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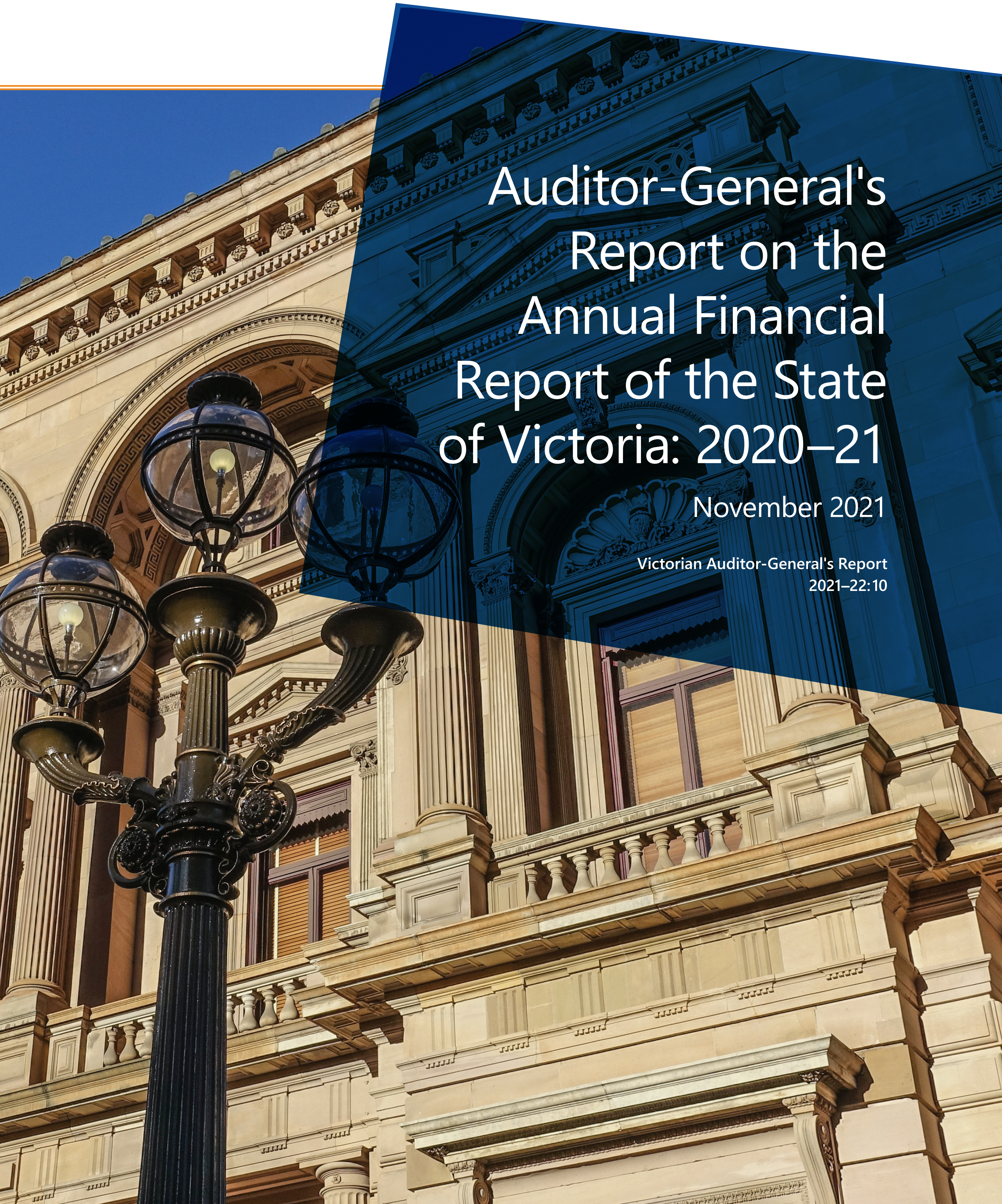
Victorian Auditor-General's Office

Auditor-General's Report on the Annual Financial Report of the State of Victoria: 2020–21

November 2021

Victorian Auditor-General's Report
2021–22:10



Auditor-General's Report on the Annual Financial Report of the State of Victoria: 2020–21

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The Hon Nazih Elasmar 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 the *Audit Act 1994*, I transmit my report *Auditor-General's Report on the Annual Financial Report of the State of Victoria: 2020–21*.

Yours faithfully

Andrew Greaves
Auditor-General
17 November 2021

The Victorian Auditor-General’s Office acknowledges Australian Aboriginal peoples as the traditional custodians of the land throughout Victoria. We pay our respect to all Aboriginal communities, their continuing culture and to Elders past, present and emerging.

Contents

Report snapshot

The *2020–21 Annual Financial Report of the State of Victoria* is free from material error, and we issued an unmodified audit opinion on it.

Key audit matters

We qualified the financial statements of Victorian Rail Track (VicTrack), which is a significant controlled entity of the state.

We identified serious weaknesses in asset accounting at VicTrack that reduce the reliability of its reported results.

We continue to find significant weaknesses in information technology (IT) controls, which departments and agencies need to resolve. Several prior year IT issues remain unresolved.

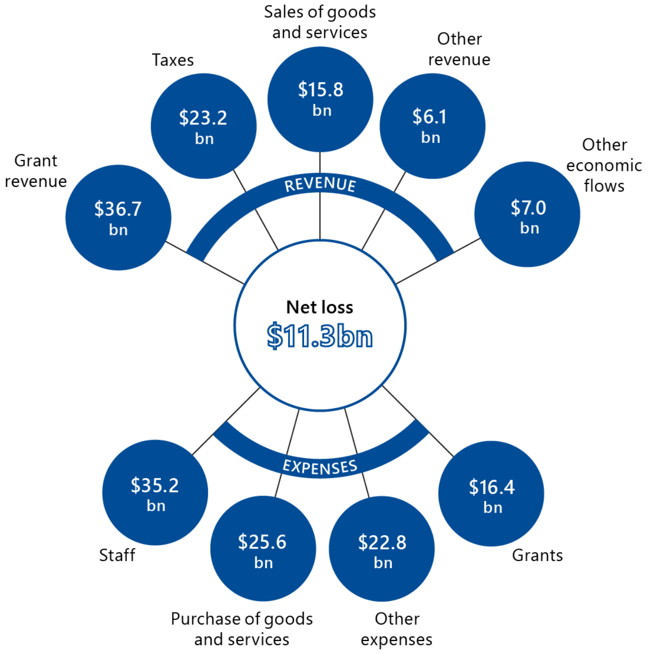
Financial performance

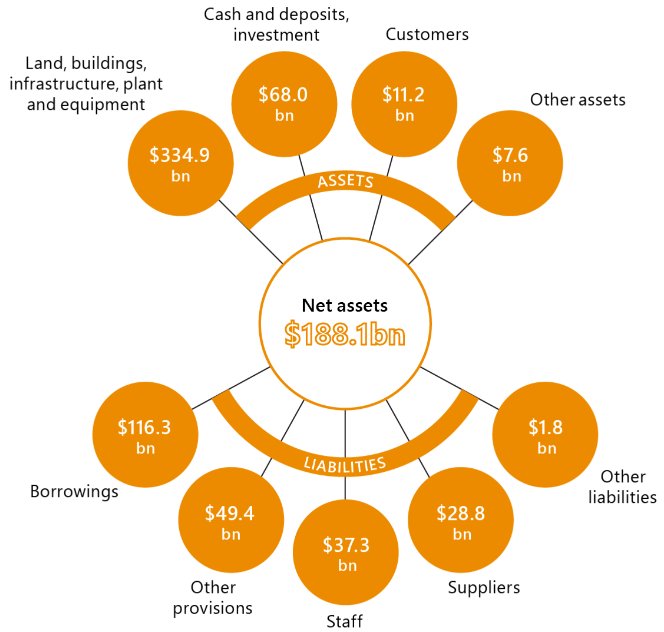
The COVID-19 pandemic continues to affect the financial performance and position of the state, with longer term consequences for its financial sustainability.

The underlying issues with the growth in employee and other costs that existed before the pandemic, remain.

The full impact the COVID-19 pandemic has had on revenue and expenditure is not clear. Achieving previously announced savings measures and understanding the full cost of the pandemic under COVID-normal conditions, is critical to future performance.

Key numbers for the State of Victoria for the year ended, and as at, 30 June 2021





What we found and recommend

We consulted with the agencies named in this report and considered their views when reaching our conclusions. The agencies' full responses are in Appendix A.

Results of our audit of the *2020–21 Annual Financial Report of the State of Victoria* and material entities

The *2020–21 Annual Financial Report of the State of Victoria* (AFR) is reliable, but we issued an adverse opinion to VicTrack.

VicTrack concluded that the lease arrangement it has with the Department of Transport (DoT), for operational transport assets, is an operating lease. Consequently, it reported the leased assets, and all associated transactions and balances, in its financial report.

We concluded it is a finance lease based on the respective roles and responsibilities of all parties in the transport network. In substance, DoT is responsible for the operation of the transport network as a whole, including its assets. This means that VicTrack should not have reported leased assets and all associated transactions and balances. Instead, VicTrack should have reported a nominal finance lease receivable. The effect of this incorrect accounting is material and pervasive to VicTrack's financial report.

DoT correctly accounted for the arrangement and recorded right-of-use assets, and the Department of Treasury and Finance (DTF) made an adjustment on consolidation in the AFR to correct the inconsistent accounting treatment between DoT and VicTrack.

We identified other material errors in VicTrack's financial report, which its management did not correct. DTF also corrected these on consolidation in the AFR.

Understanding financial performance

The impact of COVID-19

Last year, in response to the COVID-19 pandemic, the government's revenue and expenditure policies shifted significantly when compared to past reporting periods and budget forecasts.

This shift continued in 2020–21 as the government managed its response to the worsening circumstances of the pandemic. Revenue remained at levels below, and expenditure well above, pre-pandemic expectations, while debt grew. The general government sector (GGS) was the most impacted, with a few notable exceptions.

The GGS had a net operating deficit of $14.6 billion this year (compared with a $6.5 billion deficit in 2019–20). We identified $11.7 billion of net costs that could be attributed to the COVID-19 response. We arrived at this figure after reviewing information on DTF's website and intelligence we gathered as part of our audit. COVID-19 also indirectly affected GGS revenue and expenditure, as we explain in Section 2.3. DTF cannot reliably determine what part of the remaining $2.9 billion operating deficit is attributable to the pandemic.

