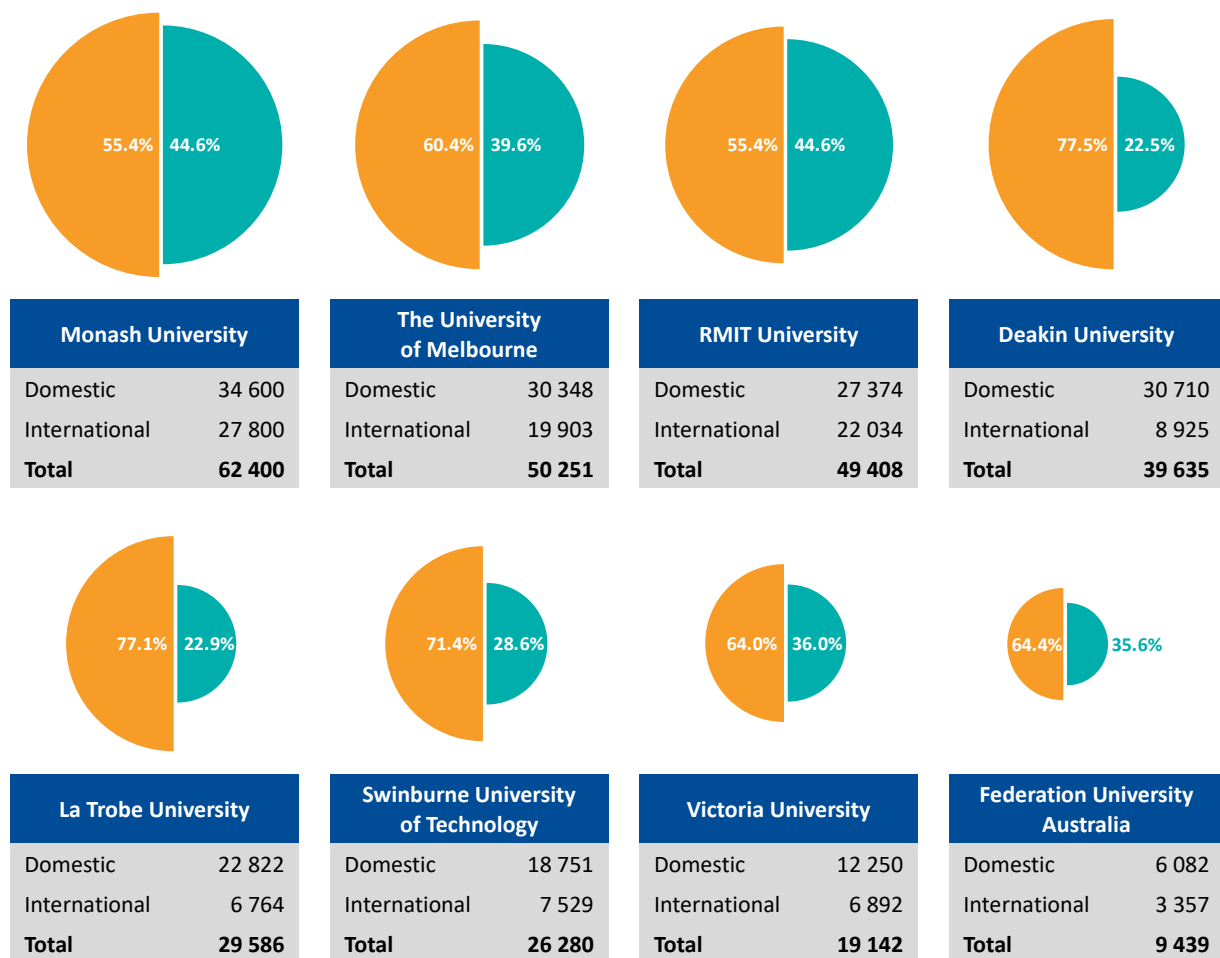
Most of the sector's income comes from providing higher education services to both domestic and international students. Higher education fees can either be paid directly by the students, or through government funding.

As most international students pay full fees for their courses, they are a significant source of revenue for most universities. As a result, the sector is increasing its involvement in international operations and partnerships with overseas institutions to diversify and broaden its reach to international students.

Figure 1B shows the number of domestic and international student enrolments at Victorian universities in 2017.

The total equivalent full-time student load (EFTSL) in 2017 was 286 141, an increase of 4.3 per cent compared to 2016. The proportion of international to total EFTSL in 2017 was 36.1 per cent (34.3 per cent in 2016).

Figure 1B
Domestic and international EFTSL at Victorian universities, 2017



Key: ● Domestic enrolments; ● international enrolments.

Source: VAGO based on unaudited data from universities.

One of the unique features of universities, when compared to other higher education providers, is that they conduct research. This contributes to expanding knowledge and advancing technology not just in the state, but also nationally and globally. This research is funded by both public and private sources.

The remainder of the sector's income comes from other sources, such as:

- investment income
- capital grants from the Commonwealth and state governments
- rents from operating leases
- fees for other ancillary services such as accommodation, and health and fitness facilities.

1.1 Legislative and reporting framework

The universities and their controlled entities are subject to a range of complex accountability and financial reporting frameworks, with many and varied reporting requirements.

In Victoria, public universities are established by their own respective enabling legislations. As a result, they fall within the definition of a public body under the *Financial Management Act 1994* (FMA) and must comply with its requirements for the preparation of annual financial reports. However, since the universities are not controlled by the State of Victoria, their financial results are not consolidated into the state's annual financial report.

From the perspective of the Commonwealth, universities:

- are registered with the Tertiary Education Quality and Standards Agency and are, therefore, subject to the regulation of the *Tertiary Education Quality and Standards Agency Act 2011* (TEQSA Act)
- receive the majority of their grant funding from the Commonwealth Government and fall within the scope of any legislation associated with this funding, including the *Higher Education Support Act 2003* (HESA Act).

The TEQSA and HESA Acts, and many of the funding agreements that underpin the funding universities receive for research and other purposes, also impose other financial reporting requirements on the universities in addition to the requirements of the state-legislated FMA. The Commonwealth requires some of these reporting requirements to be included in universities' annual financial reports. As a result, universities' annual financial reports contain disclosures that are not usually found in general-purpose financial reports.

Many universities and their controlled entities are registered charities with the Australian Charities and Not-for-profits Commission. This means they have further reporting obligations under the *Australian Charities and Not-for-profits Commission Act 2012*.

Entities controlled by the universities do not automatically fall within the scope of the FMA, but may be required by the respective enabling legislation of their parent university to produce financial reports in a form approved by the minister administering part 7 of the FMA.

1.2 Report structure

In this report, we provide information on the outcomes of our financial audits of the eight Victorian universities and their 50 controlled entities for the year ended 31 December 2017. The financial results of controlled entities are consolidated into those of their respective parent entities. We restrict our comments on the controlled entities to the extent that they are relevant and significant to the consolidated results of their respective groups.

We identify and report on the key matters arising from our audits and analyse the information included in the universities' financial reports.

Figure 1C outlines the structure of this report.

Figure 1C
Report structure

Part	Description
2 Results of audits	Evaluates the audit opinion results from our financial audits of universities, and the timeliness, accuracy and quality of their reporting.
3 Internal controls	Assesses the strength of the internal controls designed, implemented and maintained by the universities.
4 Financial outcomes and sustainability	Reports on the sector's financial results and evaluates its propensity for long-term financial sustainability and growth. It includes a focus on the adequacy of asset maintenance in the sector, and a case study on one university's better practice approach to asset management.

Source: VAGO.

Appendix B provides a list of all 58 entities included in this report and details the financial audit opinions issued for the year ended 31 December 2017.

We carried out the financial audits of these entities under section 8 of the *Audit Act 1994* and Australian Auditing Standards. Each entity pays the cost of its audit.

The cost of preparing this report was \$180 000, which is funded by Parliament.

2

Results of audits

2.1 Financial report audit opinions

Emphasis of matter is a paragraph included in an audit opinion that refers to a matter appropriately presented or disclosed in the financial report that, in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial report.

Independent audit opinions add credibility to financial reports by providing reasonable assurance that the information reported is reliable and accurate. A clear audit opinion confirms that the financial report presents fairly the transactions and balances for the reporting period, in keeping with the requirements of relevant accounting standards and applicable legislation. We carried out our financial audits of the entities in the university sector in accordance with Australian Auditing Standards.

We issued clear audit opinions for the financial year ended 31 December 2017 to six of the eight universities (six in 2016) and 41 of the 50 controlled entities (50 of 51 in 2016). We included an emphasis of matter paragraph in the audit opinions of two of the 41 controlled entities, due to these entities preparing financial reports for the special purpose of meeting minimum reporting requirements of the Australian Charities and Not-for-profits Commission. These financial reports were not prepared in accordance with a general purpose framework.

At the date of this report, the audits of nine controlled entities had not been finalised. Appendix B provides a list of the dates we issued our auditor's reports.

Incorrect recognition of grant revenue

We qualified the audit opinions of two entities' financial reports in 2017 (three in 2016) because, in our opinion, their recognition of Australian, state and local government financial assistance did not conform with Australian Accounting Standards. This has caused a material misstatement in the financial reports of:

- Deakin University
- the University of Melbourne.

In 2016, we also qualified the financial report of ANAM. At the date of this report, our audit of ANAM had not been finalised.

A material misstatement is an error that may result in the omission or misstatement of information, which could influence the economic decision that users make based on the financial report.

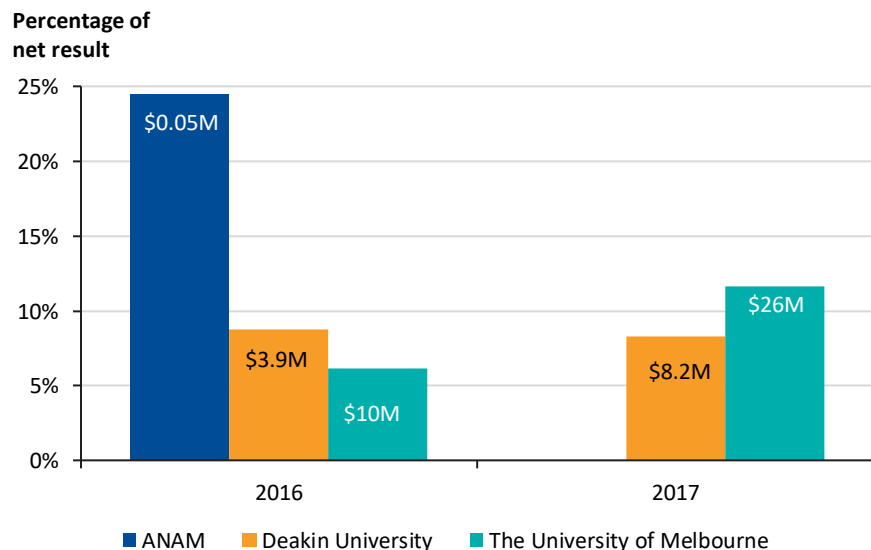
The financial reports of these entities record the grant income they have received as a liability and do not record the associated grant revenue until the university has delivered the services in the grant agreement. However, Australian Accounting Standard AASB 1004 *Contributions* requires entities to record these grants as revenue when they receive them.

This timing difference could result in a material misstatement of revenue and net result in any given year. The liabilities recorded on the entity's balance sheets would also be misstated, since there is no obligation to pay that money.

In the 2017 financial year, the revenue and net result were both materially understated, and liabilities were materially overstated. The qualifications included in the audit opinions alert readers of the financial reports to be cautious when interpreting the financial results and financial positions of these entities.

If these grants were recognised in accordance with AASB 1004, the revenue and net results of these three entities would be higher. The net asset position would also be improved with the reduction in liabilities. Figure 2A shows the impact of the incorrect recognition of grant revenue as a percentage of net result over the past two years. The value of understatements in revenue and net result is also shown.

Figure 2A
Impact of qualification as a percentage of net result



Note: At the date of this report, the 2017 audit of ANAM had not been finalised.

Source: VAGO.

Revenue recognition is a longstanding issue in the sector. Deakin University and the University of Melbourne have received this qualification for over 10 consecutive years. This situation may change when new revenue standards are introduced within the next two years. This is an opportune time for the universities to review and realign their accounting policies, as complying with these standards will require a significant amount of work. See Section 2.4 for further information about the new standards.

2.2 Key audit themes

Each financial year, as we plan our audit work across the sector, we seek to identify key audit risks. We communicate these key risks in our audit strategy documents, which we present to those charged with governance at each university before the end of the financial year. These risks, if not addressed, may lead to material misstatements in financial reporting.

The similar nature of universities means that there are often common risk themes across the sector.

The main themes influencing the financial reporting by universities for the year ended 31 December 2017 were:

- the implementation of Australian Accounting Standard AASB 124 *Related Party Disclosures*
- streamlining of financial reports.

AASB 124 *Related Party Disclosures*

The most significant change this year was the requirement for not-for-profit entities to apply AASB 124 *Related Party Disclosures* for the first time. This meant that all universities needed to disclose information about material related-party relationships and transactions that may have affected their financial performance or position. The application of AASB 124 created challenges for both those preparing financial reports and for their auditors, in making sure the information disclosed was complete and accurate.

Across the sector, material related-party relationships that required disclosure included:

- key management personnel and their close family members
- other entities controlled by key management personnel
- all other entities controlled by the university.

The level of disclosures varied across the sector. In total, 72 per cent of the related-party relationships and transactions that the universities disclosed regarding key management personnel were with private non-government entities.

Overall, we found the universities had appropriate processes in place to capture and disclose the information needed to meet the requirements of AASB 124.

Materiality—in the context of financial reporting, information is material if its omission, misstatement or non-disclosure has the potential to affect the economic decisions of users of the financial report, or the discharge of accountability by management or those charged with governance. The size, value and nature of the information and the circumstances of its omission or misstatement help in deciding how material it is.

Streamlining of financial reports

Streamlined financial reports aim to:

- comply with the Australian Accounting Standards and relevant legislation
- present only relevant information by removing disclosures that are not material in the context of the financial report taken as a whole
- tailor the presentation of financial information to focus on the objectives, service delivery, financial performance and financial position of the university
- enhance the report's readability and make it more user friendly.

Although streamlining was not mandatory for universities, we were encouraged that all eight universities took the opportunity to partially or fully streamline their financial reports to realign and refresh the structure and content.

Overall, we found the readability of the financial reports for the sector has improved. Four of the eight universities further simplified their financial reports by reducing the volume of irrelevant note disclosures. This resulted in a more concise financial report.

The sector can further customise and improve the usefulness of financial reports by:

- removing immaterial disclosures in the context of an individual university's financial report to increase relevance
- grouping immaterial items on the financial statements and streamlining the presentation.

We encourage the sector to continue to streamline and enhance the relevance of financial reports for users. The materiality assessment is critical to the streamlining process—entities should document this assessment and seek input from key stakeholders, such as audit committees and auditors.

2.3 Quality of financial reporting in the sector

Two important and inter-related quality attributes of financial reporting are the timeliness of the published financial reports and the accuracy of draft reports presented for audit.