GGS borrowings increased by $30.2 billion during the year. The government used the increased borrowings to fund infrastructure investment, but it also required debt to finance the GGS operating cash deficit of $13.0 billion.

Before COVID-19, borrowings as a proportion of revenue were around or below 60 per cent. Currently sitting at 128 per cent, this measure of the government's ability to service its debt is now well above parity. The government estimates gross debt will exceed 200 per cent of consolidated revenue by 2024–25. This is over three times more than pre-pandemic levels.

Emerging financial risks

We have identified the following emerging financial risks that the government will need to closely monitor and manage:

- operating expenditure growth in the GGS
- insurance claims liabilities in the WorkCover scheme
- increasing cost of capital works.

Operating expenditure growth in the GGS

The government has identified $4.3 billion in cost savings that departments will need to achieve over the next four financial years. In comparison, we identified $2.9 billion of this year's operating deficit that was not clearly identifiable as the short-term, temporary costs incurred in response to the COVID-19 pandemic. This shortfall increases the risk that underlying revenue and expenditure policy settings are not financially sustainable over the medium to long term.

Without structural reform, achieving the targeted reductions and maintaining current service levels will be difficult, since over one-third of the state's operating expenses are on employees, and these costs are generally subject to annual increases included in enterprise bargaining agreements.

Outstanding insurance claims liabilities

Three of the six public financial corporations (PFC) are insurers—Victorian WorkCover Authority (WorkSafe), the Transport Accident Commission (TAC) and the Victorian Managed Insurance Authority (VMIA).

Outstanding insurance claims liabilities at these entities increased by $3.2 billion, or 7.2 per cent, during the year. At 30 June 2021, these liabilities totalled $47.3 billion. The performance of WorkSafe is the primary reason for the increase.

Last year we noted a significant increase in the number of injured workers accessing weekly benefits. The time they spent on the scheme had also increased. This trend has continued.

In 2020–21, an independent review of the financial sustainability of the scheme concluded that its financial trajectory is unsustainable. WorkSafe is developing initiatives aimed at addressing these pressures and managing long-term financial sustainability.

To minimise the impact on businesses and provide time to explore options before approving premium increases, the government provided WorkSafe with $550 million in 2020–21 to sustain its financial position over the short term. The payment was recorded as a grant expense by the GGS, and grant revenue in the PFC sector.

Increasing cost of capital works

The state added $20.2 billion of newly built or acquired assets to its balance sheet in 2020–21—$15.6 billion of that was added to the GGS.

The significant pipeline of assets under construction presents risks to future outlays from price movements in materials and labour, and from any unexpected delays or contractual disputes.

In our *Major Projects Performance* report (September 2021), we found the total estimated investment of almost two-thirds of the reviewed projects ($99.3 billion) had changed compared to their first public budget. The net impact of these changes was an increase in costs of $4.9 billion or 4.9 per cent.

Internal control weaknesses

We found serious deficiencies in the design and operating effectiveness of internal controls at some material entities.

Accounting for fixed assets at VicTrack and inadequate asset records

We again found significant shortcomings in asset accounting at VicTrack which are material to its financial performance and position. This included:

- an inability to identify individual assets in the VicTrack asset register
- delays in the recognition of assets, which means that depreciation was not charged from when the asset was available for use
- insufficient assessment of spending against the asset recognition criteria under AASB 116 *Property, Plant and Equipment*
- inadequate review of work-in-progress, resulting in stale work-in-progress amounts and asset write-offs
- asset disposals and replacements not being identified in the VicTrack asset register.

VicTrack and DoT continue to work to address the issues. However, we cannot yet conclude that the asset register at VicTrack is complete and accurate. We were unable to verify $8.2 billion of the $39.1 billion in transport assets on the register.

DoT plan to implement an asset collection and attribution framework in 2021–22. They intend for this to address the systemic issues underlying proper and timely asset recording in the transport sector. VicTrack also plans to continue its work to resolve the issues that existed at 30 June 2021.

Reporting of administered fines and fees receivables at the Department of Justice and Community Safety

Last year we identified an error in the calculation of, and accounting treatment for, the loss allowance for unpaid fines and fees. This resulted in an overstatement of $1.4 billion to the receivables balance reported at 30 June 2020. This year we again identified issues with the calculation of the loss allowance, including:

- incorrect cash collection rates applied when estimating the loss allowance
- incorrect adjustments made to the loss allowance for bad debts written off in the past
- future economic and other assumptions, such as unemployment rates and the effect of the COVID-19 pandemic on the collectability of fees and fines at 30 June 2021, not accurately incorporated in the loss estimate modelling.

This resulted in the receivables balance being understated by $166.1 million at 30 June 2021, which required correcting.

Establishing internal controls supporting the government's response to the COVID-19 pandemic

The critical nature of the government's response to the COVID-19 pandemic made it necessary for it to establish new processes in a short time frame. These were intended to contain the spread of the virus and provide financial support for Victorian individuals and businesses.

The design and implementation of an effective system of internal controls was given less priority during this period. Consequently, we concluded that controls to support complete and accurate financial reporting were not adequate at the Department of Jobs, Precincts and Regions (DJPR) and the Department of Justice and Community Safety (DJCS). We identified:

- deficiencies in controls that support the validity and accuracy of $3.4 billion in grants paid to support Victorian individuals and businesses affected by the COVID-19 pandemic
- deficiencies in manual and IT controls that support the completeness and accuracy of employee expenses and revenue at COVID-19 Quarantine Victoria (CQV), which is an administrative office of DJCS.

An **administrative office** is established and abolished through orders under section 11 of the Public Administration Act. Each office is established in relation to a department.

We could not rely on the controls as part of our financial audit and had to perform alternate procedures to gain comfort that reported transactions and balances were materially correct.

Information systems controls

We again found weakness in IT controls in the financial systems agencies use to transact and report.

Effective IT controls reduce the risk of unauthorised access and changes to systems and help protect the underlying integrity of data. They are a prerequisite for the smooth day-to-day operation of entities and reliable financial reporting.

We are particularly concerned that we continue to identify similar deficiencies in logical access, change management and monitoring controls. Further, several deficiencies we identified in prior periods remain unresolved.

Recommendations about internal controls and financial reporting

We recommend that:			Response
Department of Justice and Community Safety	1.	report gross and net administered fines and fees receivables, and the expected credit loss provision associated with those receivables, in its financial report.	**Accepted.**
All departments and relevant agencies	2.	make sure additional disaggregated information, by way of notes to the financial statements, is provided for all material administered items, as required in DTF's model report for Victorian departments.	**Noted by the Treasurer of Victoria on behalf of the sector and accepted as they specifically relate to the Department of Treasury and Finance.**
All departments and agencies transitioning to cloud-based systems	3.	ensure controls that are suitably designed, and tailored for business needs, work effectively in the new system before migrating data and transitioning to them.	
All departments and agencies	4.	prioritise the resolution of IT control deficiencies that: • pose a risk to complete and accurate financial reporting, or the ability to achieve process objectives and comply with relevant legislation; or • remain unresolved from prior reporting periods.	

1. Results of audits

Conclusion

Our unmodified opinion provides reasonable assurance that the financial performance and position of the state of Victoria, and within that the general government sector, as reported in the 2020–21 AFR, is reliable.

The separate financial statements of 24 of the 26 material entities (entities that contribute most to the consolidated financial results in the AFR) are also reliable. We identified material errors in the financial statements of VicTrack, but they were corrected on consolidation into the AFR.

At the time we prepared this report, we were yet to provide our opinion to the Victorian Commission for Gambling and Liquor Regulation.

This chapter covers:

- Our audit opinions
- The quality of financial reports
- The timeliness of financial reports

1.1 **Audit opinions**

Each year we audit and provide opinions on the financial statements of the 274 state-controlled entities consolidated into the AFR. We also audit and provide an opinion on the AFR.

We have included more information about this report, our financial audits and the entities included and not included in the AFR in Appendix B.

The AFR

We provided a clear audit opinion on the 2020–21 AFR. A clear audit opinion adds credibility to the AFR providing reasonable assurance that the reported information is reliable and accurate and complies with the requirements of relevant Australian accounting standards and applicable legislation.

The key audit matters (KAMs) highlighted in our audit opinion address our approach to auditing the:

- significant COVID-19 grant programs
- recognition and measurement of transport assets
- recognition and measurement of service concession assets and liabilities
- valuation of the defined benefit superannuation liability
- valuation of the provision for insurance claims.

Key audit matters are determined by the auditor as the matters of most significance to the audit and are included in the auditor's report to provide transparency and insights about the audit process.

Appendix C contains a copy of the audit report that is included in the AFR and tabled in Parliament.

Material entities

In 2020–21, 26 entities accounted for most of the state's assets, liabilities, revenue and expenditure. We focused on the financial transactions and balances of these 'material' entities when forming our opinion on the AFR. Appendix D lists these entities and the results of our audits of them.

We provided clear opinions on 24 of the 26 material entities' financial reports. We also:

- provided an adverse opinion to VicTrack
- have not yet provided an opinion to the Victorian Commission for Gambling and Liquor Regulation (VCGLR).

VicTrack

We issued an adverse opinion on the financial statements of VicTrack again this year. This is because it continues to incorrectly account for the assets it leases to DoT. The effect of this incorrect accounting is material and pervasive to VicTrack's financial report.

We concluded the arrangement between VicTrack and DoT is a finance lease based on the respective roles and responsibilities of all parties in the transport network. In substance, DoT is responsible for the operation of the transport network as a whole. In this regard, DoT:

- directs the use of these assets by setting the timetables and operating conditions for all modes of transport with no significant input from VicTrack
- substantially has the risks and rewards of ownership of the operational transport assets.

VicTrack maintained its accounting position from 2019–20. It concluded the arrangement is an operating lease because it believes it has significantly all the risks and rewards incidental to ownership of the operational transport assets.

FIGURE 1A: **Accounting for lease arrangements for operational transport assets**

Background

VicTrack is the legal custodian of the state's transport-related assets. It reported total property, infrastructure, plant and equipment assets of $39.1 billion at 30 June 2021. These assets include operational transport assets, such as land, stations, tracks, rolling stock and signalling systems, that are collectively used to operate the state's transport network.

VicTrack leases all operational transport assets to DoT, which in turn provides operators of the train, tram and regional transport networks access to them. The lease between VicTrack and DoT is significantly below market terms and conditions, with only nominal amounts paid to VicTrack.

Adopted accounting treatment

	VicTrack	*DoT*	*AFR*
Opinion type	**Adverse**	**Unmodified**	**Unmodified**
Adopted accounting treatment	Incorrectly recorded the arrangement as an operating lease under AASB 16 *Leases* because it believes it is exposed to substantially all the risks and receives the rewards from ownership of the assets.	Correctly recorded right-of-use assets under AASB 16. DoT disclosed in its financial report that it has the right to direct the use of the leased assets and obtains substantially all the economic benefits from their use.	A central adjustment was made on consolidation in the AFR to correct the inconsistent accounting treatment between DoT (a GGS entity) and VicTrack (a public non-financial corporation).

	VicTrack	*DoT*	*AFR*
Opinion type	**Adverse**	**Unmodified**	**Unmodified**
Impact	Leased assets and all associated transactions and balances should not have been reported in VicTrack's financial report. Instead, VicTrack should have reported a nominal finance lease receivable.	DoT availed itself of temporary relief provided by the Australian accounting standards to record leases with significantly below-market terms and conditions at cost for 30 June 2021. This meant that for 2020–21, the assets and associated depreciation expenses were not reflected in the GGS. [a]	The fair value of the underlying assets and all associated transactions and balances were correctly reinstated at the state of Victoria level.

Note: [a] The Australian Accounting Standards Board has added a narrow-scope project to its work program to consider accounting for right-of-use assets under concessionary leases by not-for-profit entities. If the temporary relief from fair valuing these assets is removed, it is expected that these amounts will be fully reflected in DoT and the GGS financial reports. This will adversely affect their net result from transactions because the depreciation expenses from the assets will also need to be recognised.

Source: VAGO.

Victorian Commission for Gambling and Liquor Regulation

VCGLR collects casino and gambling tax on behalf of the state and reports the associated transactions and balances in the notes to its financial report. At the time we prepared this report, the financial statements of VCGLR had not been finalised, and the financial audit was not complete.

In February 2021, the Victorian Government established a Royal Commission to inquire, report and make recommendations on the suitability of Crown Melbourne Limited (Crown) to hold a casino licence. One finding from the Royal Commission was that when Crown was calculating amounts payable to VCGLR, it may have incorrectly deducted certain complementary benefits comprising dining, hotel and parking given to patrons, and therefore underpaid casino tax.

On 27 July 2021, Crown notified VCGLR that it had completed a review of potential casino tax underpayments and advised that deducting complementary benefits was not correct. It made a payment of $62 million to the state, representing an underpayment of casino tax of approximately $37 million, which had accumulated since 2012, and penalty interest. This amount was reported as revenue by VCGLR (a GGS entity) in 2020–21. VCGLR is currently deciding if it has sufficient information to be able to confirm $62 million is the correct amount, which we will then audit. This did not impact our ability to issue an opinion on the AFR because we concluded that the risk of a material misstatement in the AFR was low.

As reported in Note 2.1 of the AFR, Counsel assisting the Royal Commission has also alleged that Crown is likely to be liable for matchplay amounts that have been deducted when calculating tax payable. The state proposes to engage with Crown after the delivery of the Royal Commission's final report. For any shortfall in casino taxes identified from this process, the state will seek to secure any required payment along with penalty interest. The state did not recognise any further amounts in the 2020–21 AFR, because the Royal Commission had not delivered its final report at the time the Treasurer and DTF authorised it.

1.2 Quality of financial reports

The nature, frequency and size of errors in financial reports are direct measures of the quality of financial reports submitted for auditing. Entities must correct material errors before we can issue a clear audit opinion.

Quality financial reports reliably represent an entity's financial performance and position.

We identified material errors that required correcting at five material entities. This is an improvement from last year when material errors were identified at nine material entities.

VicTrack's unadjusted material errors

An **adjustment** is a change made to the financial statements to resolve errors or to avoid double counting in the financial statements (when there are intra-entity transactions, for example).

In addition to the leasing matter above, we identified three material errors in VicTrack's financial report that management did not correct. Figure 1B explains those errors. Had we not qualified VicTrack's financial report for the leasing matter, we would have qualified for these errors if they remained uncorrected.

DTF adjusted these errors in the AFR because it agreed that VicTrack's accounting treatment was incorrect. This allowed a clear audit opinion to be issued on the AFR.

FIGURE 1B: **Unadjusted material errors in VicTrack's financial report**

Statements affected	Impact of error	Reason for error
Comprehensive operating statement	Net gain/(loss) on non-financial assets is overstated, and other operating expenses is understated, by $715.1 million.	Maintenance costs that had been incorrectly capitalised were written-off through other economic flows included in the net result. They should have been recorded as an operating expense through the net result from transactions.
Comprehensive operating statement and statement of changes in equity	Changes in physical asset revaluation surplus (comprehensive operating statement), asset revaluation reserve (statement of changes in equity) and other operating expenses are understated by $377.0 million.	Maintenance and other costs that had been incorrectly capitalised were adjusted through other economic flows included in the net result. They should have been recorded as an operating expense through the net result from transactions.
Comprehensive operating statement and balance sheet	Other gains/(losses) from other economic flows is understated, and net deferred tax liability is understated, by $1.1 billion.	Management did not provide sufficient evidence to demonstrate the probability future tax profits will be achieved at VicTrack. Consequently, $1.1 billion in deferred tax losses should not have been carried forward.

Source: VAGO.

Adjusted material errors

We identified material errors at four material entities that management corrected, which enabled us to provide clear audit opinions to those entities. Figure 1C explains those errors.

FIGURE 1C: **Adjusted material errors in draft financial reports**

Entity	Statements/ notes affected	Impact of error	Reason for error
DOT	Disclosure—Commitments for expenditure	$1.0 billion increase in Service Concession Arrangement commitments.	The liability for the high-capacity metro trains project was not disclosed in the commitments for expenditure note. This was inconsistent with all other Service Concession Arrangement commitments disclosures.
DOT	Cash flow statement	$2.4 billion increase in operating cash receipts and operating cash payments.	The cash receipts and payments relating to third party motor vehicle insurance collected by the department, and then paid to the Transport Accident Commission, were not disclosed in the cash flow statement. This occurred after VicRoads transferred to the department where disclosure previously occurred.
DJCS	Disclosure—Administered items	$166.1 million decrease in the loss on statutory receivables (administered operating statement) and corresponding increase in receivables (administered balance sheet).	When the department estimated the expected credit loss relating to administered fines and fees receivables, it did not correctly apply cash collection rates, bad debts written off and forward-looking information.
DH	Disclosure—Maturity analysis of borrowings	$1.1 billion decrease in nominal value	The department incorrectly included the total nominal commitment value for the New Footscray Hospital in its borrowings' disclosure, instead of the nominal value of borrowings to date.
DH	Disclosure—Uncommissioned public private partnership (PPP) commitments	$1.6 billion increase in commitments (including GST)	The department did not disclose the full uncommissioned commitment to fund the New Footscray Hospital PPP as it was initially included in borrowings.
DELWP	Comprehensive operating statement	$200 million decrease in grants and other transfers expense and corresponding increase in the initial recognition expense from financial instruments. This did not affect the net result from transactions.	The department misclassified the initial recognition of a financial liability as a grant expense.
DELWP	Cash flow statement	$292 million decrease in operating cash receipts and operating cash payments.	A mapping error at the department resulted in a non-cash movement being included in cash transactions.

Source: VAGO.

1.3 Timeliness of financial reports

The dates by which material entities and DTF entities must complete tasks are prescribed in the *Financial Management Act 1994* and the *Audit Act 1994*. DTF also sets dates that material entities must follow. Figure 1D shows the dates for this year.

FIGURE 1D: **2020–21 annual reporting requirements for material entities and DTF**

2021

Date set by
DTF
Financial Management Act 1994
Audit Act 1994

Material entity dates

27 July
Material entities provide trial balances to DTF

10 August
Material entities provide requested note disclosure information to DTF

25 August
Material entities must provide financial statements to the Auditor-General

2 September
Material entities provide certified financial statements and audit opinions to DTF

22 September (or four weeks following receipt)
Final date for the Auditor-General's opinion on material entity's financial statements

31 October (or the first sitting day after the end of that month)
Material entitites' auditied financial reports are transmitted to Parliament

AFR dates

20 September (or before)
The Treasurer provides a copy of the AFR to the Auditor-General

4 October (must be reasonable time before the AFR is required to be transmitted to Parliament)
Final date for the Auditor-General's opinion on the AFR

15 October
Audited AFR is transmitted to Parliament

27 October (minimum 10-day comment period)
The Auditor-General gives a copy of his proposed report (this report) to the Treasurer for comments

11 November
The Treasurer provides comments to the Auditor-General on his proposed report

24 November
The Auditor-General transmits his report on the AFR to Parliament

Source: VAGO.

DTF and VAGO rely on the timely provision of complete and accurate financial information from material entities to meet their legislative timelines. Delays impact the timeliness of our audit opinions and the preparation and tabling in Parliament of the material entity financial reports and the AFR. With the impact of the COVID-19 pandemic in mind, DTF and VAGO worked with entities and remained agile to meet reporting timelines.

The *Financial Management Act 1994* requires entities to provide certified financial statements to VAGO within eight weeks of balance date (30 June), which is 25 August.

The *Audit Act 1994* requires us to provide the entity with an audit opinion within four weeks of receiving their certified financial statements. That means we should provide audit opinions by 22 September. To meet this date, the year-end audit program at material entities begins in mid-July.

The COVID-19 pandemic affected the preparation and production of financial reports in the public sector again this year. Consistent with 2019–20, DTF and VAGO continued to adopt a staggered approach to the year-end financial reporting program this year in response to the challenges of the pandemic. This approach prioritised the preparation and audit of material entity financial reports and the AFR. We jointly acknowledged that during times of crisis, transparency and accountability of significant government expenditure is critical, hence the need to focus on these financial reports.

In 2020–21, seven material entities provided certified financial statements, and a further 14 provided draft financial statements, by 25 August. We were able to provide 18 of the 26 material entities with an audit opinion by 22 September, and a further six before we provided the Treasurer our audit opinion on the AFR. The financial statements of DJCS and VCGLR had not been finalised, and the financial audits were not complete, by that date. This did not impact our ability to issue our audit opinion on the AFR because we had finalised our audit of the transactions and balances at those entities that were significant to the AFR. Further, no issues were identified that would have a material impact on the AFR.