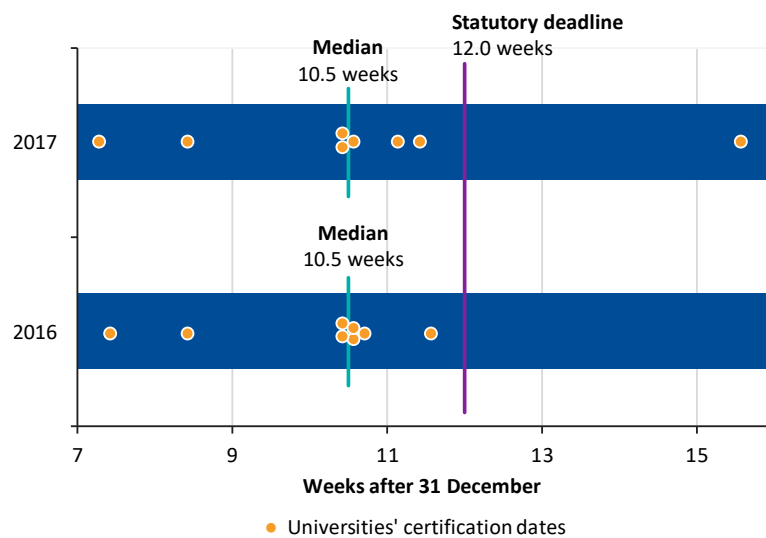
Timeliness

Timely financial reports enable users to make better-informed and prompt decisions. The later financial reports are produced after year-end, the less useful they become.

In line with the FMA, universities and their controlled entities must finalise their financial reports and have them audited within 12 weeks after 31 December each year.

As shown in Figure 2B, seven of the eight universities met the statutory deadline for finalising their financial reports. In 2016, all universities met the statutory deadline.

Figure 2B
Timeliness of universities' financial reports



Source: VAGO.

Figure 2B shows one university, Victoria University, took more than 12 weeks to finalise its financial report in 2017. Victoria University did not meet the statutory deadline because more work was needed to assess the assumptions and methodology the university and the valuer used in the valuation of the university's physical assets. This complex issue caused delays and meant the university's financial report was signed on 19 April 2018.

Streamlining financial reports can help universities to further improve their timeliness by allowing management and auditors to focus on the areas that are relevant to the users of the reports. This should help universities to improve their reporting time lines in the future.

Errors that are **clearly trivial** are clearly inconsequential, whether taken individually or in aggregate and whether judged by any criteria of size, nature or circumstances. An error that is not clearly trivial can still be immaterial to the financial report as a whole.

Accuracy

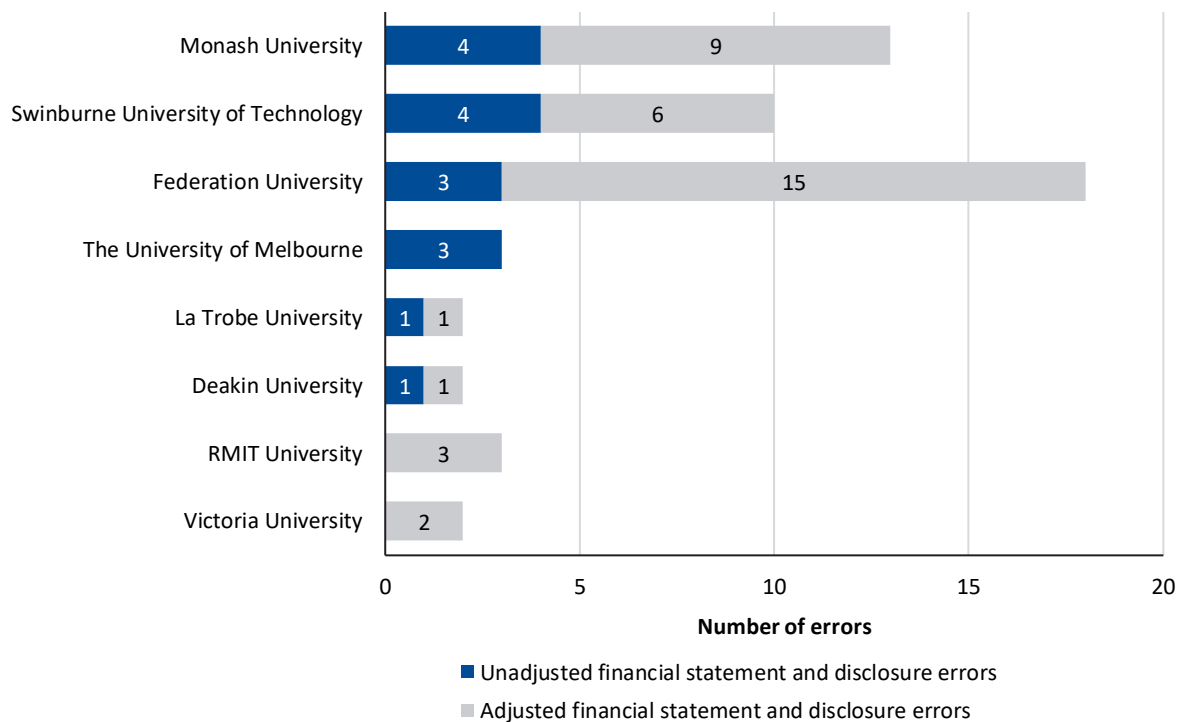
We measure the accuracy of draft financial reports by the number and size of the errors we identify through our audit. Ideally, there should be no errors or adjustments required as a result of an audit.

A quality draft financial report with few or no errors allows the audit to be finalised on time and statutory deadlines to be met. It also signals to management that the entity has effective financial reporting and quality assurance processes in place.

Unless they are clearly trivial, we raise errors that we find in the draft financial reports with management for correction. Material errors must be corrected before we can issue a clear opinion. Management can decide whether or not to adjust errors that are not material.

During our 2017 audits, we identified a number of financial transaction, balance and disclosure errors. Figure 2C summarises our findings.

Figure 2C
Draft financial statement and disclosure errors identified in 2017



Source: VAGO.

As shown in Figure 2C, our audits identified 53 errors across the universities and their controlled entities. This low error rate indicates that, while there is some room for improvement, the sector's draft financial reports provided to us were generally accurate. Errors that are not adjusted by management provide an indication of the accuracy of the financial reports when they are finalised and signed.

Seventy per cent of errors identified by audit were adjusted by management.

Two of the 16 unadjusted errors resulted in a qualification on the financial reports of Deakin University and the University of Melbourne, as discussed in Section 2.1. We assessed the remaining 14 unadjusted errors to be immaterial to the users of the financial reports.

While Federation University Australia was the first university in the sector to finalise its financial report, it had the highest number of errors in the draft document provided for audit. This highlights the need for balance between quality and timeliness. The errors were largely caused by weak management oversight, highlighting the importance of a robust quality assurance process. Universities should not rely on the audit process as the quality assurance review of their financial report.

The number of errors we identified at Monash University can be attributed to the larger number of controlled entities that fall within the consolidated group. These errors were small in the context of Monash University's consolidated financial report.

The errors we identified at Swinburne University of Technology could be reduced with a robust quality assurance process.

Figure 2D shows details of significant errors identified as part of the audits.

Figure 2D
Significant dollar and disclosure adjustments identified across the 2017 audits



**Dollar
adjustments**

Overall, we identified 26 financial statement errors across the eight universities and their controlled entities totalling \$436 million. Common themes included:

- grant revenue not being recognised under the requirements of AASB 1004 *Contributions*
- errors in the valuation of investment properties, land and financial assets
- errors in the calculation of employee provisions
- recognising transactions in the wrong financial year
- recognising transactions as prepayments when invoices have not been paid
- incorrect classification of debtors.



**Disclosure
adjustments**

Common financial report disclosure adjustments we identified related to:

- classification errors of balances within the same class
- calculation errors relating to commitments
- calculation errors for related-party disclosures and compensation of key management personnel.

Source: VAGO.

Quality of the financial report preparation process

We assessed the quality of universities' financial reporting processes against better practice criteria, detailed in Appendix C. Overall, the financial report preparation processes of most of the universities were sound, as summarised in Figure 2E.

Figure 2E
Assessment of financial report preparation against better practice elements

Proforma financial report—a financial report prepared by management prior to balance date to assist with planning the structure and contents of the actual financial report.



Source: VAGO.

As shown in Figure 2E, universities can improve their processes by implementing rigorous quality control and assurance procedures for the compilation, preparation and presentation of their financial reports.

We assessed the universities' financial report preparation process against a maturity criteria scale. We rated half of the universities as 'developing' because we identified a number of errors during the audit process. Universities should not use the audit process as a quality assurance review.

University management can improve quality control and assurance processes by incorporating some of the following actions into the timetable for preparing financial reports:

- recalculating complex balances
- checking large and unusual transactions
- ensuring information in the draft financial report is supported by sufficient and appropriate evidence
- reviewing complex accounting matters and ensuring that the appropriate disclosures have been included in the draft report
- ensuring key reconciliations have been performed correctly.

2.4 Upcoming changes to Australian Accounting Standards

There are several significant changes in accounting standards on the horizon that will impact the university sector's financial reporting.

New revenue standards

Two new revenue standards will apply to the universities' 2019 financial reports. The two new standards are:

- AASB 15 *Revenue from Contracts with Customers*
- AASB 1058 *Income of Not-for-profit Entities*.

Universities need to start collecting this information for the 2018 year to be able to disclose comparative information and comply with the new standards in 2019.

AASB 15 applies to all revenue received under enforceable contracts, including government grants, research income and contract revenue. AASB 1058 applies to all other revenue such as 'peppercorn' leases, research training programs, income received for capital projects and donations.

A performance obligation is a promise made in a contract to transfer goods and services to a customer.

Both standards will require a major change in how and when the university sector recognises revenue. Revenue recognition under the new standards focuses on meeting performance obligation criteria, while the current standard, AASB 118 *Revenue*, focuses on transfer of risks and rewards. The new standards will also require additional disclosures in universities' financial reports.

Implementing these standards will require significant work by the universities and their controlled entities, including:

- reviewing all contractual arrangements in place and clearly defining the performance obligations that drive revenue recognition
- critically assessing each non-contractual revenue stream and determining the appropriate accounting treatment to apply
- reviewing and adapting existing systems to ensure they can capture the required performance obligation evidence needed to trigger revenue recognition
- developing plans that allow enough time to implement the changes to systems, processes and policies.

We commend the sector for the proactive action taken so far to prepare for the implementation of these standards. Victorian universities, in conjunction with other major Australian universities, have engaged an independent firm to analyse the treatment of common income streams in the sector. We have been consulted as part of this work.

Each university will need to look closely at any of its unique income streams and factors to ensure they fully comply with the new accounting standards. This will include research income, donations, non-Commonwealth scholarships and other revenue.

VAGO has liaised with Victorian universities and requested position papers, grant agreements and research contracts from them. As part of our audits from 2019, we will need to assess each university individually for compliance with the new revenue standards.

New standard—AASB 16 *Leases*

This accounting standard will require universities to record all assets leased from others with a term of more than 12 months on their balance sheet. The major difference resulting from this change is that operating leases—currently disclosed in the notes to the financial statements—will need to be recognised in the balance sheet.

This accounting standard will have a significant impact on the financial position of the sector—we expected to see a large spike in liabilities and property, plant and equipment. However, the impact on the operating result will be marginal, as leases on the balance sheet will be brought into the income statement over time, with a corresponding depreciation and finance charge recognised over the lease terms. Also, operating leases which are currently expensed as incurred will no longer occur.

The new standard will apply from 1 January 2019. Universities can elect not to restate the comparative prior-year figures.

3

Internal controls

Effective internal controls help entities to reliably and cost-effectively meet their objectives. Entities require well-designed and efficient internal controls to help them deliver reliable, accurate and timely external and internal financial reports.

In our annual financial audits, we consider the internal controls relevant to financial reporting and assess whether entities have managed the risk that their financial reports will not be complete and accurate. Poorly designed or inefficient internal controls make it more difficult for an entity's management to comply with relevant legislation and may also increase the risk of fraud and error.

3.1 Internal control observations

To the extent that we tested them, universities' internal controls for financial reporting were adequate for ensuring the reliability of their financial reporting. However, universities need to strengthen some important internal controls and address a number of financial reporting matters.

During our 2017 audits, we identified 37 new internal control weaknesses and financial reporting issues (47 in 2016), and reported them to university management and audit committees.

Figure 3A shows the number of issues identified by risk rating and the areas they relate to. This figure excludes the 15 low-risk issues we reported directly to the entities' management teams, and we did not identify any extreme- or high-risk issues in 2017. We define each risk rating in Appendix D.

Figure 3A

Internal control weaknesses identified in 2017 audits, by area and risk rating

Area of issue	Risk rating			Total
	Extreme	High	Medium	
IT controls	–	–	8	8
Policies and frameworks	–	–	6	6
Financial reporting	–	–	2	2
Expenditure and payables	–	–	2	2
Revenue and receivables	–	–	2	2
Property, plant and equipment	–	–	1	1
Payroll	–	–	1	1
Total	–	–	22	22

Source: VAGO.

Medium-risk issues

During 2017, we reported 22 medium-risk internal control weaknesses (25 in 2016). Of these, 77 per cent have not been addressed by management.

Common themes in the medium-risk control weaknesses require universities to improve their:

- IT controls
- policies, procedures and practices for property, plant and equipment, related-party transactions and grant revenue
- monitoring of controls for revenue, receivables and financial reporting.

IT controls

Of the medium-risk issues we identified, 36 per cent (40 per cent in 2016) related to the universities' IT control environments.

A **cyber-attack** is a deliberate act by a third party to gain unauthorised access to an entity's data with the objective of damaging, denying, manipulating or stealing information.

IT controls protect computer applications, infrastructure and information assets from threats to security and access. They reduce the risk that employees or third parties can circumvent processes and gain unauthorised access to systems, which may result in the destruction of data or recording of non-existent transactions. They also reduce the risk of a successful cyber-attack.

To reduce the risk of a successful cyber-attack, or potential fraud or errors arising, it is imperative that universities address IT control deficiencies in a timely manner.

A **patch** is an additional piece of software designed to fix security vulnerabilities or operational issues.

The eight medium-risk issues we identified in universities' IT controls relate to two key areas:

- **Weak user access management controls for finance-related systems**
Assigning users inappropriate and excessive access rights to systems may result in unauthorised use of data and programs, leading to potential errors, financial fraud and reputational loss.
- **Patches not applied in a timely manner**
Periodic patching of IT systems is important because it reduces the risk of security vulnerabilities in systems and enhances the overall security profile of the IT infrastructure.

It is pleasing that management at two universities acted immediately on these issues and implemented corrective action. This resolved five of the eight medium-risk IT controls issues during the year.

Policies and frameworks

Management teams at universities implement policies, procedures and practices to help minimise business risks, reduce the risk of fraud and error, and meet business objectives.

Three of the six issues we identified in this area relate to deficiencies in universities' asset maintenance framework. Property, plant and equipment make up two-thirds of the university sector's total assets. It is important that the universities have an effective asset maintenance framework in place to ensure buildings and other assets are kept in a condition that allows them to deliver the required services.

See Part 4 for further discussion of these deficiencies in asset maintenance and our recommendations relating to them.

Monitoring controls

Monitoring controls are the methods used by management to observe internal controls in practice and assess their effectiveness. This may be done through ongoing supervision, periodic self-assessments or separate evaluations.

Five of the 22 medium-risk issues we identified relate to ineffective monitoring controls for revenue and receivables, property, plant and equipment, and financial reporting, which resulted in misstatements. Universities need to improve their monitoring controls related to:

- the reconciliation review process
- quality control assurance processes for reviewing asset valuation reports
- financial reporting disclosures.

It is important for universities to have effective monitoring controls to reduce the risk of fraud and error.

3.2 Status of internal control issues raised in previous audits

We monitor the status of internal control issues raised in our prior-year management letters to ensure they are resolved in a timely manner. Where issues remain outstanding, we factor this into our risk assessment for the following year's audit.

Figure 3B shows the status of internal control issues that we identified in our audits for the past three years.

Figure 3B
Status of prior-period internal control issues, by rating

Area of issue	Risk rating			Total
	Extreme	High	Medium	
Resolved	–	6	20	26
Unresolved	–	3	10	13
Total	–	9	30	39

Note: Issues rated as low risk are excluded from this analysis.

Source: VAGO.

Thirty-nine high- and medium-risk internal control weaknesses raised during previous audits were unresolved at the start of 2017 (70 in 2016). Encouragingly, two-thirds of these were resolved during 2017.

In line with better practice time lines for corrective action, we expect management to implement a detailed action plan for any issue raised within two months for high-risk matters and within six months for medium-risk matters.

Three high-risk and 10 medium-risk issues raised in previous years remain unresolved. We raised these issues more than 12 months ago but they have not been corrected within the better practice time lines.

Details of the three unresolved high-risk matters are shown in Figure 3C.

Figure 3C
High-risk unresolved matters identified in previous audits

University	Description of issue
Deakin University	<p>1 During 2015, we identified that the key financial system used by the university was unsupported.</p> <p>Continued use of unsupported systems increases the risk of security vulnerabilities and may lead to compatibility issues with other operating systems and applications. In turn, this may lead to potential financial, reputational or operational issues.</p> <p>The process for replacing a key financial system takes time. Management at Deakin University developed a formal plan to resolve this matter.</p>

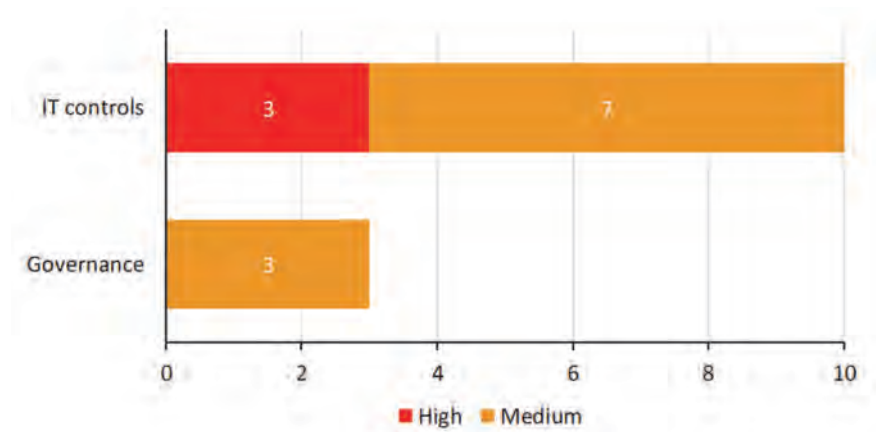
Figure 3C
High-risk unresolved matters identified in previous audits—*continued*

University	Description of issue
Swinburne University of Technology	2 During 2016, we found inappropriate user access rights assigned to financial-related systems. Effective user access management controls are needed to prevent unauthorised use and disclosure, modification or loss of data. Management at Swinburne University of Technology has committed to a plan to resolve this issue. The university has actioned three of the four recommendations we made.
	3 During 2016, we also found that the university needed to improve its password controls, as they did not align with better practice requirements. Password controls reduce the risk of unauthorised access to systems. Inadequate password controls may lead to breaches of confidentiality, integrity and availability of business systems and data. Reputational and financial losses may also occur. Management at Swinburne University of Technology has committed to a plan to resolve this issue.

Source: VAGO.

Figure 3D shows the areas and rating of unresolved prior-year issues.

Figure 3D
Unresolved prior-year internal control issues, by area and rating



Source: VAGO.

Universities need to resolve issues we report in our management letters in a timely manner. Failure to resolve these issues reduces the effectiveness of the internal control environment. This may lead to universities not being able to meet their business objectives or identify material misstatements.

4

Financial outcomes and sustainability

In this part of the report, we summarise the financial outcomes of the university sector for the year ended 31 December 2017 and comment on the sustainability of the sector in the context of information we obtained and observed during our audits.

The detailed data and calculations that underpin our commentary are provided in Appendix E, which lists our financial sustainability indicators, risk assessment criteria, benchmarks and the results of each indicator for each of the universities over the five financial years 2013 to 2017.

4.1 Conclusion

Overall, the sector is financially secure, and most universities have demonstrated strong financial performance and sustainable financial and operational management practices.

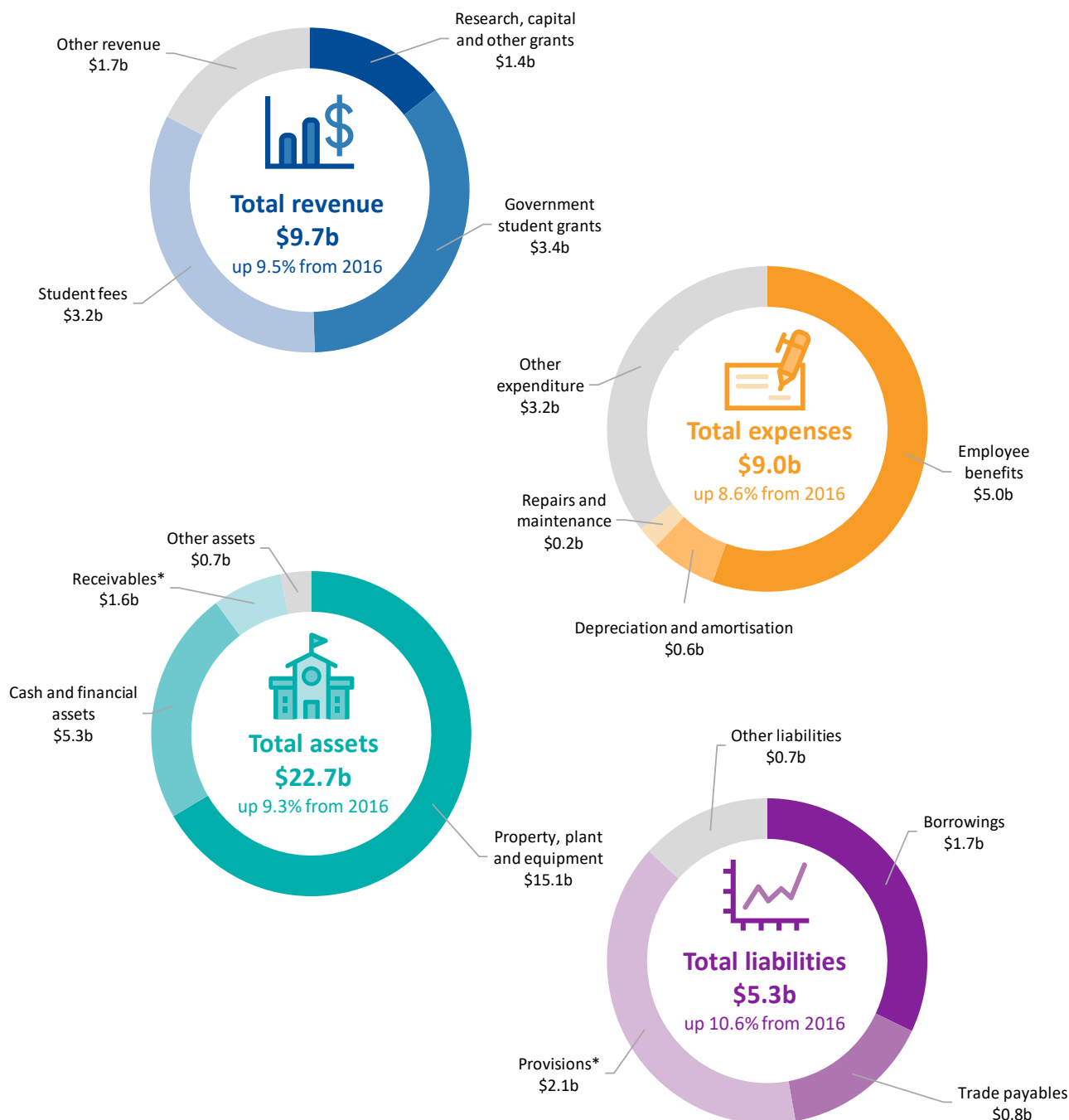
4.2 Financial results

Financial performance and position

Figure 4A provides a snapshot of the financial results of the sector in 2017.

Figure 4A

Financial results of the university sector for the year ended 31 December 2017

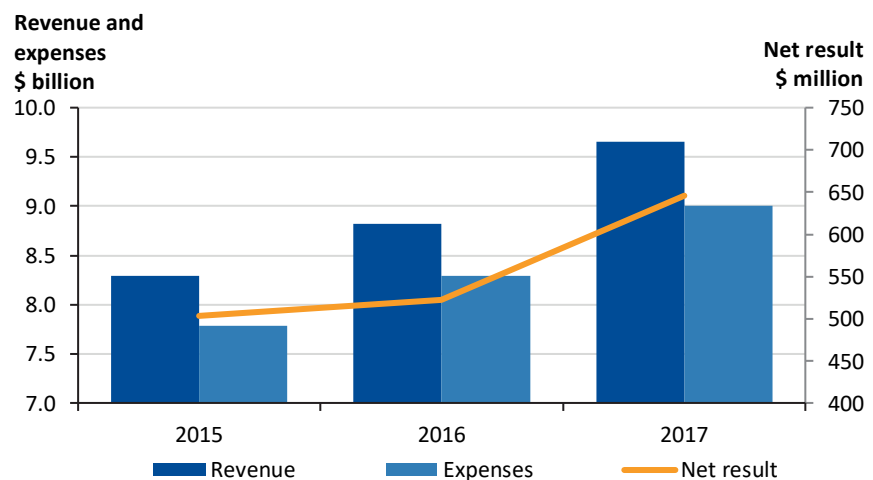


Note: *Provisions includes the sector's estimated deferred superannuation contributions of \$1.1 billion (2016: \$1.1 billion). An identical amount is included in receivables as the Commonwealth and state governments have agreed to meet this liability.

Source: VAGO.

Figure 4B shows that the sector's financial performance has continued its long-term growth, with expenses and revenue continuing to increase at similar rates. This continued operational growth reflects strong demand for university-level higher education. As shown in Figure 4E, the sector's total EFTSL continues to grow, increasing from 274 241 in 2016 to 286 141 in 2017.

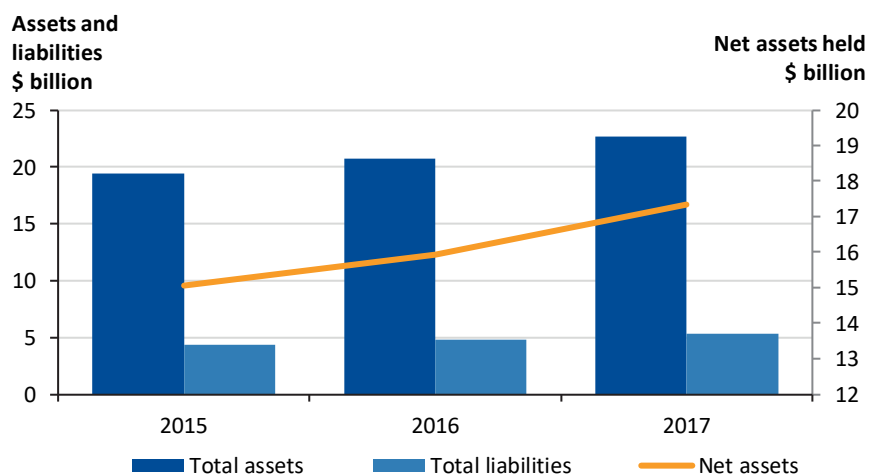
Figure 4B
Financial performance of the university sector, for the years ended 31 December 2015 to 2017



Note: Figures have been adjusted for the qualified universities.
Source: VAGO.

As shown in Figure 4C, the sector had a strong net asset position at 31 December 2017, which is consistent with prior periods. We discuss the sector's liquidity in further detail in Section 4.3.

Figure 4C
Financial position of the university sector, for the years ended 31 December 2015 to 2017



Note: Figures have been adjusted for the qualified universities.
Source: VAGO.

The value of assets held by the sector increased over 2017, reflecting its strong financial performance, as well as further investments in capital projects to meet the increased student demand. Some examples of the sector's capital expenditure include:

- Monash University spending over \$200 million in 2017 on major projects, including new buildings and refurbishment of its libraries and other facilities
- RMIT University spending around \$200 million in 2017 on various infrastructure and facilities upgrades, including its New Academic Street project, which resulted in 32 000 square metres of new and refurbished space for students
- Swinburne University of Technology spending around \$50 million on infrastructure and IT upgrades, as well as some investment in its student residences
- Deakin University constructing additional student accommodation with capacity for 500 students at a cost of \$47 million.

4.3 A sustainable Victorian university sector

To be sustainable, universities need to manage their financial resources and infrastructure efficiently to enable them to meet the effects of future changes to the sector and to manage foreseeable risks. They should achieve this without any significant swings in the quality and level of the services they provide, and without large fluctuations in their expenditure.

Large cash and investment reserves—in themselves comparable to the sector's total liabilities, detailed in Figure 4A—mean that the sector is likely to remain financially secure in the short to medium term. To remain sustainable in the longer term, universities must continually address their operational and financial risks, including reducing unnecessary costs, managing dependency on particular revenue streams and ensuring that they remain relevant to stakeholder needs.

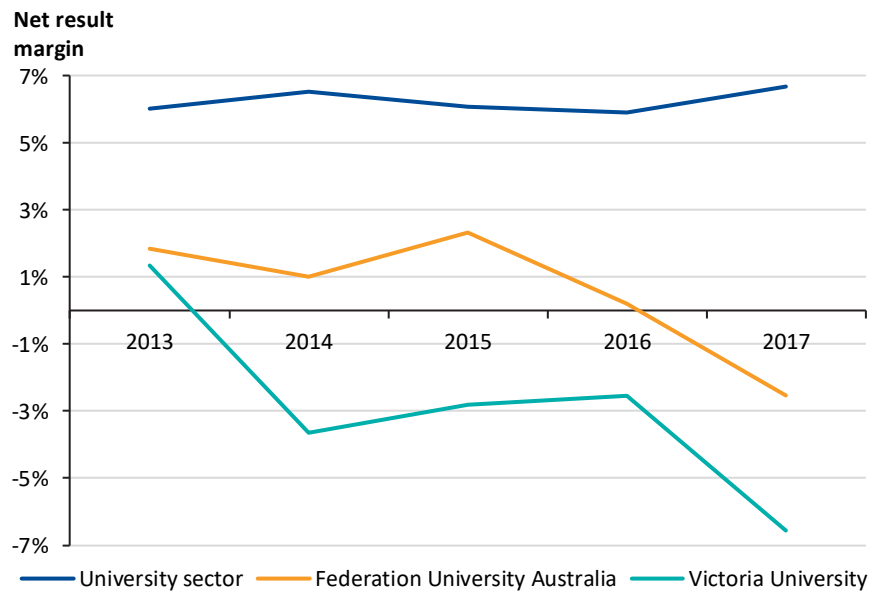
Sustainable financial performance

Net result margin

The net result margin compares the sector's net result as a percentage of total revenue. It gives an indication of how efficiently the sector is using its operational and other income. Figure 4D shows the net result margin for the sector over the past five years.

Figure 4D

Net result margin for the university sector and selected universities, for the years ended 31 December 2013 to 2017



Note: Figures have been adjusted for the qualified universities.

Source: VAGO.

One **basis point** is one hundredth of a per cent, or 0.01%.