Despite the additional time pressures resulting from delays at material entities, the AFR was finalised on 4 October, and we provided our audit opinion on 6 October.

Adopting the staggered approach to year-end meant that the audits of the non-material entities, which are also consolidated in the AFR, occurred much later than in the past, with some still occurring at the date of this report.

2.
Financial performance and position

Conclusion

The financial performance and position of the state deteriorated significantly in 2020–21.

This year the state made an operating loss of $18.3 billion (compared to $9.0 billion in 2019–20) and had net operating cash outflows of $9.3 billion ($375 million net inflows in 2019–20). This was largely a result of increased costs incurred by the GGS responding to the COVID-19 pandemic.

Net debt increased by $20.1 billion in 2020–21, which is largely attributable to an increase in the GGS of $28.4 billion. The state borrowed to fund the operating cash deficit and its infrastructure program. Net debt is expected to increase by a further $98.2 billion ($83.6 billion in the GGS) by 30 June 2025.

This chapter covers:

- Current year results
- Our GGS analysis
- Financial risks

2.1 Interpreting current year results

Last year, in response to the COVID-19 pandemic, the government's revenue and expenditure policies shifted significantly when compared to past reporting periods and its expectations in the 2019–20 Budget.

This shift continued in 2020–21 as the government managed its response to the worsening circumstances of the pandemic through increased services and economic support measures. Revenue remained at levels below, and expenditure well above, pre-pandemic expectations. As a result, the state reported a larger operating loss compared to last year and borrowings continued to increase.

The 2020–21 Budget forecasts reflected the government's perceived risks and expectations in responding to the pandemic and economic impact. However, given the unforeseeable operating and economic environment at the time the Budget was prepared, the forecasts were subject to a higher degree of estimation uncertainty.

In this context, we have analysed financial outcomes against the prior year and, where appropriate, the 2020–21 Budget and future forecasts to highlight the financial performance of the GGS throughout the pandemic. We explain the magnitude of changes in key financial measures and the underlying reasons for these changes, distinguishing between those attributable to the COVID-19 pandemic and those that are not.

Key financial measures are metrics used to analyse the financial performance and position of the GGS.

Movements between years in the GGS results explain most of the movements in the state's consolidated results, with some notable exceptions. Our analysis focusses on the GGS.

2.2 GGS financial measures and targets

The state Budget sets out the government's long-term financial management objectives for the GGS, and the key financial measures and targets to achieve them.

The measures and targets were amended in 2020–21 to reflect the current economic and fiscal environment, and the government's focus on economic recovery and longer term financial management post pandemic. The targets are now incremental rather than absolute to allow for greater flexibility in times of economic and fiscal uncertainty. Except for one; fully funding the unfunded superannuation liability by 2035.

Figure 2A summarises the key financial measures for the GGS, the targets set by the government in the 2020–21 Budget, and the actual outcomes for 2020–21.

FIGURE 2A: **GGS key financial measures, targets, and results, 2020–21**

Financial measure	Target	2020–21 budget	2020–21 actual
Net debt to gross state product (GSP) [(a)]	General government net debt as a percentage of GSP to stabilise in the medium term.	19.5 per cent	15.6 per cent
Interest expense to revenue	General government interest expense as a percentage of revenue to stabilise in the medium term.	4.2 per cent	3.6 per cent
Superannuation liabilities (contribution to the State Superannuation Fund)	Fully fund the unfunded superannuation liability by 2035.	$1.1 billion	$1.1 billion
Operating cash surplus [(b)]	A net operating cash surplus consistent with maintaining general government net debt at a sustainable level after the economy has recovered from the COVID-19 pandemic.	$21.8 billion net operating cash deficit	$13.0 billion net operating cash deficit

Notes: [(a)] Net debt represents gross debt less liquid financial assets. It is the sum of deposits held, advances received, government securities, loans and other borrowings—less the sum of cash and deposits, advances paid, investments, loans and placements.

[(b)] This is represented by the net cash flows from operating activities as disclosed in the consolidated cash flow statement.

Source: VAGO.

Actual results are better than expected, reflecting a stronger than expected economic recovery. This resulted in:

- higher than expected revenue and operating cash inflows, and consequently, lower borrowing requirements
- higher expected GSP than initially forecast due to higher consumer spending and strong employment growth in Victoria.

The government also sets short-term sustainability objectives for the budget and forward estimate period. In 2021–22, the objectives are:

- the operating deficit will reduce over the budget and forward estimates
- an operating cash surplus will be achieved before the end of the forward estimates.

The government expects to meet these objectives if economic recovery continues as, or better than, initially forecast. Any future extended public health restrictions, such as the one Victoria experienced in early 2021–22, will have financial consequences and may affect their achievement.

2.3 GGS net operating result

The net operating result, or net result from transactions, is a key measure of GGS financial performance and operating sustainability. The GGS reported a net loss from transactions of $14.6 billion this year, a deterioration of $8.0 billion compared to last year.

Net operating result is revenue from transactions minus expenses from transactions. It is the part of the change in net worth that can directly be attributed to government policies.

GGS operating revenue increased by $4.8 billion from $67.9 billion in 2019–20 to $72.7 billion this year. However, operating expenses increased by $12.7 billion from $74.5 billion in 2019–20 to $87.2 billion this year leading to a higher net loss.

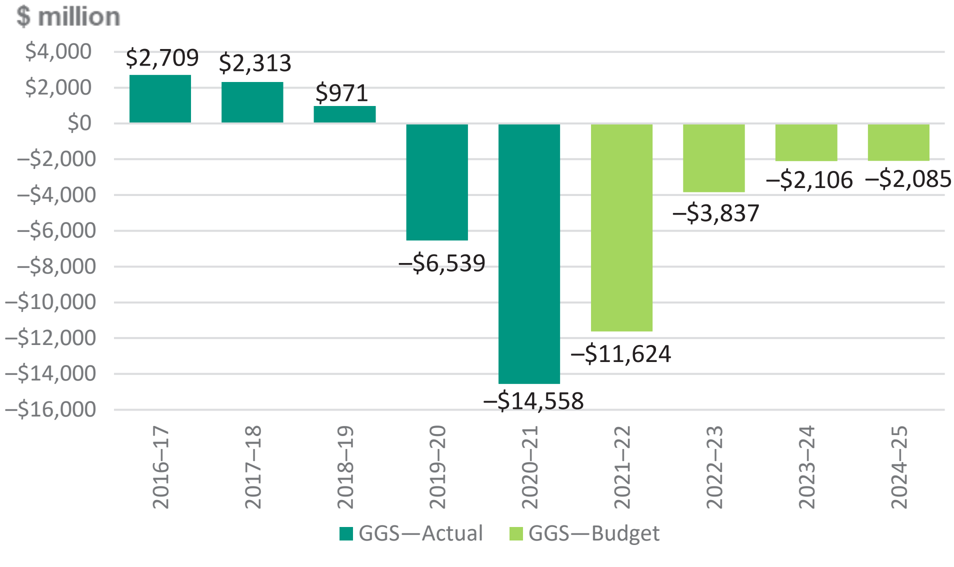
The increase in revenue was driven by $4.2 billion additional grants received in 2020–21. The grants include:

- greater GST grant revenue from the Australian Government of $2.7 billion resulting from stronger than expected economic recovery due to greater public consumption and dwelling investment across Australia
- an increase in Australian Government grants relating to the National Partnership on HomeBuilder, the National Health Reform Agreement, the COVID-19 Response National Partnership Agreement and capital grants for various road projects.

The increase in expenditure was driven mainly by grants ($6.8 billion), employees ($2.8 billion), and other operating expenses ($2.3 billion). In Chapter 2 of the AFR, the government attributes the increase in total expenses mainly to increased service delivery and additional resources in response to the COVID 19 pandemic.

Figure 2B shows that the GGS net operating result has declined over the past five financial years, most sharply in 2019–20 and 2020–21, reflecting the financial impact of the COVID-19 pandemic.

FIGURE 2B: **GGS net operating result**



Source: VAGO.

Over the past five years the growth in operating expenditure, especially in employee costs, has continued to outpace the growth in revenue year on year.

Employee costs are the largest GGS operating expense. In 2020–21, the GGS incurred $30.0 billion ($27.2 billion in 2019−20) in employee expenses, which was 34.5 per cent of its total operating expenses for the year (36.5 per cent in 2019−20).

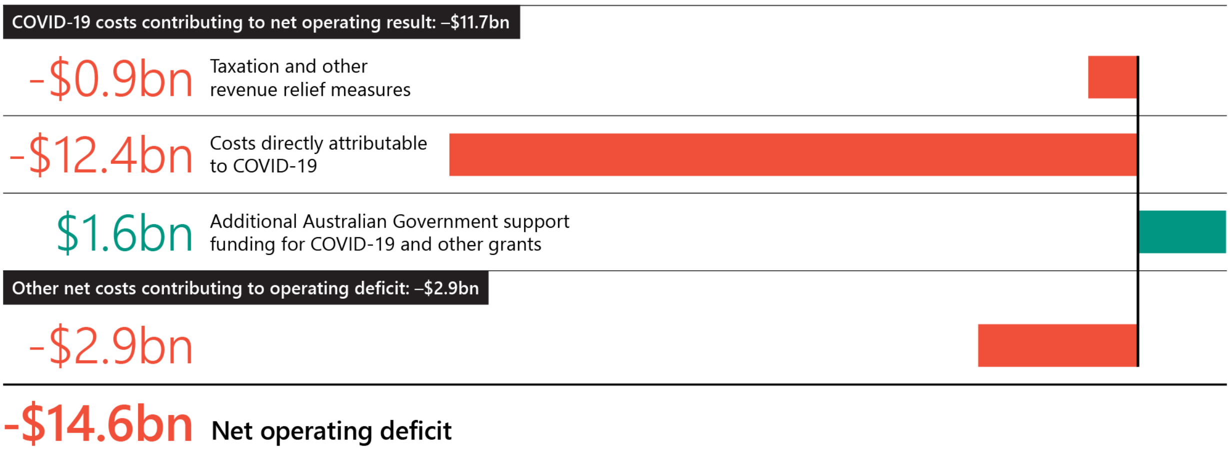
Annual increases in the Victorian public sector FTE workforce, and year-on-year wages growth, have caused the significant increases in these costs. Since 2015–16, they have increased by $10.0 billion, an average annual increase of 8.5 per cent. Continued growth in employee expenses will put pressure on the state's operating result since, once in place, these expenses are difficult to reduce without reducing either the level or standard of services.