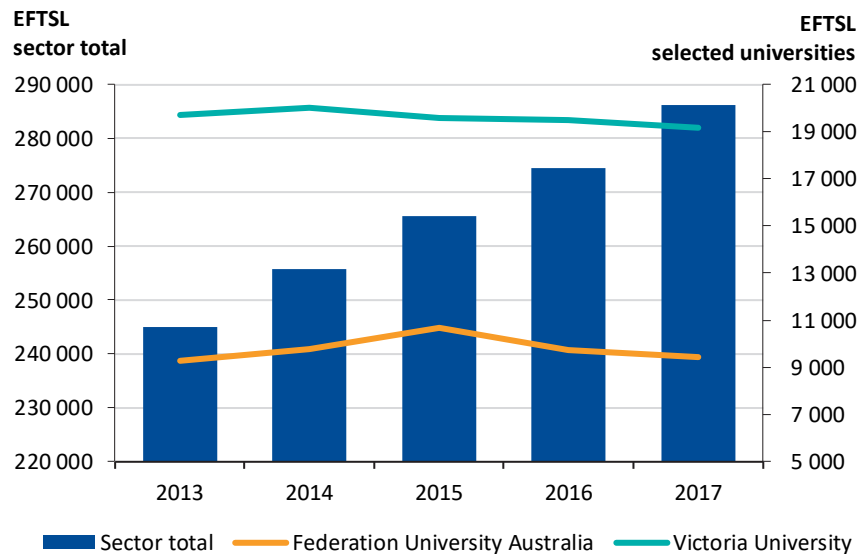
The sector's net result margin improved in 2017 by 76 basis points but remained relatively stable overall. Individually, most universities showed strong and consistent results over the five-year period, indicating that they are managing their costs well while continuing to attract more revenue for their services. The key drivers of a net result margin are revenue and expenditure on staff.

However, Federation University Australia and Victoria University posted negative net operating results, and therefore had a negative net result margins.

As shown in Figure 4D, over the past five years the net result margins for these two universities have been relatively weak compared to the rest of the sector. Victoria University has recorded a deficit since 2014, with 2017 being its largest deficit to date. This is the first year Federation University Australia has recorded a deficit, but its results have been declining since 2015.

As Figure 4E shows, student numbers in the sector overall continue to increase. However, Federation University Australia and Victoria University are the only universities in the sector whose student numbers have declined over the past five years.

Figure 4E
EFTSL for the university sector and selected universities, for the years ended 31 December 2013 to 2017



Source: VAGO based on data from the Commonwealth Department of Education and Training, and unaudited data from public sector universities.

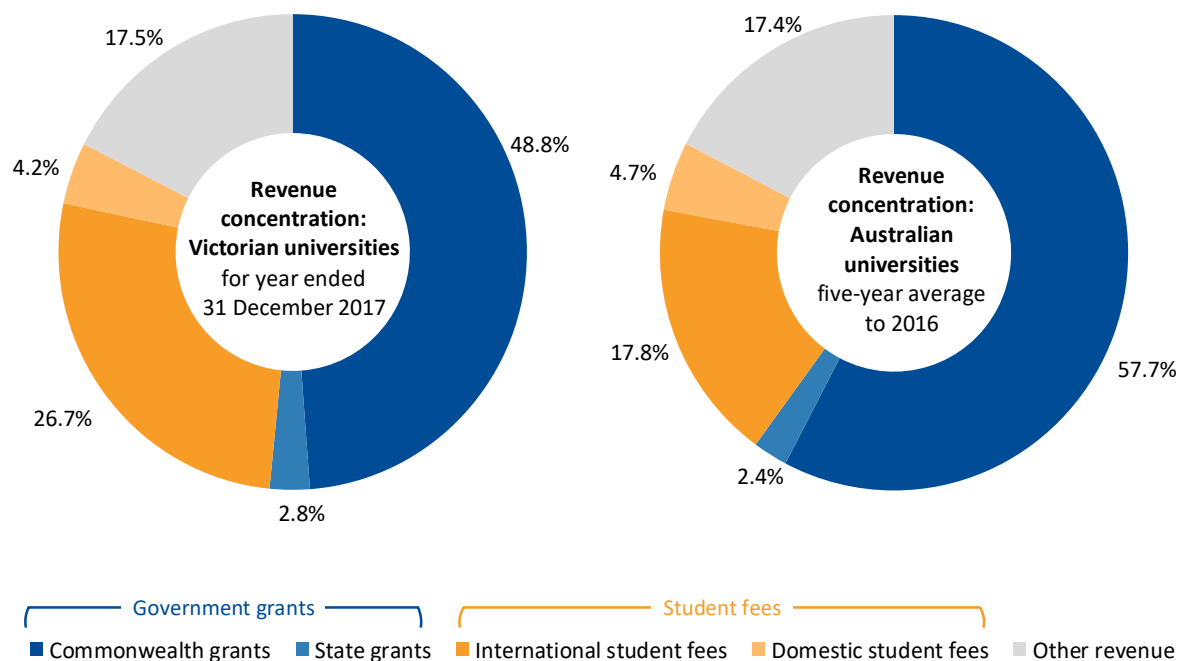
Difficulties in attracting students is contributing to the weaker financial performance of Federation University Australia and Victoria University. Given this, it would be prudent for these two universities to assess the relevance and financial sustainability of their current course offerings, as well as their staff profile.

Federation University Australia has significant cash and investments, and a relatively strong balance sheet. As such, it is likely to be solvent for the short to medium term. However, such a review would enable it to improve its financial performance in the longer term. We comment on Victoria University's short-term liquidity in further detail below.

Revenue diversity

The diversity of the sector's income types and income sources is an important factor in its resilience. The more diverse the revenue, the better the sector will be able to withstand changes in its operating environment.

Figure 4F
Revenue sources for Victorian and Australian universities



Note: Figures have been adjusted for the qualified universities.

Source: VAGO and Commonwealth Department of Education and Training.

As shown in Figure 4F, at both the state and national level, a significant portion of the sector's income comes from Commonwealth funding. In December 2017, changes to the Commonwealth Grants Scheme were proposed, including a two-year freeze and a shift to performance-based funding by 2020. Other proposed measures include reducing the threshold for repayments of, and imposing a lifetime limit on, student loans. Given this, the sector should look to reduce its dependency on Commonwealth funding and strengthen its internally generated sources of income.

Some universities in the sector are already responding to this risk by:

- increasing their involvement in international partnerships and other joint operations with overseas partners—this should increase income from fees and private research grants from international sources
- providing online or cloud-based learning, which allows the university to offer courses to people who previously may not have been able to attend due to geographical challenges—this should increase fee and grant income from domestic sources.

These diversification efforts have already had some success—the proportion of revenues from government grants in the Victorian university sector is lower than the five-year national average. Most of this difference is due to international student revenue, which has increased to its present 26.7 per cent of total revenue, up from 19.9 per cent in 2013.

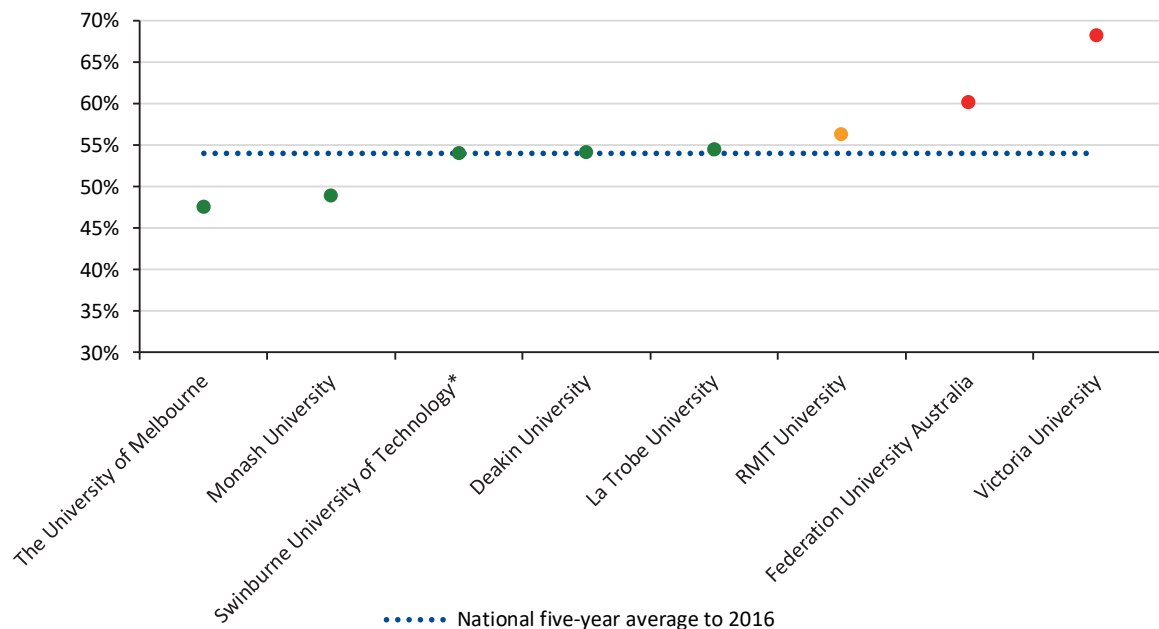
Staff spending

The sector's largest recurring expenditure is employee benefits. Universities rely on their employees to deliver teaching services and research, and to perform administrative functions. In 2017, the sector spent \$4.98 billion on employee benefits, which accounted for around 55 per cent (55 per cent in 2016) of sector expenses. This is in line with prior years, and slightly below the five-year national average (2012 to 2016) of 57.7 per cent.

To gain an insight of how efficiently each university uses its staff to deliver revenue-generating services, we can compare the ratio of employee benefits expenditure to the total revenue received by a university in the financial year. We then compare this to the national five-year average of 54 per cent. Generally, a smaller ratio indicates a more efficient and sustainable workforce. The ratios for the year ended 31 December 2017 are shown in Figure 4G.

Figure 4G

Employee benefits ratio for the year ended 31 December 2017, compared to the national five-year average



Note: * For the purposes of this analysis only, we have adjusted Swinburne University of Technology's total revenue to remove a significant one-off gain resulting from the sale of an investment, which did not reflect the university's day-to-day operations.

Note: Figures have been adjusted for the qualified universities.

Source: VAGO and the Commonwealth Department of Education and Training.

Consistent with our observations about their net result margin, Victoria University and Federation University Australia were significantly above the benchmark for this indicator. This indicates they need to improve the efficiency of their staffing structure.

Sustainable financial position

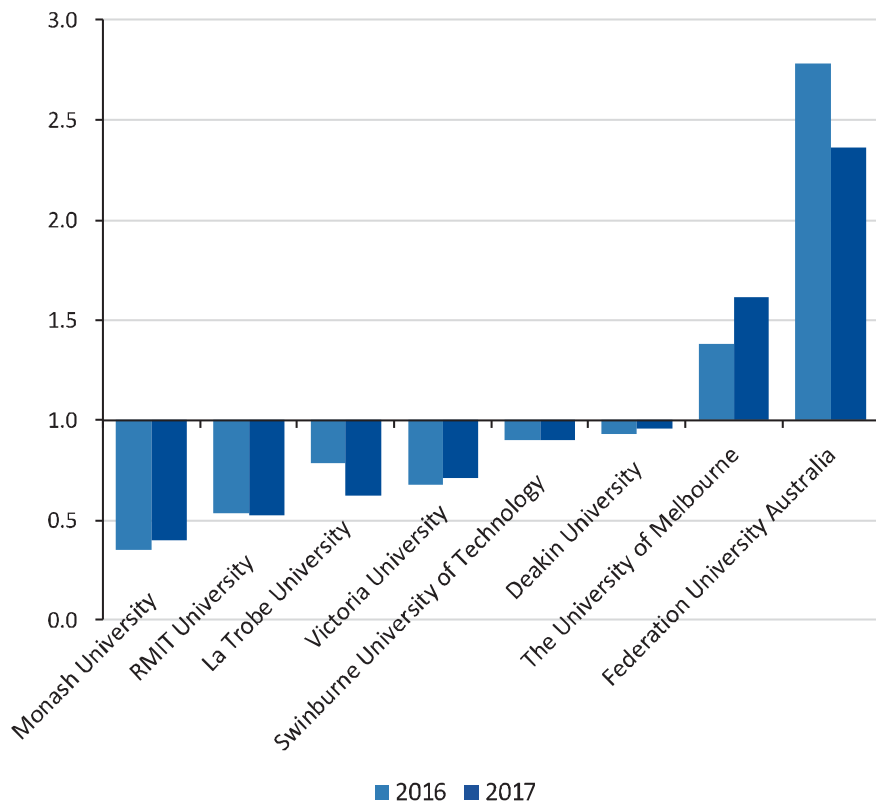
Solvency

Current ratio—a ratio that compares cash and other assets that are expected to convert to cash within 12 months, to liabilities that are payable within 12 months. A value of 1.0 or greater generally indicates that an entity is likely to be able to meet its short-term obligations.

To remain solvent, universities must be able to settle their debts as they are due. As the sector leverages more debt, the risk of a university becoming insolvent increases. Given the universities' approach to managing their finances, we have looked at each of their current ratios as an indication of their solvency.

Overall, the sector's average current ratio has decreased slightly to 1.01 (1.04 in 2016). However, as shown in Figure 4H, most of the universities have more short-term liabilities than assets. This is consistent with our observations in 2016, in that the universities are simultaneously leveraging more debt funding and holding longer-term investments (as opposed to cash) with the aim of making higher returns.

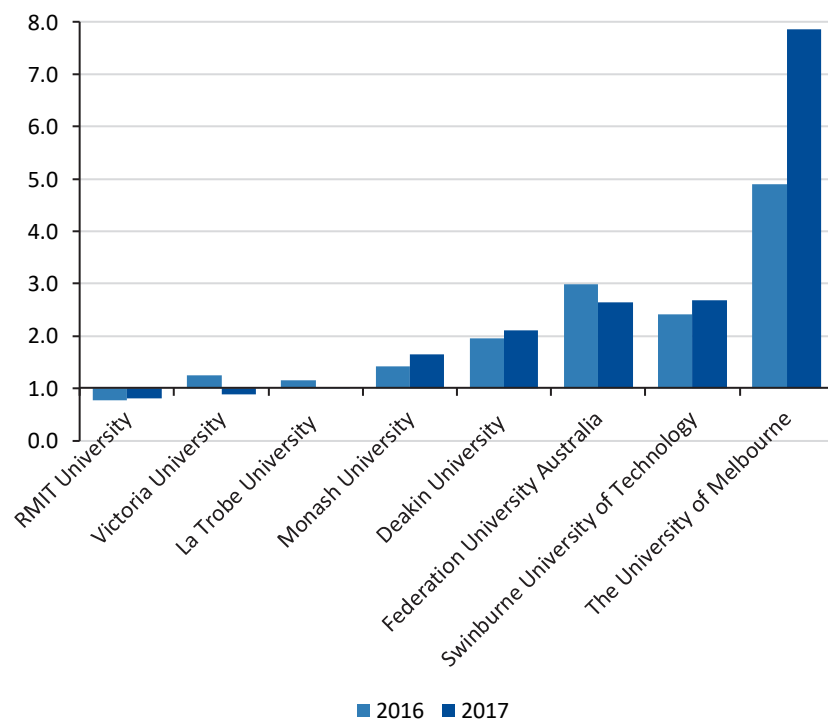
Figure 4H
Liquidity ratio for universities at 31 December 2016 and 2017



Note: Figures have been adjusted for the qualified universities.
Source: VAGO.

In Figure 4I, we adjust the ratio to include each university's non-current available-for-sale financial assets. These assets are classified as non-current due to the universities' intention not to access them during 2018. However, most of them can be converted to cash or cash equivalents at short notice and are available to the universities to meet any liabilities if required.

Figure 4I
Adjusted liquidity ratio for universities at 31 December 2016 and 2017



Note: Figures have been adjusted for the qualified universities.
Source: VAGO.

This adjustment shows that, as at 31 December 2017, all universities except RMIT University and Victoria University had enough liquid assets to meet their short-term liabilities. In 2017, RMIT University had a strong net result and a net cash inflow significantly greater than its net liability. On this basis, the risk of it being unable to meet its short-term obligations is low. Management at RMIT University also actively monitor cash flows and debt levels to manage the risk of insolvency.

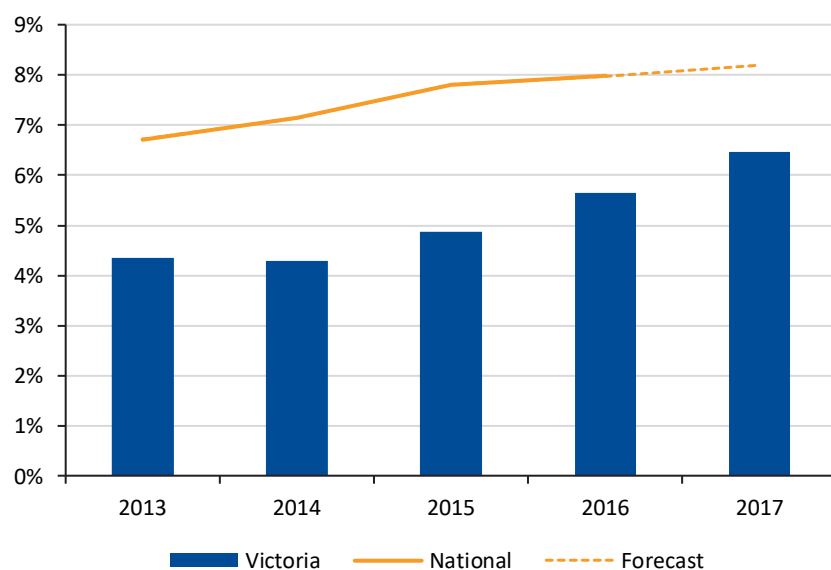
Victoria University needs to look at measures to improve its short-term liquidity. As suggested above, this may include reviewing its current course offerings, as well as its staff profile, to increase revenue and reduce expenses.

Dependence on external sources of funding

Debt to equity ratio—the total of the sector's current and non-current borrowings, expressed as a percentage against the sector's equity (net assets).

An increase in debt (as opposed to equity) as a source of funding increases the risk that universities may become insolvent, as they will generally be required to repay debt and interest at agreed and fixed times. By looking at the sector's debt-to-equity ratio, we can get an understanding of how reliant the sector is on debt for funding—see Figure 4J.

Figure 4J
Debt-to-equity ratio for university sector at 31 December



Note: 2017 national data was not yet available at the time of this report. We have forecast the 2017 national average based on historical results for the five years ended 31 December 2016.

Note: Figures have been adjusted for the qualified universities.

Source: VAGO and Commonwealth Department of Education and Training.

As shown in Figure 4J, the sector does not rely excessively on debt funding. Although the ratio continues to increase, it is relatively low, at 6.5 per cent (5.6 per cent in 2016) and still well below the projected national equivalent of 8.2 per cent (8.0 per cent in 2016).

Consistent with our earlier observations, this trend reflects the sector's use of debt as a financial management tool to maximise the return on the assets it has available for investment.

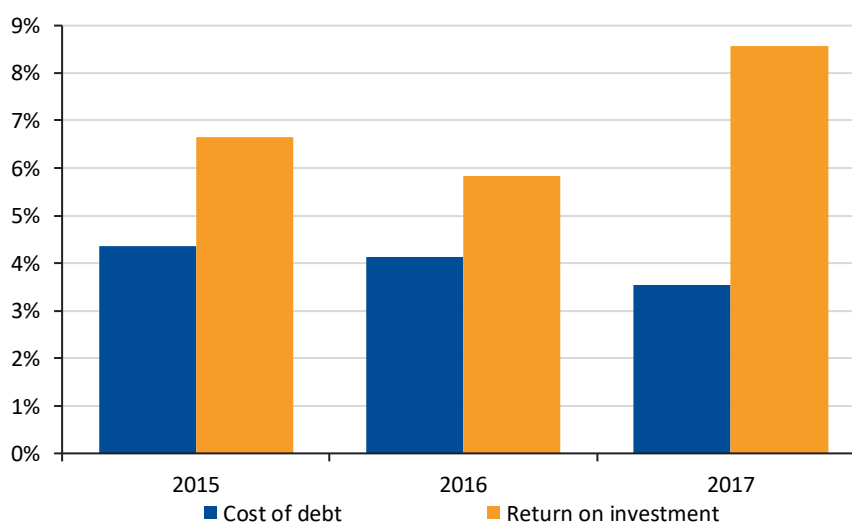
Return on investments—calculated as total investment revenue divided by total cash and investments.

Cost of debt—calculated as total finance costs divided by total borrowings

Return on investment compared to cost of debt

As seen in Figure 4K, the sector's rate of return on its investments is much higher than its cost of debt. Further, the rate of return has increased significantly in 2017, while cost of debt has continued to fall. This supports the sector's actions and indicates that most universities are managing their financial resources well. By leveraging debt and managing investments to increase its surplus, the sector is further reducing its dependence on government funding.

Figure 4K
Cost of debt compared to return on investments for the sector, for the years ended 31 December 2015 to 2017



Source: VAGO.

4.4 Sustainable resource management

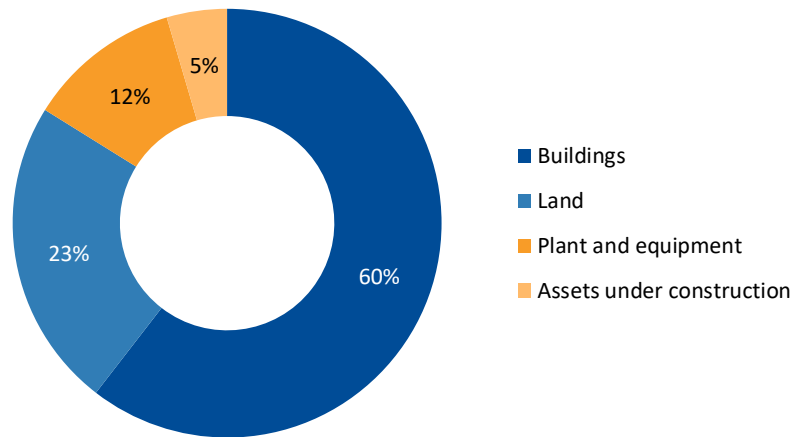
Book value—the value of assets as reported in the financial report. It takes into account accumulated depreciation and any reductions in value due to impairment.

The sector's sustainability requires universities to manage their physical and non-financial resources effectively and efficiently to meet demand. This includes keeping existing assets in operational condition, acquiring new assets in a timely manner to match operational growth, and meeting ongoing maintenance using the funds generated by ongoing operations.

Asset replacement and funding

The universities rely heavily on their long-term physical assets—including campus buildings and specialised laboratory equipment—to deliver their services. As at 31 December 2017, property, plant and equipment in the sector had a book value of \$15.1 billion and comprised 66.6 per cent of the sector's total assets (66.8 per cent in 2016).

Figure 4L
Proportion of types of property, plant and equipment by book value at 31 December 2017



Source: VAGO.

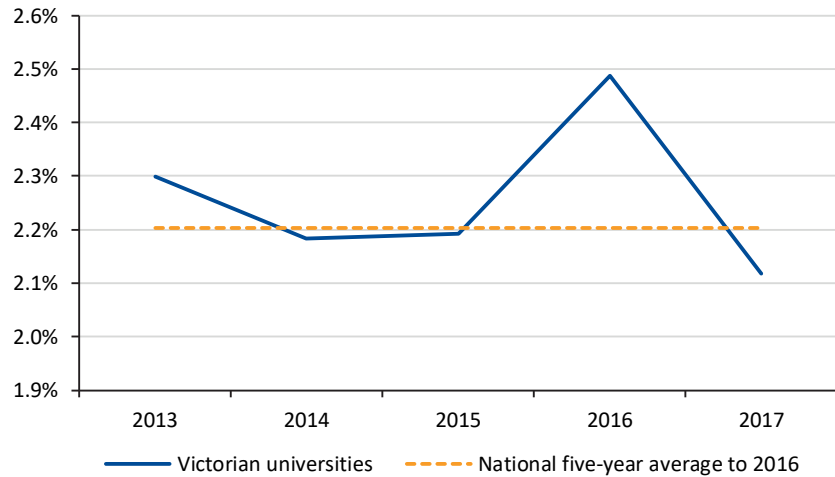
To deliver services efficiently, effectively and safely, universities need to adequately maintain their assets. Where appropriate, they must also replace or refurbish these assets at the end of their useful lives, to enable them to continue to provide services.

Figure 4M compares the sector's repairs and maintenance expenditure against the value of its completed buildings, plant and equipment. Generally, a higher proportion of maintenance expenditure indicates adequate maintenance.

By comparing it to the national average, we get an understanding of the adequacy of the Victorian universities' expenditure on repairs and maintenance compared to the national universities sector. The Victorian universities have a similar or higher ratio of repairs and maintenance spend compared to the five-year national average. On this basis, it appears that repairs and maintenance spending is adequate.

Figure 4M

Ratio of repairs and maintenance spend to book value of maintainable assets, for the years ended 31 December 2013 to 2017



Source: VAGO.

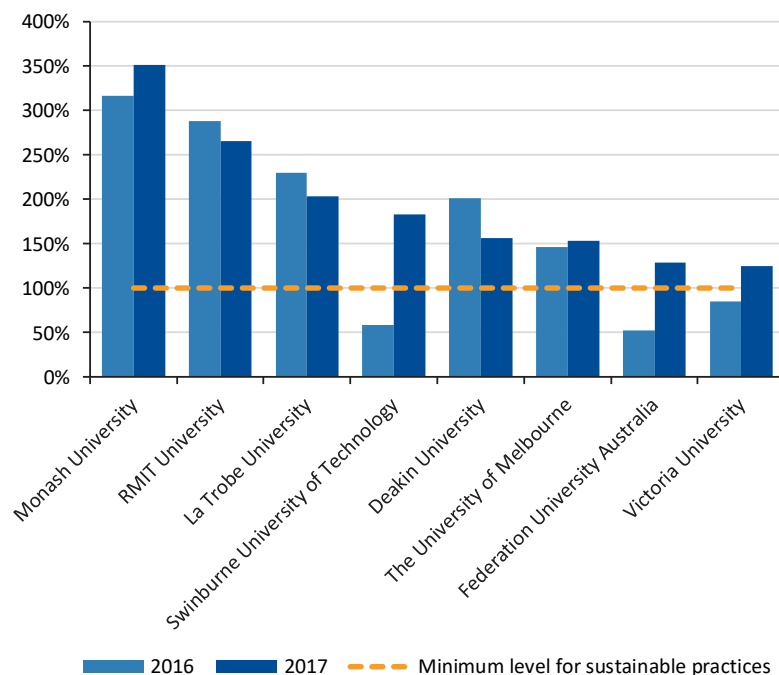
Depreciating assets— assets whose values erode over time due to use and/or consumption. Common examples of depreciating assets include buildings, plant and equipment, motor vehicles and furniture and fittings.

Examples of non-depreciating assets include land and cultural art works as their value does not generally deteriorate due to age or use.

To understand whether universities are replacing or renewing their assets in a timely manner, we compare their capital spend on depreciating assets to their depreciation expense for the year, as shown in Figure 4N. A ratio of less than 100 per cent on an ongoing basis may indicate that a university is allowing its assets to deteriorate at a greater rate than the rate at which it is renewing or replacing them.

Figure 4N

Asset renewal ratio, for the year ended 31 December 2017



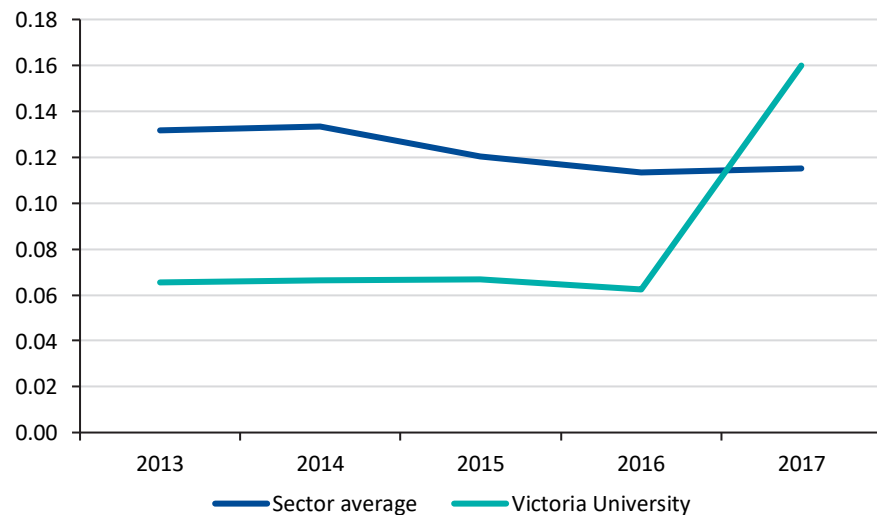
Source: VAGO.

Backlog maintenance refers to the cost of maintenance works that are due and necessary to prevent the deterioration of assets or their functions, but which have not been carried out.

All universities had asset renewal ratios above the 100 per cent benchmark in 2017, including those with ratios below the benchmark in 2016. This indicates that the universities are adequately renewing their long-term assets. However, this indicator does not distinguish between new assets and the replacement of existing assets. Universities need to ensure that existing assets continue to be fit for service. Part of this involves maintaining the assets to a good standard.

At 31 December 2017, the sector had an asset maintenance and refurbishment backlog of \$1.13 billion (\$1.15 billion in 2016). We analysed the trend of the sector's maintenance and refurbishment backlog against the replacement value of its maintainable assets (buildings, plant and equipment) to assess whether maintenance practices support the sustainability of the sector—see Figure 40.

Figure 40
Ratio of maintenance and refurbishment backlog to buildings, plant and equipment, at 31 December 2013 to 2017



Source: VAGO and unaudited data obtained from sector universities—the universities report this to the Tertiary Education Facilities Management Association annually. We obtained this information directly from the universities.

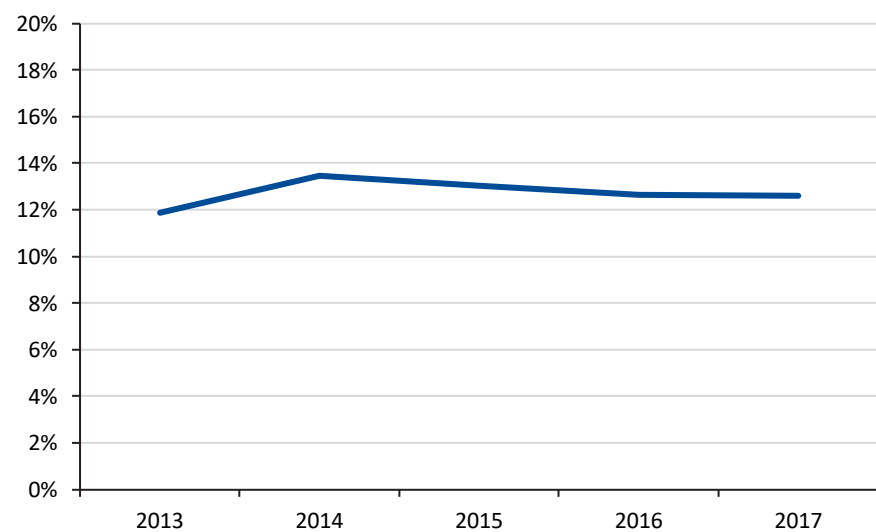
The sector's average ratio has been decreasing since 2014, indicating that universities in general are spending adequately on maintenance. There was a slight rise in the average ratio from 2016 to 2017, and this was a result of a spike in the ratio for Victoria University in 2017. This spike resulted from Victoria University being in a period of transition, bringing its previously outsourced asset management function in-house. We discuss the issues around Victoria University's asset maintenance framework in further detail in Section 4.5.