The government estimates that GGS employee costs will increase by a further 5.6 per cent in 2021–22 and then, on average, 2.6 per cent a year over the three subsequent years.

The government forecast the operating deficit to reduce over the next four financial years as the gap between revenue and expenditure decreases. Over that period, revenue is expected to grow by an average of 4.1 per cent, and expenditure is expected to decrease over the next two financial years, before returning to 2020–21 levels by 2024–25. If this is to be achieved it will be necessary to manage growth in employee and other costs, and to realise the savings measures planned and announced before the COVID-19 pandemic. This in turn will require the government to understand and isolate the impact of the pandemic on its revenue and expenditure profiles as we return to COVID-normal.

From information disclosed on DTF's website and gathered as part of our financial audit of the AFR, we were able to identify $11.7 billion of net costs attributable to the COVID-19 pandemic that contributed to the net operating deficit. The COVID-19 pandemic also indirectly affected GGS revenue and expenditure, as explained below. DTF cannot reliably determine what part of the remaining $2.9 billion operating deficit is attributable to the pandemic.

FIGURE 2C: **COVID-19 net costs contributing to operating deficit**



Source: VAGO.

Impact of the COVID-19 pandemic on GGS operating results

Since the COVID-19 pandemic began, the government has incurred additional costs from:

- supporting jobs and businesses
- delivering its frontline health response
- addressing the impact on the Victorian education and transport sectors
- providing additional social support.

The government has also supported individuals and businesses through taxation and other revenue relief measures.

Distinguishing changes to financial performance and position that are one-off and temporary, such as the impact of the COVID-19 pandemic, from those that will lead to a more permanent shift in inflows and outflows is important. Last year, we recommended that DTF prepare and publish a separate statement identifying the COVID-19 pandemic direct costs. All departments now track direct COVID-19 related initiative spending and report it to DTF, and DTF publishes this information on its website.

The COVID-19 disclosures on the DTF website provide greater transparency and increase accountability by separating changes to the state's financial performance and position from previous and new policy settings. The COVID-19 disclosures enable a reader of this year's AFR to determine the portion of the net deficit that is attributable to COVID-19, and the remainder, which is not.

The data on the DTF website shows that departments incurred $13.3 billion net costs—both increased expenses and reduced revenue resulting from taxation and other revenue relief—on COVID-19 initiatives in 2020–21 ($4.4 billion in 2019–20). Most of the spending was on the front-line health response and business support packages.

Figure 2D shows costs incurred by each department on COVID-19 initiatives as a proportion of total portfolio operating expenditure.

FIGURE 2D: **Departmental COVID-19 costs as a proportion of total portfolio operating expenditure**

	2020–21			2019–20		
Portfolio	**COVID-19 $ million**	**Total $ million**	**%**	**COVID-19 $ million**	**Total $ million**	**%**
Jobs, Precincts and Regions	4 531.4	7 930.0	57.1	1 147.9	3 524.0	32.6
Health and Human Services[(a)]	4 273.9	34 128.0	12.5	1 836.8	29 508.0	6.2
Education and Training	1 071.1	20 456.0	5.2	296.8	19 491.0	1.5
Treasury and Finance[(b)]	1 063.6	9 088.0	11.7	782.9	8 415.0	9.3
Justice and Community Safety	1 019.2	10 799.0	9.4	48.1	8 846.0	0.5
Transport	872.4	10 345.0	8.4	234.7	9 479.0	2.5
Environment, Land, Water and Planning	279.7	3 866.0	7.2	16.1	4 067.0	0.4
Premier and Cabinet	106.6	929.0	11.5	24.5	898.0	2.7
Courts	39.4	756.0	5.2	2.1	714.0	0.3
Regulatory bodies and other partly funded agencies	0	2 997.0	0	0	2 867.0	0
Parliament	0	308.00	0	0	227.0	0
Eliminations and adjustments[(c)]	0	(14 396.0)	0	0	(13 548.0)	0
Total	**13 257.2**	**87 207.0**	**15.2**	**4 389.8**	**74 487.0**	**5.9**

Notes: Information disclosed on the DTF website has not been subject to audit and is current at the time of preparing this report. Costs do not include COVID-19 initiatives funded from reprioritisations that were not centrally endorsed. They have been omitted because DTF have determined they are not material.

[(a)] Effective from 1 February 2021, the Department of Health and Human Services was renamed the Department of Health (DH) and the new Department of Families, Fairness and Housing (DFFH) was created. 2020–21 costs include DH and DFFH costs.

[(b)] DTF costs include taxation and other revenue relief measures of $779.8 million in 2019–20 and $900.6 million in 2020–21.

[(c)] Comprising payroll tax, capital asset charge and inter-departmental transfers.

Source: DTF.

The costs in Figure 2D were partially offset by additional Australian Government funding. Victoria received $986 million in the form of grants to support Victoria's COVID-19 related expenditure. The state also reported $614 million GST-equivalent grant income that was receivable from the Australian Government at 30 June 2021, and is attributable to a stronger than expected recovery from the COVID-19 pandemic. As disclosed in Note 2.5 of the AFR:

> *… the $614 million increase is largely driven by a higher national GST pool due to stronger national household consumption and dwelling investment, along with changes in the share of consumption subject to GST during the coronavirus (COVID-19) pandemic.*

Other factors affecting GGS operating results

Public health restrictions due to COVID-19 also indirectly impacted GGS revenue. For example:

- Electronic gaming machine and casino gambling tax income was lower because of the temporary closure of Crown Casino, hotels and clubs.
- Hospital and patient fee revenue was lower because of restrictions on elective surgery.
- Regulatory fee income was impacted by reduced traffic volumes resulting in fewer traffic fines being issued.

The COVID-19 disclosures on the DTF website do not include indirect impacts due to the pandemic because DTF cannot reliably determine those amounts. They also do not include COVID-19 initiatives funded from reprioritisations that were not centrally endorsed, such as the redeployment of existing staff to COVID-19 initiatives, or Commonwealth government led initiatives that it funded.

Increased service delivery and new output initiatives have also resulted in increased costs this year. Several output initiatives announced in the state budget, which do not relate to the government's response to the pandemic, received significant new funding in 2020–21. They include the:

- breakthrough Victoria fund
- community sports infrastructure stimulus program
- energy efficient upgrades for homes
- inclusion for all: new funding and support model for school students with disability
- school-enrolment based funding.

Actual costs for each output initiative are not separately shown in the AFR or departmental financial reports, so we could not determine how much of the approved funding was spent in 2020–21.

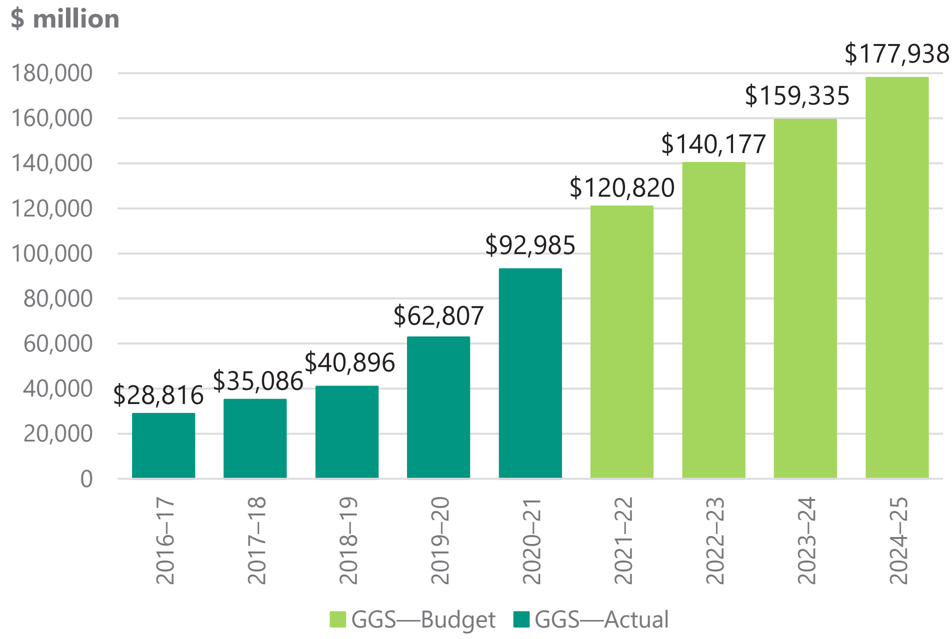
The government also provided WorkSafe with $550 million in 2020–21 to sustain its financial position over the short-term, as explained in Section 2.5. The payment was recorded as a grant expense by the GGS and impacted the net operating result.

2.4 GGS borrowings

Gross debt

Figure 2E shows that borrowings for the GGS have continued to grow.

FIGURE 2E: **GGS borrowings**



Note: The increase in 2018–19 includes $3.0 billion resulting from the first-time application of AASB 1059 *Service Concession Arrangements: Grantors*. The increase in 2019–20 incudes $3.6 billion resulting from the first-time application of AASB 16 *Leases*.

Source: VAGO.

The growth in debt between 2016–17 and 2019–20 was used to fund the government's infrastructure program.

In 2019–20 and 2020–21, the government continued to borrow to fund its infrastructure program. Major projects included the level crossing removal program, Metro Tunnel, West Gate Tunnel and North East Link. The government also increased its domestic borrowings to fund its net operating cash deficit of $2.9 billion in 2019–20, and $13.0 billion in 2020–21, which is disclosed in the cash flow statement.

The government has acknowledged that sound fiscal management in the medium term requires the realignment of revenues and expenditure, coupled with a strategy to fund the government's infrastructure program. To that end the government has developed a medium-term strategy aligned with its key financial measures and sustainability objectives. It involves four steps:

- Step 1: creating jobs, reducing unemployment and restoring economic growth
- Step 2: returning to an operating cash surplus

Fiscal sustainability requires:
• sustainable revenue and expenditure settings that result in an operating surplus over the medium to long-term. This ensures government has sufficient revenues to cover its operating expenditure, and also support the replacement of existing assets and repay debt.
• an operating cash surplus over the medium to long-term. This means the state is generating sufficient cash inflows to offset its cash outflows on operating activities.

- Step 3: returning to operating surpluses
- Step 4: stabilising debt levels.

The state must return to an operating cash surplus and generate a positive operating result before it can stabilise debt levels. In its 2021–22 state Budget, the government expects that:

- from 2022–23 it will return to operating cash surpluses
- the operating deficit will reduce over the next four financial years.

Longer term financial sustainability risks exist for the state if debt continues to grow at the same pace and maturing debt is not repaid.

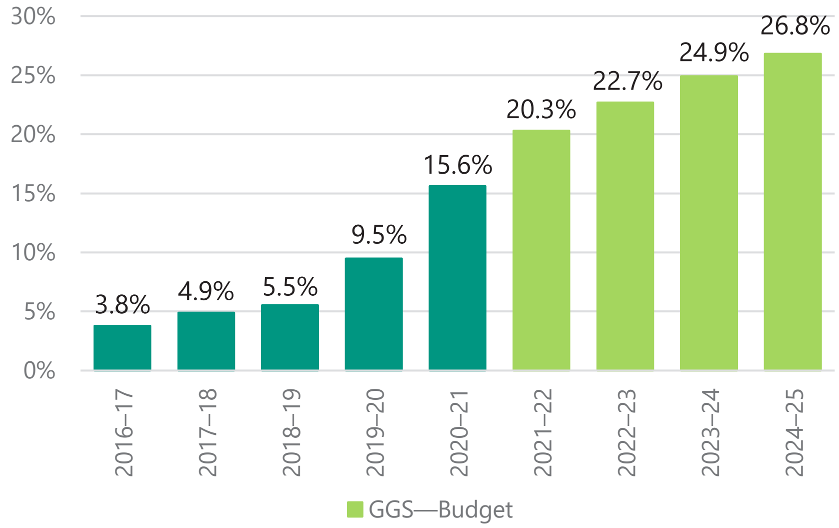
Net debt as a proportion of GSP

Net debt as a proportion of GSP indicates how significant the state's debt is relative to the size of the Victorian economy.

The **net debt as a proportion of GSP** ratio is one measure of the manageability of state debt.

Figure 2F shows that net debt as a proportion of GSP has continued to increase. This trend is expected to continue until operating surpluses are at a level that limits the growth in debt to the growth rate of GSP. An increasing ratio means that state debt is growing faster than the economy. This scenario puts additional pressure on debt service costs and consequently the net operating results, making it harder to repay debt.

FIGURE 2F: **Net debt as a proportion of gross state product**



Source: VAGO.

In 2018, the government indicated it would increase debt to deliver three major productivity-enhancing capital projects—North East Link, Melbourne Airport Rail and the removal of an additional 25 level crossings by 2025. It committed to stabilise GGS net debt at 12 per cent of GSP over the medium term (*Labor's Financial Statement 2018).*

The government has exceeded that target because it had to leverage its historically strong balance sheet to respond to the COVID-19 pandemic. This is consistent with most other jurisdictions across Australia.

Moving forward, the state's large infrastructure program will have a significant effect on net debt. Government infrastructure investment is projected to average $22.5 billion a year over the budget and forward estimates, compared to an average $13.4 billion per year between 2019–20 and 2022–23 (as estimated in the 2019–20 state Budget). The government will also need to borrow to fund the $2.0 billion GGS operating cash deficit in 2021–22.

Gross debt as a proportion of operating revenue

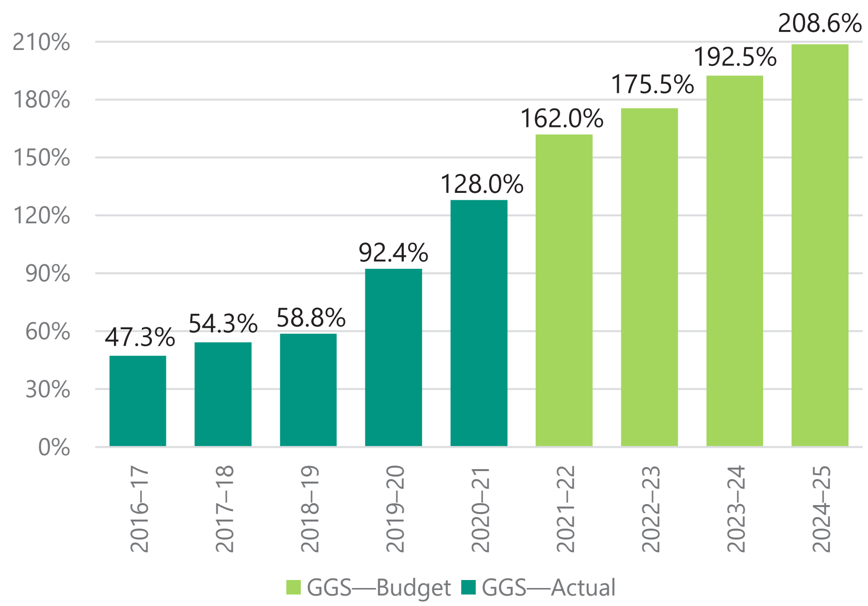
Although state governments commonly use net debt as a proportion of GSP as a measure, gross debt to public sector revenue is also a useful measure. This can be particularly informative:

- if the growth in state revenue uncouples from economic growth
- in higher-interest-rate regimes, especially where the interest rate is higher than annual GSP growth.

In these scenarios, debt servicing can be problematic, as interest repayments take a greater bite from operating revenue.

Figure 2G shows that gross debt as a percentage of operating revenue has continued to increase.

FIGURE 2G: **Gross debt as a percentage of operating revenue**



Source: VAGO.

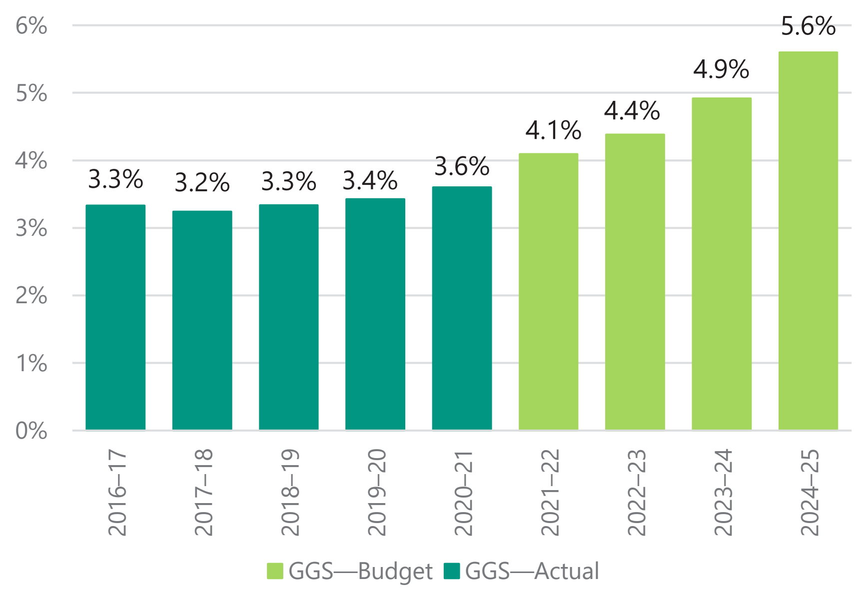
Gross debt as a proportion of operating revenue was below 60 per cent before COVID-19. It is now well above parity. GGS gross debt is estimated to exceed 200 per cent of consolidated revenue by 2024–25, over three times pre-pandemic levels.

Interest expense as a proportion of operating revenue

As the state's debt increases, so does the interest expense incurred to service the debt. Comparing interest expense to operating revenue provides information on the share of revenue devoted to servicing debt costs (the interest bite).

Figure 2H shows that the interest bite will increase over the next four financial years. In 2020–21, 3.6 per cent of the GGS operating revenue was needed to service debt costs compared to 3.4 per cent in 2019–20. This is estimated to increase to 5.6 per cent by 2024–25.

FIGURE 2H: **GGS interest expense as a proportion of GGS operating revenue**



Source: VAGO.

Current low interest rates mean that interest expense as a proportion of operating revenue remains low, and debt remains manageable. Although interest rates are expected to remain low in the short-term, the potential for them to increase in the medium to long-term presents a risk to the state that will need to be monitored.

Sustainable debt is what the state can repay while balancing factors such as economic growth, interest rates and a capacity to generate surpluses in the future.

GGS debt is expected to continue increasing over the budget and forward estimates, reaching $177.9 billion by 2024–25. The state ensures that it has relative certainty over servicing costs by usually borrowing at a fixed interest rate. At 30 June 2021, approximately 90 per cent (96 per cent at 30 June 2020) of the state's borrowings were at fixed rates of interest.

2.5 **Emerging financial risks**

Managing operating expenditure growth

After a comprehensive review of GGS expenditure, the government has identified $2.4 billion in cost savings which departments will need to achieve over the next four financial years, and $959.3 million each year thereafter. This is in addition to efficiency dividends the government announced in its 2021–22 state Budget which require departments to achieve a further $1.9 billion savings over that period.

Without structural reform, achieving the targeted reductions and maintaining current service levels will be a challenge, since over one-third of the state's operating expenses are on employees, and these costs are generally subject to annual increases included in enterprise bargaining agreements.

An **efficiency dividend** is a budget policy tool the government uses to constrain growth in departmental operating funding. It is intended to drive efficiencies in public service delivery (the efficiency) and realise the associated financial benefits of expense reduction targets (the dividend).

State insurance entities

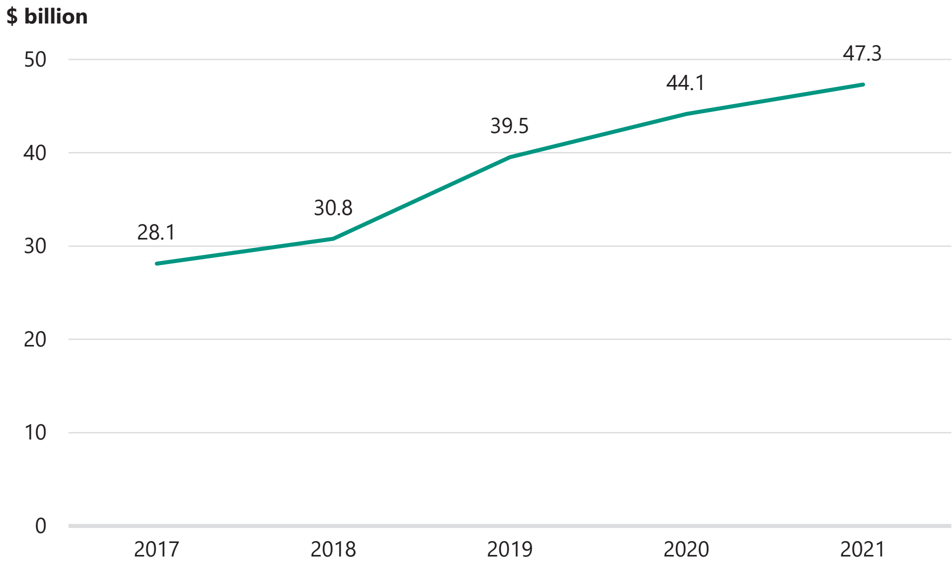
Three of the six public financial corporations (PFC) are insurers—WorkSafe, TAC and VMIA. These entities, which are not in the GGS, have a considerable influence on the net result and balance sheet of the PFC sector.