Adequacy of infrastructure

One indicator of whether a university's infrastructure is adequate to support demand from enrolled students is whether its gross floor area is increasing at a rate that matches its growth in EFTSL.

As shown in Figure 4P, the sector's ratio of gross floor area to onshore EFTSL has been relatively constant over the past five years. This indicates that universities are increasing their capacity at a rate that matches their growth in student load.

Figure 4P
Ratio of gross floor area per onshore EFTSL, at 31 December 2013 to 2017



Source: Unaudited data obtained directly from public sector universities—the universities report this to the Tertiary Education Facilities Management Association annually.

4.5 Asset maintenance

It is important that the universities have an effective asset maintenance framework in place to ensure buildings and other assets are kept to the standard required to deliver services. The key elements of an effective asset maintenance framework are detailed in Figure 4Q.

Figure 4Q
Elements of an asset maintenance framework

Component	Key elements
Asset management policies and strategies	<p>An asset maintenance strategy is in place that aligns with business strategy and comprises:</p> <ul style="list-style-type: none"> • a maintenance plan • regular reviews • a funding plan • a risk management plan • appropriate reporting to board and executive management. <p>An asset maintenance policy exists that includes:</p> <ul style="list-style-type: none"> • regulatory requirements • roles and responsibilities—including authorisation requirements • an approach to asset maintenance and replacement—including when maintenance is required and what procedures need to be undertaken • the requirement to maintain an asset register • systems and procedures for measurement of asset performance • methods of disposal • adequacy of maintenance spending • life cycle maintenance and costing—including future requirements • funding requirements • contingency plans for maintenance of assets after natural disasters.
Management practices	<ul style="list-style-type: none"> • Adhering to asset maintenance policies and relevant legislative requirements • Evaluating asset performance, through assessment of physical condition, utilisation, functionality and financial performance • Periodically reviewing policies, practices and processes • Comprehensively reviewing assets held, the condition of significant assets, and the replacement cycle • Ranking and evaluating acquisition proposals to determine the most effective use of limited capital funding • Comprehensive reporting to the board and executive
Governance and oversight	<ul style="list-style-type: none"> • Monitoring compliance with policy requirements • Reviewing and approving the asset management strategy • Assessing the risks associated with asset maintenance • Engaging internal audit to review policy compliance and practices

Source: VAGO compiled from *Strategic Asset Management Guidelines*, Tertiary Education Facilities Managers Association, 2010; *Sustaining Our Assets policy*, Department of Treasury and Finance, 2010; *Guidelines for Developing and Asset Management Policy, Strategy and Plan*, Department for Victorian Communities, 2004; *Better Practice Guide on the Strategic and Operations Management of Assets by Public Sector Entities*, Australian National Audit Office, 2010; *Asset Management Accountability Framework*, Department of Treasury and Finance, 2016.

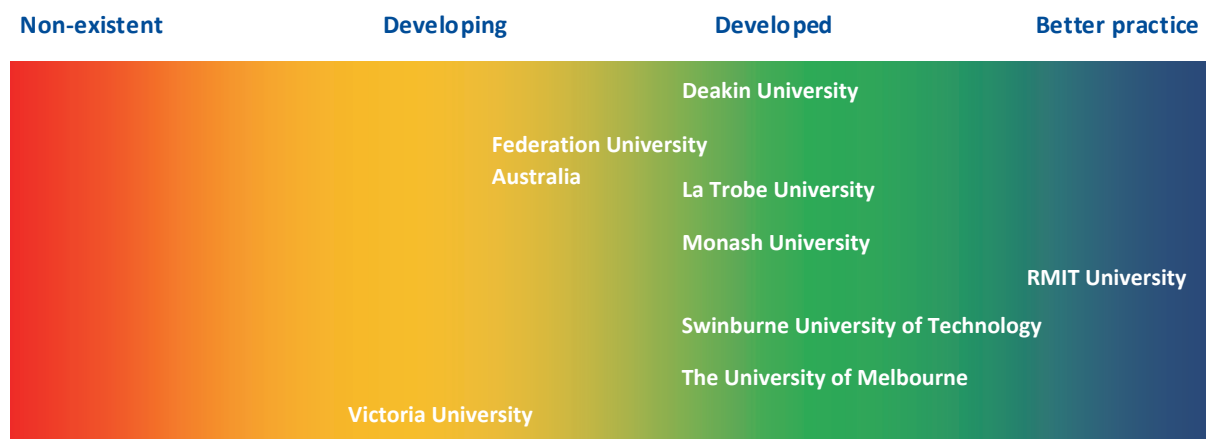
University policies and processes

We assessed the maturity of the universities' asset maintenance frameworks against the key elements listed in Figure 4Q. We used four maturity ratings:

- Non-existent—had few or no elements of a better practice asset maintenance framework.
- Developing—had some elements of a better practice asset maintenance framework but was lacking in one or more key areas.
- Developed—had most elements of a better practice asset maintenance framework, with some minor areas lacking.
- Better practice—had all the elements of a better practice asset maintenance framework.

Figure 4R shows our assessments against these ratings.

Figure 4R
Maturity of universities' asset maintenance frameworks, 2017



Source: VAGO.

We assessed most universities as having a 'developed' framework. Most have the majority of the key elements of an asset maintenance framework in place, including a documented asset maintenance strategy or equivalent. All universities had an asset maintenance plan in place. In addition, most recorded a risk related to asset maintenance in their risk register, and documented steps to address this risk.

However, we noted that six of the eight universities did not have a documented asset maintenance policy. Some of these universities had elements of an asset maintenance policy covered in various other policies and guidelines. The absence of a documented asset maintenance policy to guide decisions on capital spending increases the risk that the asset maintenance strategy will be ineffective.

At the lower end of the scale, Victoria University and Federation University Australia were missing several key elements of a better practice framework.

While Federation University Australia had an asset maintenance policy, it was missing critical elements including:

- documented processes for funding asset maintenance
- specific asset maintenance procedures including whether to repair or replace an asset.

Asset maintenance operations at Federation University Australia are confined to one division, and decisions to repair or replace major plant are assessed on a case-by-case basis as the need arises. This is currently not reflected in the university's asset policy, but we recommend that the university address this.

The gaps in Federation University Australia's asset maintenance framework increase the risk of significant unexpected maintenance costs and the potential for key assets to be unavailable for use.

Victoria University had previously outsourced the management of its asset maintenance function and recently brought this back in house. It is currently undertaking a project to establish an asset management framework that is intended to comply with ISO 55001:2014 *Asset Management*.

At the time of our audit, Victoria University's asset maintenance framework had not been established, and most of its asset maintenance was being conducted on an ad-hoc basis. Most of the key elements of a better practice asset maintenance plan were also absent, and the university did not record asset maintenance as a risk in its risk register. While we note management's intention to obtain ISO 55001 certification, not having a developed asset maintenance framework in place in the interim exposes the university to the risk that its assets will not be maintained, and that they may be unsuitable to deliver the services required.

Asset management and life cycle modelling at RMIT University

Within the Victorian university sector, we observed that RMIT University has all the elements of a better practice asset maintenance plan and strategy in place, held together in a cohesive framework. As evidence of this, in early 2018, RMIT University became the first Australian university to be certified under ISO 55001:2014 *Asset Management*. Underlying this framework is an asset life cycle modelling system that provides RMIT University's management team with detailed information that enables it to implement the university's asset maintenance policies and plans effectively.

In 2015, RMIT University's property services team initiated a project to overhaul its asset maintenance framework to improve its service delivery and better align its asset management strategy to the university's long-term strategic objectives. This involved shifting from a focus on scheduled asset maintenance to monitoring asset life cycles and using data modelling to predict the university's asset management needs over the long term.

Over 2016 and 2017, the property services team conducted an extensive process to catalogue the entire physical asset portfolio under its responsibility, and audited the condition of each individual asset. This included concealed components and infrastructure such as lifts, piping and in-ground assets. The property services team gathered information about each asset's nature, installation date, expected life and current condition.

The information gathered from this process was compiled onto an asset management system developed by the university's School of Engineering. This system has comprehensive data analytics and visualisation abilities which enables the property services team to have a detailed understanding of the condition of its portfolio and to accurately forecast its asset needs in any given period.

The information allows RMIT University to assign each asset a condition risk rating based on the likelihood of failure, as well as the magnitude of the consequences of failure should it occur. It can then focus its maintenance activity on assets at higher risk.

To keep the information up to date, RMIT University performs audits on an annual cyclical basis. This ensures that information on the condition and risk associated with individual assets is current. The university has also implemented comprehensive policies and procedures for additions, disposals, maintenance expenditure and other asset-related transactions to ensure that these are captured in the system.

The benefits of RMIT University's asset management system

The ability to analyse detailed asset information allows the property services team to align its asset maintenance and management programs very closely with the university's strategic plan and business plan. In many aspects, this results in the asset management strategy not just supporting, but helping to advance RMIT University's strategic goals.

A better awareness and understanding of the physical asset portfolio

As a result of the implementation of the system, RMIT University's asset registers went from having just under 6 000 known maintainable assets in 2015 to over 55 000 in 2017. The comprehensive audits and controls around additions and disposals that RMIT has in place, as well as the data captured and recorded on the asset management system, allow management to have a very detailed understanding of the assets in its portfolio.

This, in turn, allows the university to manage that portfolio efficiently and sustainably, as discussed below.

Risk-focused maintenance activity and streamlined budgeting

Having access to detailed information about the condition of its assets, how important they are to the university's operations, as well as their life cycle stage, allows RMIT University to forecast its required maintenance spend very accurately. It is also able to prepare informative, evidence-based reports for decision-makers. This allows the decision-makers, such as the university's council or its delegated subcommittee, to make informed decisions about the approval of budgeted maintenance expenditure, in less time and with more confidence that funds will be spent on areas likely to have the greatest impact to the university's operations and reputation.

The detailed information in the model also allows RMIT University to forecast changes in its maintenance and capital expenditure according to changes in demand, allowing decision-makers to take forecast growth in operations into consideration.

Reactive maintenance, also known as 'breakdown maintenance', is unscheduled repairs and maintenance work that is performed due to an asset breaking down. Reactive maintenance generally costs more than scheduled maintenance, as there are higher costs and longer operational down times associated with the short notice.

Reduced reactive maintenance leading to more operational efficiency and reduced costs

The life cycle modelling developed by RMIT University, in conjunction with the risk ratings, allows it to make better decisions about whether to repair, refurbish or replace an asset. For example, based on its life cycle model, the university is able to forecast when critical assets such as climate control units or elevators are likely to require replacement. The university is then able to schedule the necessary maintenance or replacement of these assets slightly ahead of the end of their useful lives, rather than waiting for the assets to actually fail.

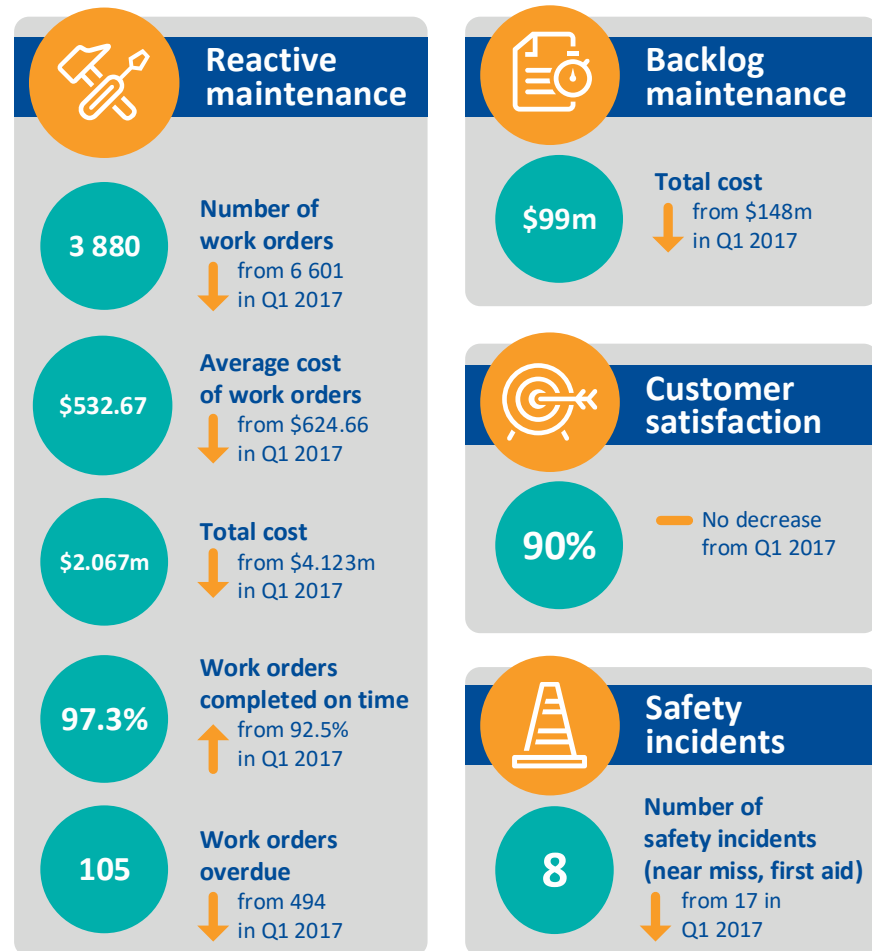
This results in a better ratio of scheduled maintenance to reactive maintenance. As at the first quarter of 2018, the university had improved its ratio of scheduled to reactive maintenance above the generally accepted 70:30 industry benchmark, described in NASA's *Reliability-centred maintenance guide for facilities and collateral equipment* (2008).

As a result of being able to plan and schedule a greater portion of its repairs and maintenance activity, the university has started to realise the following benefits:

- Staff and students experience improved health and safety, as assets are refurbished or replaced before they fail.
- There is reduced operational downtime, as alternative arrangements can be planned and made ahead of time. Also, replacement parts or units can be ordered in advance, reducing the impact of lead times.
- Funding is used more efficiently. Planned orders also allow the university to take better advantage of economies of scale by ordering the required items in bulk.

Figure 4S provides further details on improvements realised by the university.

Figure 4S
Maintenance improvements at RMIT University following the implementation of its life cycle model for Quarter 1, ended 31 March 2018



Source: VAGO and RMIT Property Services.

Providing higher education through the Work-Integrated Learning program

A significant portion of the annual assets audits are conducted by senior students from the School of Engineering as part of RMIT's Work Integrated Learning program, supported by staff from the property services team and the engineering faculty. The in-house asset management software was also developed by the School of Engineering and continues to be updated by its staff and students. As a result, selected students receive actual experience in surveying and condition assessments.

By involving students as a core component of its asset management strategy, RMIT University is leveraging its own asset management needs to provide hands-on experiences to its students. From this perspective, the university's asset management strategy not only supports its operations by ensuring its asset portfolio is in operational condition, it also directly aligns to the university's organisational objective of providing higher education through practical experiences and preparing each student for future employment.