At 30 June 2021, state insurance entities held $47.6 billion of total assets and $50.3 billion of total liabilities. 94.1 per cent of those total liabilities related to outstanding insurance claims.

Figure 2I shows that the value of the total outstanding insurance claims liability for the state, as reported in the AFR, has grown over the last five years.

An **outstanding insurance claim** is a claim that the insuring entity is responsible for paying in the future, where the claim arises from an event that occurred on or before the valuation date. The liability includes an allowance for claims that have occurred but have not yet been reported to the insuring entity.

FIGURE 2I: **Outstanding insurance claims liability for the state at 30 June**



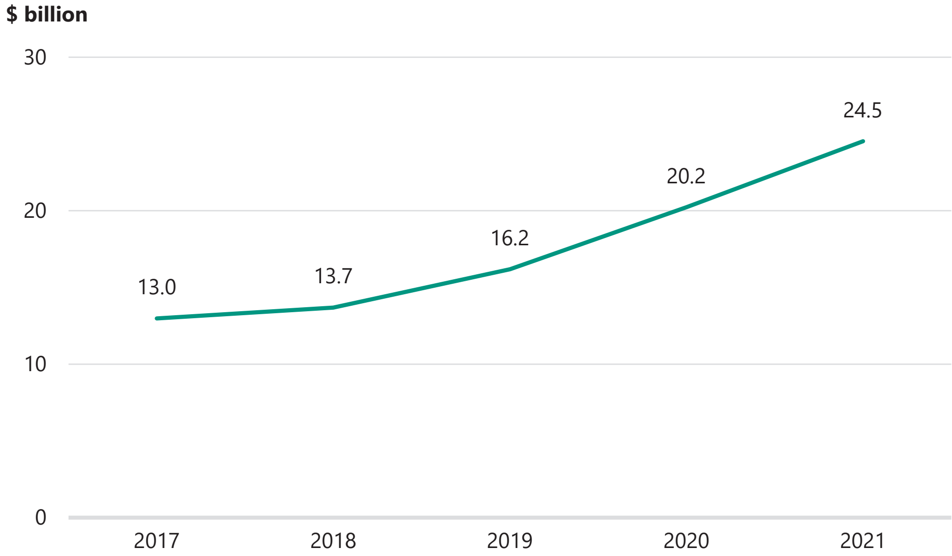
Source: VAGO, using data extracted from the AFR.

Changes in the insurance claims liability result from claims experience, remeasurements, and claims payments. The performance of WorkSafe is the primary reason the liability increased in 2020–21.

WorkSafe

Figure 2J shows that the value of the outstanding insurance claims liability for WorkSafe, as reported in the AFR, has almost doubled over the last five years. In 2020–21, the insurance claims liability at WorkSafe increased by $4.3 billion, following an increase of $4.0 billion in 2019–20.

FIGURE 2J: **Outstanding insurance claims liability for WorkSafe at 30 June**



Source: VAGO, using data extracted from the AFR.

Figure 2K shows the composition of the movement in the value of the liability over the last two financial years.

FIGURE 2K: **Components of movement in outstanding WorkSafe insurance claims liability: 2019–20 and 2020–21 ($ million)**

Component	30 June 2020	30 June 2021
Outstanding claims liability—opening balance 1 July	**16 181**	**20 232**
Current year claims cost	4 205	4 925
Prior year claims cost	236	214
Net operating balance impact	**4 441**	**5 139**
Changes in economic assumptions (discount rate and inflation rate movements)	–233	–542
Remeasurement of previously recognised claims	2 635	2 702
Other remeasurements	–441	–523
Net result impact	**6 402**	**6 776**
Claims payments and recoveries/GST	–2 351	–2 481
Outstanding claims liability—closing balance 30 June	**20 232**	**24 527**

Source: VAGO, using data extracted from WorkSafe's financial report.

Last year we noted the significant change in the number of injured workers accessing weekly benefits. The time they are on the scheme had also increased. This trend of more injured workers accessing weekly benefits for longer has continued, resulting in the value of previously recognised claims increasing by $2.7 billion in 2020–21 ($2.6 billion in 2019–20). This is in addition to $4.9 billion new claims recognised for the first time in 2020–21 ($4.2 billion in 2019–20).

An independent review of the financial sustainability of the scheme in 2020–21 concluded that the current financial trajectory is unsustainable. The reviewers found the following financial pressures affecting the scheme:

- an increase in the duration injured workers remain on the scheme due to softer application of capacity tests after recent Ombudsmen reports
- poor and declining return to work outcomes
- an increase in the number and complexity of mental health related claims
- sustained, unchanged average premium rates
- investment revenue likely to decline.

WorkSafe is developing initiatives aimed at addressing these pressures and managing long-term financial sustainability. The initiatives focus on prevention, recovery and return to work, and include a review of the WorkSafe outsourced agent model.

To minimise the impact on businesses and provide time to explore options before considering premium increases, the government provided WorkSafe with $550 million in 2020–21 to sustain its financial position over the short term. The payment was recorded as a grant expense by the GGS, and grant revenue in the PFC sector. The inter-sector transaction was eliminated upon consolidation at the state of Victoria level.

The government established a WorkCover Scheme Sustainability Steering Committee in December 2020 to support WorkSafe in implementing strategies to address long-term financial sustainability challenges and provide consolidated advice to relevant ministers. The committee consists of deputy secretary and executive director representatives from the Department of Premier and Cabinet (DPC), DTF, DJCS and WorkSafe.

Dividends paid by state insurance entities

GGS revenue includes dividends and dividend equivalent amounts received from state insurance entities. After consulting with the board and the relevant minister, the Treasurer determines the dividends payable each year. The Treasurer's determination is based on:

- reported profit
- liquidity
- operating cash flow and forecast cash requirements
- gearing and interest cover of the business
- retained earnings
- any other specific factors relating to individual businesses.

In the past 10 financial years, the GGS has collected $2.4 billion from state insurance entities in the form of dividends. The performance of these entities, coupled with the onset of COVID-19 in 2020, affected the amount collected in the past two financial years. No dividends were paid by the state insurance entities to the GGS in 2019–20, and only VMIA made a dividend equivalent payment of $36 million in 2020–21. WorkSafe has not paid a dividend to the GGS since 2014–15.

The GGS expects to receive $2.4 billion from TAC ($400 million in 2021–22 and 2022–23 and $775 million in 2023–24 and 2024–25) and $150 million from VMIA ($50 million in 2021–22 and 2022–23 and $25 million in 2023–24 and 2024–25) over the next four financial years, as forecast in the 2021–22 state Budget. Amounts are subject to annual review and to the final determination of the Treasurer. Performance of the entities may affect the dividends.

Capital works contingent liabilities

The state added $20.2 billion of newly built or acquired assets to its balance sheet in 2020–21—$15.6 billion of that was added to the GGS. These largely relate to major transport infrastructure projects.

The significant pipeline of assets under construction presents risks to future outlays from price movements in materials and labour, and from any unexpected delays or contractual disputes. The government allows for contingencies in its capital project budgets to partly mitigate the risks, which are disclosed in the state's Budget papers.

In our *Major Projects Performance* report (September 2021), we found the total estimated investment of almost two thirds of the reviewed projects ($99.3 billion), had changed compared to their first public budget. The net impact of these changes was an increase in costs of $4.9 billion or 4.9 per cent.

Metro Tunnel contingent liability

Last year, the AFR disclosed a non-quantifiable contingent liability for the Metro Tunnel. At 30 June 2020, the state had signed a commercial principles deed to make further financial commitments, but they could not be disclosed at that time.

A binding agreement was subsequently signed by the state on 23 December 2020. The key financial implications of the amended agreement are that the:

- private consortium will incur additional costs of $2.7 billion to construct the assets of which $1.37 billion will be paid by the state, with the balance of $1.37 billion progressively recognised as revenue by the state, in the form of an asset received free of charge, as construction is complete
- state has confirmed it will exercise its option to pay the $1.2 billion state maintenance phase contribution in September 2027, subject to the private consortium having achieved final acceptance and satisfied certain other conditions.

The amended agreement includes revised progress milestones and dates for project completion payments. In accordance with the amended agreement, at 30 June 2021, the state had paid $240 million of the additional costs and received a further $400 million in assets that were recorded as revenue.

3. Proper accounts and records

Conclusion

DTF implemented effective internal controls to support the preparation of a complete and accurate AFR.

The internal control framework of VicTrack was not adequate. The internal control frameworks of the other material entities were generally adequate to support their preparation of complete and accurate financial reports. However, some entities need to strengthen some internal controls to ensure their financial reports remain reliable.

This chapter covers:

- Entity-specific internal controls
- Information systems

3.1 Entity-specific internal controls

We assessed the internal controls at each material entity that ensure their financial report is complete and accurate and complies with relevant legislation. We have reported significant issues found to the relevant entity's management and their audit committees, as required under the auditing standards.

VicTrack—accounting for fixed assets and inadequate asset records

The state continues to invest in building, developing and replacing assets in the transport sector. The level of investment has been increasing year on year, with asset additions recorded by DoT in 2020–21 of $9.4 billion ($8.5 billion in 2019–20). With regards to the delivery of rail projects, DoT enters into the contracts and oversees the capital spend and then transfers the completed assets to VicTrack as the state’s legal custodian of them.