Conclusion

The shift to asset life cycle modelling has given RMIT University the information it needs to implement an asset management strategy that will allow it to better manage its sustainability risks over the longer term, and to cope with forecast changes in the size of its operations. It will also allow the university to better manage its asset-related expenditure and improve the effectiveness of and accountability for the way capital grants and other public funding are spent. These are benefits that should be of interest to public sector entities in general.

We recommend that the other universities weigh the costs and benefits of implementing an asset life cycle modelling system that will provide them with the information needed to support an effective asset management framework that aligns directly to their organisations' strategic and long-term objectives.

Appendix A

Audit Act 1994 section 16— submissions and comments

We have consulted with DET and the eight public universities in Victoria, and we considered their views when reaching our audit conclusions. As required by section 16(3) of the *Audit Act 1994*, we gave a draft copy of this report, or relevant extracts, to those agencies and asked for their submissions and comments. We also provided a copy of the report to the Department of Premier and Cabinet.

Responsibility for the accuracy, fairness and balance of those comments rests solely with the agency head.

Responses were received as follows:

DET	58
Deakin University.....	59
Federation University Australia	61
Victoria University	62

RESPONSE provided by the Secretary, DET



Department of
Education & Training
Office of the Secretary

2 Treasury Place
East Melbourne Victoria 3002
Telephone: +613 9637 2000
DX210083

BRI018887

Mr Andrew Greaves
Auditor-General
Victorian Auditor-General's Office
Level 31, 35 Collins Street
MELBOURNE VIC 3000

Dear Auditor-General

Thank you for your letter of 8 May 2018 providing the Department of Education and Training with the opportunity to comment, under section 16(3) of the *Audit Act 1994*, on the proposed audit report *Result of 2017 Audits: Universities*.

The Department has reviewed the report and supports the recommendation made.

The eight university Acts contain no general Ministerial power of direction over universities. The legislative responsibilities of the Minister for Training and Skills under the eight university Acts is limited to making some Council appointments, approving the acquisition, disposal and leasing of some land, approving certain commercial activities, and approving the amendment of university statutes.

I am therefore supporting, rather than formally accepting, this recommendation.

If you would like further information, you may contact Xavier Csar, Executive Director, TAFE and Participation, Higher Education and Skills Group, Department of Education and Training on 9637 2924 or by email: csar.xavier.f@edumail.vic.gov.au.

Yours sincerely

Gill Callister
Secretary
16/5/2018



RESPONSE provided by the Vice-Chancellor, Deakin University



14 May 2018

Mr Andrew Greaves
Auditor-General
Victorian Auditor-General's Office
Level 24, 35 Collins Street
Melbourne VIC 3000
By email <UniSnapshot18@audit.vic.gov.au>

Dear Mr Greaves,

Deakin University: Audit Qualification for the year ended 31 December 2017

The Victorian Auditor-General has again qualified the University's financial report on the grounds that unspent grants provided by the Federal and State governments received in advance as at 31 December 2017 have been recognised as income in advance and recognised as a liability in the Statement of Financial Position.

The University's treatment is in accordance with Australian Accounting Standard AASB 118 – Revenue. The University regards the receipt of these payments as a reciprocal transfer where the grants have outstanding performance or return conditions.

The Victorian Auditor-General has taken the view that these payments are non-reciprocal government grants and should be accounted for in accordance with Australian Accounting Standard AASB 1004 – Contributions, whereby such payments are treated as income in the year of receipt.

The University does not agree with this interpretation of the nature of the income and has external advice to confirm its interpretation.

The Australian Accounting Standards Board (AASB) has completed its considerations in relation to revenue accounting for Not-for-Profit entities.

The new Accounting Standards to be applied from 1 January 2019 – AASB 15 Revenue from Contracts with Customers and AASB 1058 Income of Not-for-Profit Entities – are consistent with Deakin's current approach to revenue recognition for 'grant income'. Deakin will undertake a full review of the new requirements prior to the application date of 1 January 2019.

Office of the Vice-Chancellor
Deakin University
Email: vc@deakin.edu.au
Tel: +61 3 5227 8502 Fax: +61 3 5227 8500

Geelong Waterfront Campus,
1 Gheringhap Street, Geelong, Victoria, Australia
Locked Bag 20001, Geelong, VIC 3220
deakin.edu.au

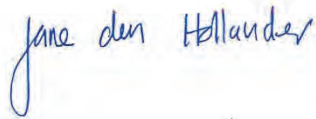
Deakin University CRICOS Provider Code: 00113B

RESPONSE provided by the Vice-Chancellor, Deakin University—continued

The Victorian Auditor-General has also highlighted a high-risk issue relating to the IT control environment that remained unresolved for more than 12 months after initial identification. The risk relates to the current ERP system which had reached the end of its useful life. The University undertook a rigorous assessment that identified the best option was to replace this with a new Enterprise Resource Planning (ERP) system. After a comprehensive search and selection process a new ERP system was identified as the best solution for the University. The program to implement the future ERP system is currently underway with a current 'go live' date of January 2019 which will address and remove the identified risk.

We request that this letter be included as an appendix to the Auditor-General's full report to the Victorian Parliament.

Best wishes,

A handwritten signature in blue ink that reads "Jane den Hollander". The signature is written in a cursive style with a large initial 'J'.

Professor Jane den Hollander AO
Vice-Chancellor

**RESPONSE provided by the Vice-Chancellor and President,
Federation University Australia**



15 May 2018

Mr Andrew Greaves
Auditor-General
Victorian Auditor-General's Office
Level 24, 35 Collins Street
Melbourne VIC 3000

Dear Mr Greaves,

Federation University Australia Response to Results of 2017 Audits: Universities

Thank you for your invitation to provide submissions to be included in the published report on the Results of 2017 Audits: Universities. Our comments are outlined below:

Recommendation 1: Timeliness of University financial reports

In response to concerns regarding errors in the statement of accounts, the University's management has commissioned a detailed action plan to ensure that sufficient time is allowed to quality assure all work prior to submission to the auditors. The acknowledgement of being the first university to submit the accounts is appreciated, but we will review and ensure the appropriate balance between timely submission and accuracy for the 2018 statement of accounts.

Recommendation 2: Financial Sustainability

Federation University Australia has recently conducted an in-depth analysis of every aspect of the University's business and operations, which has resulted in the development of a Transformational Strategy to ensure long-term sustainability. Incorporated within the Strategy is a focus on the key aspects highlighted in the report, including improving the efficiency of our staffing structure. The University has undertaken a considerable amount of financial modelling and has a number of growth strategies in the pipeline, with the intention to increase student numbers and revenue over the next 3-4 years.

Recommendation 3: Asset Maintenance

The University will strengthen its asset maintenance documentation in line with audit advice contained in the asset maintenance policy review.

Please do not hesitate to contact me if you wish to discuss the financial plans that underpin the University's long-term sustainability.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Helen Bartlett".

Professor Helen Bartlett
Vice-Chancellor and President

Office of the Vice-Chancellor and President ~ Professor Helen Bartlett

University Drive, Mt Helen | POST PO Box 663 Ballarat VIC 3353 | EMAIL vc@federation.edu.au
CALL +61 3 5327 9201 | WEB federation.edu.au | ABN 51 818 692 256 | CRICOS PROVIDER No. 00103D | RTO CODE 4909

RESPONSE provided by the Vice-Chancellor and President, Victoria University



Professor Peter Dawkins AO
Vice Chancellor and President

Footscray Park Campus
Ballarat Road, Footscray
PO BOX 14428 MELBOURNE
VICTORIA 3001 AUSTRALIA
Phone +61 3 9919 4011

Tuesday 15 May 2018

Charlotte Jeffries
Director – Financial Audit
Victorian Auditor-General's Office
Level 31, 35 Collins Street,
Melbourne

Dear Charlotte,

**RE: Victoria University's formal response for inclusion in the VAGO Education
Parliamentary Report**

Please see the quote below regarding Victoria University's (VU) financial sustainability for inclusion in the VAGO Education Parliamentary Report as VU's formal response.

"In 2017, the University undertook a major transformational program to be an agile, dynamic, innovative and growing University of Opportunity and Success. As part of the implementation of this program, the University incurred major restructure costs associated with the transitioning to the revolutionary "First Year" teaching and learning model, an Australian first, the introduction of VU Research College and the development of a campus master plan. These transformational changes incorporated significant ongoing productivity improvements. In 2018 we plan to deliver a positive surplus and an improving financial position thereafter".

Yours sincerely,

Professor Peter Dawkins AO
Vice-Chancellor and President

VICTORIA UNIVERSITY ABN 83776964731 CRICOS Provider No. 00124K (Melbourne), 02475D (Sydney), RTO 3113

Appendix B

Audit opinions

Figure B1 lists the entities included in this report. It details the date an audit opinion was issued to each entity for their 2017 financial reports, and the nature of the opinion.

Figure B1
Audit opinions issued for universities and their controlled entities

Entity	Clear audit opinion issued	Auditor-General's report signed date
Deakin University	Qualified^(a)	19 March 2018
Deakin Cyber Security Accelerator Pty Ltd	✓	21 March 2018
Deakin Digital Pty Ltd	✓	20 March 2018
Deakin Residential Services Pty Ltd	✓	21 March 2018
iHosp Pty Ltd	✓	21 March 2018
FLAIM Systems Pty Ltd	✓	21 March 2018
Unilink Limited	✓	21 March 2018
Federation University Australia	✓	27 February 2018
Brisbane Educational Services Pty Ltd	✓	9 March 2018
Datascreen Pty Ltd	✓	9 March 2018
Inskill Pty Ltd	✓	9 March 2018
The School of Mines and Industries Ballarat Limited	✓	9 March 2018
UB Housing Pty Ltd	✓	9 March 2018
La Trobe University	✓	22 March 2018
Unitemps La Trobe Ltd	n/a	n/a
Monash University	✓	25 March 2018
Monash Accommodation Services Pty Ltd	✓	22 March 2018
Monash College Pty Ltd	✓	20 February 2018
Monash Commercial Pty Ltd	✓	22 March 2018
Monash Custodians Pty Ltd	n/a	n/a
Monash Investment Holdings Pty Ltd	✓	19 March 2018
Monash Investment Trust	✓	19 March 2018
Monash Property South Africa Pty Ltd	n/a	n/a
Monash University Foundation Pty Ltd	✓	9 March 2018
Monash University Foundation Trust	✓	9 March 2018
Monash University Indonesia Limited	n/a	n/a

Figure B1**Audit opinions issued for universities and their controlled entities—continued**

Entity	Clear audit opinion issued	Auditor-General's report signed date
RMIT University	✓	28 February 2018
RMIT Holdings Pty Ltd	✓	23 April 2018
RMIT Indonesia Pty Ltd	✓	23 April 2018
RMIT Online Pty Ltd	✓	23 April 2018
RMIT Spain S.L	✓	23 April 2018
RMIT Training Pty Ltd	✓	6 March 2018
RMIT University Vietnam LLC	✓	23 April 2018
Swinburne University of Technology	✓	16 March 2018
National Institute of Circus Acts Limited	✓	28 March 2018
Swinburne Intellectual Property Trust	✓	19 April 2018
Swinburne Student Amenities Association Ltd	✓	23 March 2018
Swinburne Ventures Limited	✓	13 April 2018
The University of Melbourne	Qualified^(a)	19 March 2018
Australian Music Examinations Board (Victoria) Limited	✓	27 April 2018
Australian National Academy of Music Ltd	n/a	n/a
Melbourne University Publishing Limited	n/a	n/a
Melbourne Business School Foundation	EOM ^(a)	19 March 2018
Melbourne Business School Foundation Ltd	EOM ^(a)	19 March 2018
Melbourne Business School Limited	✓	19 March 2018
Melbourne Dental Clinic Ltd	n/a	n/a
Mt Eliza Graduate School of Business and Government Limited	✓	19 March 2018
MU Student Union Limited	n/a	n/a
Nossal Institute Limited	n/a	n/a
UOM Commercialisation Pty Ltd	✓	29 March 2018
UM Commercialisation Trust	✓	29 March 2018
UOM Commercial Ltd	✓	29 March 2018
Victoria University	✓	19 April 2018
Victoria University Enterprises Pty Ltd	✓	12 April 2018
Victoria University Foundation	✓	12 April 2018
Victoria University Foundation Ltd	✓	12 April 2018
Victoria University International Pty Ltd	✓	12 April 2018
Victoria University of Technology (Singapore) Pte Ltd	✓	12 April 2018

(a) See Part 2 of this report for further information on the modified audit opinions issued.

Note: n/a = not applicable. Financial reports were not yet signed, so we have not been able to issue an audit opinion for this entity at the date of this report.

Note: EOM = emphasis of matter.

Source: VAGO.

Appendix C

Financial reporting better practice elements

Our assessment of the quality of financial reporting processes against better practice was based on elements outlined in Figure C1.

Figure C1
Better practice elements to financial report preparation

Key element	Better practice
Financial report preparation	Develop a 'financial report preparation plan' incorporating: <ul style="list-style-type: none"> a materiality determination from both a qualitative and quantitative perspective when preparing their financial report their approach to streamlining the financial report materiality and the plan were reported to relevant stakeholders such as Council, audit committees and audit for consideration.
Preparation of proforma financial report	Provide quality proforma financial report to audit within agreed time frame.
Monthly financial reporting	Prepare full accrual monthly financial reports.
Quality control and assurance procedures	Require rigorous quality control and assurance procedures surrounding the compilation, preparation and presentation of their financial report.
Supporting documentation	Prepare high quality documentation supporting and validating balances in the financial report.
Analytical reviews	Undertake rigorous analytical review procedures during the financial report preparation process to help with the accuracy and completeness of disclosures.
Quality review control and assurance procedures	Establish sufficiently robust quality review control and assurance processes that provide assurance over the accuracy and completeness of the financial report.

Source: VAGO and the Australian National Audit Office's *Better Practice Guide: Preparation of Financial Statements by Public Sector Entities*.

Appendix D

Control issues risk ratings

Figure D1 shows the risk ratings applied to issues raised in management letters. It also details what they represent and the expected time line for the issue to be resolved.

Figure D1

Risk definitions applied to issues reported in audit management letters

Rating	Definition	Management action required
Extreme	<p>The issue represents:</p> <ul style="list-style-type: none"> a control weakness which could cause or is causing severe disruption of the process or severe adverse effect on the ability to achieve process objectives and comply with relevant legislation, or a material misstatement in the financial report has occurred. 	<p>Requires immediate management intervention with a detailed action plan to be implemented within one month.</p> <p>Requires executive management to correct the material misstatement in the financial report as a matter of urgency to avoid a modified audit opinion.</p>
High	<p>The issue represents:</p> <ul style="list-style-type: none"> a control weakness which could have or is having a major adverse effect on the ability to achieve process objectives and comply with relevant legislation, or a material misstatement in the financial report that is likely to occur. 	<p>Requires prompt management intervention with a detailed action plan implemented within two months.</p> <p>Requires executive management to correct the material misstatement in the financial report to avoid a modified audit opinion.</p>
Medium	<p>The issue represents:</p> <ul style="list-style-type: none"> a control weakness which could have or is having a moderate adverse effect on the ability to achieve process objectives and comply with relevant legislation, or a misstatement in the financial report that is not material and has occurred. 	<p>Requires management intervention with a detailed action plan implemented within three to six months.</p>
Low	<p>The issue represents:</p> <ul style="list-style-type: none"> a minor control weakness with minimal but reportable impact on the ability to achieve process objectives and comply with relevant legislation, or a misstatement in the financial report that is likely to occur but is not expected to be material, or an opportunity to improve an existing process or internal control. 	<p>Requires management intervention with a detailed action plan implemented within six to 12 months.</p>

Source: VAGO.

Appendix E

Financial sustainability risk indicators

Figure E1 shows the indicators used to assess the financial sustainability risks of universities in Part 4 of this report. These indicators should be considered collectively and are more useful when assessed over time as part of a trend analysis.

Our analysis of financial sustainability risk in this report reflects on the position of each university.

Figure E1
Financial sustainability risk indicators

Indicator	Formula	Description
Net result margin (%)	Net result / Total revenue	<p>A positive result indicates a surplus, and the larger the percentage, the stronger the result. A negative result indicates a deficit. Operating deficits cannot be sustained in the long term.</p> <p>The net result and total revenue are obtained from the comprehensive operating statement.</p>
Liquidity (ratio)	Current assets / Current liabilities	<p>This measures the ability to pay existing liabilities in the next 12 months.</p> <p>A ratio of one or more means there are more cash and liquid assets than short-term liabilities.</p>
Capital replacement (ratio)	Cash outflows for property, plant and equipment / Depreciation	<p>Comparison of the rate of spending on infrastructure with its depreciation. Ratios higher than 1:1 indicate that spending is faster than the depreciating rate.</p> <p>This is a long-term indicator, as capital expenditure can be deferred in the short term if there are insufficient funds available from operations, and borrowing is not an option. Cash outflows for infrastructure are taken from the cash flow statement. Depreciation is taken from the comprehensive operating statement.</p>
Internal financing (%)	Net operating cash flow / Net capital expenditure	<p>This measures the ability of an entity to finance capital works from generated cash flow.</p> <p>The higher the percentage, the greater the ability for the entity to finance capital works from their own funds.</p> <p>Net operating cash flows and net capital expenditure are obtained from the cash flow statement.</p> <p>Note: The internal financing ratio cannot be less than zero. Where a calculation has produced a negative result, this has been rounded up to 0%.</p>

Source: VAGO.

Financial sustainability risk assessment criteria

We assessed the financial sustainability risk of each university using the criteria outlined in Figure E2.

Figure E2
Financial sustainability risk indicators—risk assessment criteria

Risk	Net result margin	Liquidity	Capital replacement	Internal financing
High	Negative 10% or less Insufficient revenue is being generated to fund operations and asset renewal.	Less than 0.75 Immediate sustainability issues with insufficient current assets to cover liabilities.	Less than 1.0 Spending on capital works has not kept pace with consumption of assets.	Less than 10% Limited cash generated from operations to fund new assets and asset renewal.
Medium	Negative 10%–0% A risk of long-term run down to cash reserves and inability to fund asset renewals.	0.75–1.0 Need for caution with cash flow, as issues could arise with meeting obligations as they fall due.	1.0–1.5 May indicate spending on asset renewal is insufficient.	10–35% May not be generating sufficient cash from operations to fund new assets.
Low	More than 0% Generating surpluses consistently.	More than 1.0 No immediate issues with repaying short-term liabilities as they fall due.	More than 1.5 Low risk of insufficient spending on asset renewal.	More than 35% Generating enough cash from operations to fund new assets.

Source: VAGO.

Financial sustainability risk analysis results

The financial sustainability risk for each university and its controlled entities (each consolidated university), for each financial year ended 31 December 2013 through to 31 December 2017 are shown in Figures E3 to E10.

Figure E3
Deakin University

Year	Net result	Liquidity	Capital replacement	Internal financing
2013	8.94%	1.16	2.79	101%
2014	7.04%	1.26	1.05	215%
2015	7.16%	1.28	1.42	165%
2016	5.10%	0.93	2.04	110%
2017	9.72%	0.96	1.62	145%

Source: VAGO.

Figure E4
Federation University Australia

Year	Net result	Liquidity	Capital replacement	Internal financing
2013	1.83%	5.02	2.37	58%
2014	1.02%	2.64	0.46	369%
2015	2.33%	3.18	0.50	206%
2016	0.20%	2.78	0.48	12%
2017	-2.54%	2.36	1.26	25%

Source: VAGO.

Figure E5
La Trobe University

Year	Net result	Liquidity	Capital replacement	Internal financing
2013	7.15%	0.99	2.67	95%
2014	2.70%	1.02	1.52	159%
2015	8.85%	0.99	1.63	111%
2016	5.10%	0.78	2.30	87%
2017	3.77%	0.62	2.11	101%

Source: VAGO.

Figure E6
Monash University

Year	Net result	Liquidity	Capital replacement	Internal financing
2013	3.33%	0.45	1.53	115%
2014	10.73%	0.42	2.23	118%
2015	7.98%	0.47	3.13	86%
2016	7.81%	0.35	3.16	90%
2017	5.98%	0.40	3.47	62%

Source: VAGO.

Figure E7
RMIT University

Year	Net result	Liquidity	Capital replacement	Internal financing
2013	6.62%	0.66	1.17	195%
2014	6.78%	0.59	2.35	99%
2015	5.81%	0.59	3.35	69%
2016	7.62%	0.53	2.84	93%
2017	5.43%	0.53	2.60	69%

Source: VAGO.

Figure E8
Swinburne University of Technology

Year	Net result	Liquidity	Capital replacement	Internal financing
2013	9.61%	1.35	3.30	105%
2014	2.43%	1.27	1.25	172%
2015	2.76%	1.28	0.48	393%
2016	3.32%	0.90	0.44	545%
2017	14.06%	0.90	1.83	118%

Source: VAGO.

Figure E9
The University of Melbourne

Year	Net result	Liquidity	Capital replacement	Internal financing
2013	4.84%	0.80	1.75	119%
2014	7.59%	0.81	1.46	95%
2015	6.60%	1.10	1.41	170%
2016	7.39%	1.38	1.15	256%
2017	9.35%	1.61	1.58	320%

Source: VAGO.

Figure E10
Victoria University

Year	Net result	Liquidity	Capital replacement	Internal financing
2013	1.33%	1.36	0.88	81%
2014	-3.64%	1.27	1.47	279%
2015	-2.81%	1.26	0.74	151%
2016	-2.52%	0.68	0.82	109%
2017	-6.57%	0.71	1.30	51%

Source: VAGO.

Appendix F

Glossary

Accountability

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

Activity-based funding

Method of allocating funding based on unit prices for each activity undertaken and the volume of that activity an entity is to perform.

Adverse opinion

An audit opinion expressed if the auditor has sufficient appropriate audit evidence and concludes that misstatements, individually and in aggregate, are both material and pervasive in the financial report.

Amortisation

The systematic allocation of the depreciable amount of an intangible asset over its expected useful life.

Asset

An item or resource controlled by an entity that will be used to generate future economic benefits.

Asset valuation

The fair value of a non-current asset on a specified date.

Audit Act 1994

Victorian legislation establishing the Auditor-General's operating powers and responsibilities and detailing the nature and scope of audits that the Auditor-General may carry out.

Audit committee

Helps a governing board to fulfil its governance and oversight responsibilities and strengthen accountability of senior management.

Audit opinion

A written expression, within a specified framework, indicating the auditor's overall conclusion about a financial (or performance) report based on audit evidence.

Calendar year

A period of a year beginning with January 1 and ending with December 31.

Capital expenditure

Money an entity spends on:

- new physical assets, including buildings, infrastructure, plant and equipment
- renewing existing physical assets to extend the service potential or life of the asset.

Capital grant/capital purpose income

Government funding for an agency to acquire or build capital assets such as buildings, land or equipment.

Carrying value

The original cost of an asset, less the accumulated amount of any depreciation or amortisation, less the accumulated amount of any asset impairment.

Clear audit opinion

A positive written expression provided when the financial report has been prepared and presents fairly the transactions and balances for the reporting period in keeping with the requirements of the relevant legislation and Australian Accounting Standards—also referred to as an unqualified audit opinion.

Control environment

Processes within an entity's governance and management structure that provide reasonable assurance about the achievement of an entity's objectives in reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

Corporations Act 2001

Commonwealth legislation governing corporations, including their financial reporting framework.

Credit rating

The rating that credit rating agencies assign to the bonds of an issuer.

Current asset

An asset that will be sold or realised within 12 months of the end of the financial year being reported on, such as term deposits maturing in three months or stock items available for sale.

Current liability

A liability that will be settled within 12 months of the end of the financial year being reported on, such as payment of a creditor for services provided to the entity.

Debt

Money owed by one party to another party.

Deficit

When total expenses are more than total revenue.

Depreciated replacement cost

Current replacement cost less accumulated depreciation to reflect the economic benefits of the assets that have been consumed.

Depreciation

Systematic allocation of the value of an asset over its expected useful life, recorded as an expense.

Disclaimer of opinion

Conclusion expressed if the auditor is unable to obtain sufficient appropriate audit evidence on which to base an audit opinion, and the auditor concludes that the possible effects on the financial (or performance) report of undetected misstatements, if any, could be both material and pervasive.

Eliminations

Removing the effect of transactions between entities when preparing a consolidated financial report.

Emphasis of matter

A paragraph included in an audit opinion that refers to a matter appropriately presented or disclosed in the financial report that, in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial report.

Entity

A corporate or unincorporated body 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 deducting its liabilities.

Expense

The outflow of assets or the depletion of assets an entity controls during the financial year, including expenditure and the depreciation of physical assets. An expense can also be the incurrence of liabilities during the financial year, such as increases to a provision.

Fair value

The price that would be received if an asset was sold or the price paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Financial Management Act 1994

Victorian legislation governing public sector entities, as determined by the Minister of Finance, including their financial reporting framework.

Financial Reporting Directions

Issued by the Minister of Finance for entities reporting under the *Financial Management Act 1994*, with the aim of:

- achieving consistency and improved disclosure in financial reporting for Victorian public entities by eliminating or reducing divergence in accounting practices
- prescribing the accounting treatment and disclosure of financial transactions in circumstances where there are choices in accounting treatment, or where existing accounting procurements have no guidance or requirements.

Financial sustainability

An entity's ability to manage financial resources so it can meet its current and future spending commitments, while maintaining assets in the condition required to provide services.

Financial year

A period of 12 months for which a financial report is prepared, which may be a different period to the calendar year.

Fiscal targets

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

General purpose framework

A financial reporting framework that dictates the presentation, disclosure and treatment of items in a financial report in a manner intended to meet the needs of common users of the financial report who may not be in a position to obtain the information they need directly from the entity that prepared it. An example of a general purpose framework is the Australian Accounting Standards and Conceptual Framework issued by the Australian Accounting Standards Board.

Going concern

An entity that is expected to be able to pay its debts when they fall due, and continue in operation without any intention or necessity to liquidate or otherwise wind up its operations.

Governance

The control arrangements used to govern and monitor an entity's activities to achieve its strategic and operational goals.

Impairment (loss)

The amount by which the value of an entity's asset exceeds its recoverable value.

Income

The inflow of assets or decrease of liabilities during the financial year, including receipt of cash and the reduction of a provision.

Income approach

A valuation technique that converts future amounts, such as cash flows or income and expense, to a single current (discounted) amount. The fair value is measured as the value indicated by current market expectations about those future amounts.

Intangible asset

An identifiable non-financial asset, controlled by an entity, that cannot be physically seen, such as software licences or a patent.

Internal audit

A function of an entity's governance framework that examines and reports to management on the effectiveness of the entity's risk management, internal controls and governance processes.

Internal control

A method of directing, monitoring and measuring an entity's resources and processes to prevent and detect error and fraud.

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.

Issues

Weaknesses or other concerns in the governance structure of an entity identified during a financial audit, which are reported to the entity in a management letter.

Liability

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

Management letter

A letter the auditor writes to the governing body, the audit committee and the management of an entity outlining issues identified during the financial audit.

Material error or adjustment

An error that may result in the omission or misstatement of information, which could influence the economic decision of users taken on the basis of the financial report.

Materiality

Information is material if its omission, misstatement or non-disclosure has the potential to affect the economic decisions of users of the financial report, or the discharge of accountability by management or those charged with governance. The size, value and nature of the information and the circumstances of its omission or misstatement help in deciding how material it is.

Modified opinion

The auditor's expressed qualified opinion, adverse opinion or disclaimer of opinion.

Net result

The value that an entity has earned or lost over the stated period—usually a financial year—calculated by subtracting an entity's total expenses from the total revenue for that period.

Non-current asset

An asset that will be sold or realised later than 12 months after the end of the financial year being reported on, such as investments with a maturity date of two years or physical assets the entity holds for long-term use.

Non-current liability

A liability that will be settled later than 12 months after the end of the financial year being reported on, such as repayments on a five-year loan that are not due in the next 12 months.

Non-reciprocal transfers

Transfers in which an entity receives assets without directly giving equal value in exchange to the other party to the transfer.

Other comprehensive income

Revenues, expenses, gains and losses under Australian Accounting Standards that are excluded from net income on the income statement and are instead listed after net income.

Peppercorn lease

The right to use an asset, usually land or building is given for a very small token amount.

Physical asset

A non-financial asset that is a tangible item an entity controls, and that will be used by the entity for more than 12 months to generate profit or provide services, such as building, equipment or land.

Present value

A current estimate of the present discounted value of the future net cash flows in the normal course of business.

Qualified audit opinion

An opinion issued when the auditor concludes that an unqualified opinion cannot be expressed because of:

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

A qualified opinion is considered to be unqualified except for the effects of the matter that relates to the qualification.

Revaluation

The restatement of a value of non-current assets at a particular point in time.

Revenue

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

Risk

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

Risk register

A tool an entity uses to help identify, monitor and mitigate risks. The register may appear in the form of a plot graph or a table.

Self-funding entities

Entities that generate most of their revenue from their operations, rather than from government funding.

Specific purpose funds/specific purpose grants

Grant funding provided by the Commonwealth to the state government for a particular area or service.

Strategic plan

A document an entity provides to its staff and board to communicate its organisational goals, the actions needed to achieve those goals and other critical elements developed during the planning exercise.

Unmodified opinion

The audit opinion that the auditor expresses when concluding that the financial (or performance) report is prepared, in all material respects, in keeping with the applicable reporting framework.

Whole-of-life cost

The cost to buy or construct an asset, plus the cost of maintaining the asset over its life.

Auditor-General's reports tabled during 2017–18

Report title	Date tabled
V/Line Passenger Services (2017–18:1)	August 2017
Internal Audit Performance (2017–18:2)	August 2017
Effectively Planning for Population Growth (2017–18:3)	August 2017
Victorian Public Hospital Operating Theatre Efficiency (2017–18:4)	October 2017
Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2016–17 (2017–18:5)	November 2017
Results of 2016–17 Audits: Water Entities (2017–18:6)	November 2017
Results of 2016–17 Audits: Public Hospitals (2017–18:7)	November 2017
Results of 2016–17 Audits: Local Government (2017–18:8)	November 2017
ICT Disaster Recovery Planning (2017–18:9)	November 2017
Managing the Level Crossing Removal Program (2017–18:10)	December 2017
Improving Victoria's Air Quality (2017–18:11)	March 2018
Local Government and Economic Development (2017–18:12)	March 2018
Managing Surplus Government Land (2017–18:13)	March 2018
Protecting Victoria's Coastal Assets (2017–18:14)	March 2018
Safety and Cost Effectiveness of Private Prisons (2017–18:15)	March 2018
Fraud and Corruption Control (2017–18:16)	March 2018
Maintaining the Mental Health of Child Protection Practitioners (2017–18:17)	May 2018
Assessing Benefits from the Regional Rail Link Project (2017–18:18)	May 2018
Results of 2017 Audits: Technical and Further Education Institutes (2017–18:19)	May 2018



All reports are available for download in PDF and HTML format on our website
www.audit.vic.gov.au

Victorian Auditor-General's Office
Level 31, 35 Collins Street
Melbourne Vic 3000
AUSTRALIA

Phone +61 3 8601 7000
Email enquiries@audit.vic.gov.au