Accounts and asset records

We reported significant shortcomings in asset accounting by DoT and VicTrack in last year's report to Parliament. The issues included:

- an inability to identify individual assets in the VicTrack asset register
- delays in the recognition of assets, which means that depreciation was not charged from when the asset was available for use
- insufficient assessment of spending against the asset recognition criteria under AASB 116 *Property, Plant and Equipment*
- inadequate review of work-in-progress, resulting in stale work-in-progress amounts and asset write-offs
- asset disposals and replacements not being identified in the VicTrack asset register.

VicTrack and DoT continue to work to address the issues, and to identify and record transport assets completely and accurately. However, an amount of $8.2 billion reported by VicTrack as assets could not be verified at 30 June 2021 ($7.2 billion at 30 June 2020). Specifically, we observed that there is:

- $5.9 billion of capitalised costs relating to projects completed in 2020–21, for which individual asset information needs to be determined. We are comfortable that these costs materially reflect capital expenditure incurred on the level crossing removal, high-capacity metro trains, and other transport projects
- $1.0 billion of capitalised costs relating to projects completed before 2019–20, for which the nature of individual assets is unknown. These costs need to be investigated by management to determine if and what assets make up this amount
- $1.3 billion of capitalised costs where the information maintained by VicTrack did not support the assets sighted by the valuer as part of a valuation exercise. These amounts also need to be investigated by management to determine if and what assets make up this amount.

Even though significant work has been undertaken by VicTrack and DoT over the past two financial years, we cannot yet conclude that VicTrack's asset register is complete and accurate. We would normally qualify a financial report for this matter, but we already qualified VicTrack’s accounts for not complying with the leasing matter explained in Section 1.1.

This did not impact our opinion on the AFR because we concluded that the risk of a material misstatement in the AFR was low.

In 2021–22, DoT plan to implement an asset collection and attribution framework to address the systemic issues underlying proper and timely asset recording in the transport sector. For effective implementation, DoT will need to adequately invest in human resources and systems. VicTrack also plan to continue its work to resolve the issues that existed at 30 June 2021.

Asset write-offs and write-downs

As part of the valuation process, $715.1 million in asset value was written-off in 2020–21 ($2.0 billion in 2019–20). The valuation process identified two issues:

- Some maintenance type works were incorrectly capitalised.
- The valuer took an approach to calculating the current replacement cost for an asset in a live operating environment that was different to the approach allowable under Australian accounting standards. A significant part of the write-offs related to level crossing removal projects, where construction occurs in an operating transport network.

The different approaches to measuring current replacement cost for public sector assets has wide-spread implications across the public sector. It is currently being considered by the AASB in its project on fair value measurement for the public sector. DoT, VicTrack and the Valuer-General, respectively, are discussing this issue. A solution is not expected in the short term and this issue is expected to materially impact the state's finances until resolved.

DJPR—deficient controls for COVID-19 grant programs

DJPR paid $6.0 billion in grants in 2020–21 ($2.2 billion in 2019–20), including $3.4 billion to support Victorian individuals and businesses affected by the COVID-19 pandemic. The department had committed a further $1.7 billion at 30 June 2021.

DJPR created new COVID-19 grant programs and processed an unprecedented amount of grant applications in 2020–21. The department established procedures and controls for these programs in a short time frame. Applicants were required to demonstrate eligibility to receive funding in each grant program, with criteria differing by program. Eligibility was verified quickly so that grants could be paid. The exception to this approach was the Working for Victoria grant program ($334 million) where the eligibility criteria was qualitatively assessed and the controls were consistent with prior years.

The applicant eligibility checks, against external data, were performed manually and staff had full and unrestricted editing access to the grants system. This means the staff had access to personal information, including bank account details of grant recipients.

As a result, we could not rely on the department's controls over the COVID-19 grant programs so we performed alternate audit procedures to gain comfort over the validity and accuracy of grant monies disbursed. We independently verified the eligibility of a sample of grant applicants in each material grant program. We identified the following anomalies:

- misclassification in project codes, which meant payments were recorded and reported against the wrong programs
- incorrect calculation of entitlements, which lead to overpayments
- inconsistent approaches being applied to assess applications, which made it difficult to determine if the process was fair
- lack of clear documentation for the procedures to approve variations to grants, which increased the risk that variations were inconsistently awarded
- not all eligibility criteria were subject to external verification, which increased the risk that payments were made to ineligible applicants.

These anomalies were not material when projected to the total grant population and we concluded that the grant expenditure amounts in the DJPR financial report were materially correct. However, the state may have paid ineligible recipients grant payments to ineligible recipients that we cannot identify and quantify.

DJCS—reporting of administered fines and fees income and receivables

Fines and fees income

The Victorian Infringement Enforcement Warrant system is the key IT application used by DJCS, through Fines Victoria, to manage and account for administered fines and fees.

In our past three reports to Parliament we commented on issues with the system and the reporting of fines and fees income. In 2020–21, management resolved financial reporting functionality issues with the system and produced reports supporting all administered fines and fee income. They also resolved control issues identified at the third-party service provider that DJCS engaged to manage the system.

Fines and fees receivables—provision for expected credit losses

Australian accounting standards require agencies to assess the collectability of debts annually and recognise a loss allowance for amounts not expected to be received. Last year we identified an error in the calculation of, and accounting treatment for, the loss allowance for unpaid fines and fees. This year we continued to identify issues with the calculation of the loss allowance including:

An **expected credit loss** is a provision for impairment loss recognised against fines and fees receivables. It considers historical and forward-looking factors.

- incorrect cash collection rates applied when estimating the loss allowance
- incorrect adjustments made to the loss allowance for bad debts written off in the past
- future economic and other assumptions, such as unemployment rates and the effect of the COVID-19 pandemic on the collectability of fees and fines at 30 June, not accurately incorporated in the loss estimate modelling.

Again, this resulted in a material adjustment required to be made to the administered fines and fees receivables balance, as explained in Section 1.2. Figure 3A shows the impact of adjustments on the reported receivables balance at 30 June 2020 and 30 June 2021.

FIGURE 3A: **Administered fines and fees receivables as at 30 June 2020 and 30 June 2021**

	30 June 2020 $ million	30 June 2021 $ million
Gross fines and fees receivables	**2 591.8**	**2 607.8**
Provision for expected credit losses made by management	(1 107.1)	(2 505.6)
Audit adjustments—provision for expected credit losses [(a)]	(1 396.9)	166.1
Net fines and fees receivables	**87.8**	**268.3**

Note: [(a)] The adjustment made to the provision for expected credit losses at 30 June 2020 included a $1 085 million correction resulting from incremental understatements since 2006. We reported this in last year's report to Parliament.

Source: VAGO.

DJCS management should disclose the above disaggregated financial information of gross fines and fees receivables, and associated loss allowance, in the department's financial report. It provides information for users of the financial report to understand the credit and other financial risks associated with these receivables. They should also show the measures they put in place to manage these risks. Management do not disclose this information.

CQV—deficient control environment

CQV was established 1 December 2020, as an administrative office of DJCS, to administer Victoria's hotel quarantine program. CQV was established to oversee all elements of the program, including:

- the frontline worker accommodation program (formerly known as 'Hotels for Heroes')
- mandatory quarantine for people entering Australia, including health hotels for positive and suspected cases or close contacts
- emergency accommodation for local residents who need a safe place to quarantine.

The financial results of CQV are included in the financial statements of DJCS.

In 2020–21, CQV spent $645.4 million administering the hotel quarantine program. Since its establishment CQV has focused on service delivery due to the criticality of the program to the government's response to COVID-19. The design and implementation of an effective system of internal controls was given less priority during this period. Consequently, CQV did not have adequate controls relevant to financial reporting for the following items.

We identified payroll control issues including:

- deficiencies in employee records, including errors in contracts and unsigned contracts
- controls over rosters and timecards not being appropriately designed and implemented.

We also identified financial reporting information system control issues, specific to CQV's invoicing and case management systems. These included:

- There were no access management controls to prevent unauthorised access.
- Staff responsibilities for the development and implementation of changes to information systems were not separated.
- Third-party service provider controls were not effectively designed or implemented.

As a result, we could not rely on CQV's controls over employee expenditure and hotel quarantine revenue, and we performed extensive substantive procedures over a large sample of transactions. Our audit procedures did not identify any material errors in CQV's reported payroll and revenue amounts.

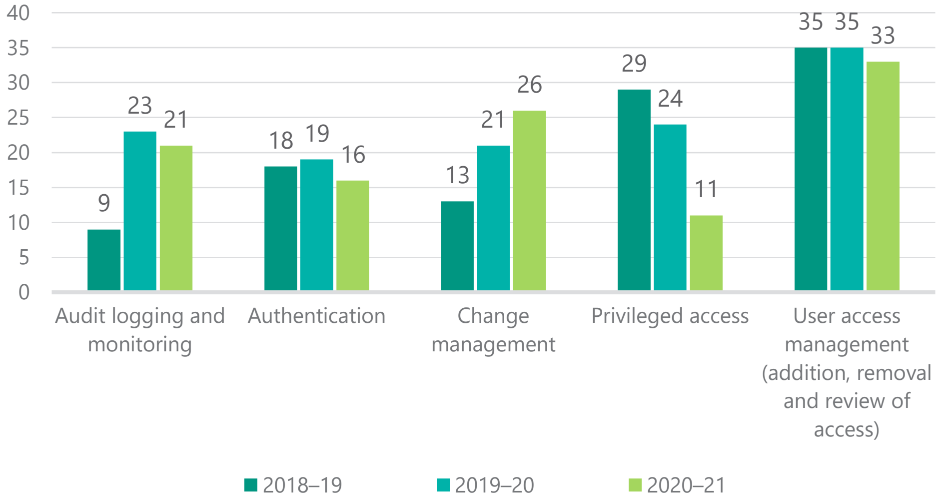
3.2 Information systems

IT controls

Effective IT controls reduce the risk of unauthorised access and changes to systems and help protect the underlying integrity of data. They are a prerequisite for the smooth day-to-day operation of entities and the reliability of financial reporting.

We are concerned that we continue to find IT control deficiencies relating to logical access, change management and monitoring at some material entities. Figure 3B summarises the number of deficiencies we identified at material entities over the past three financial years, categorised by type of issue. Several prior-year IT control deficiencies also remain unresolved. Material entities must prioritise and address these issues promptly, particularly with the shift to remote operations.

FIGURE 3B: **Number of IT control deficiencies**



Source: VAGO.

We continue to find these IT control deficiencies at material entities:

- system user access of employees who had left the entity was not revoked promptly
- new system user access was granted without approval
- system generated audit logs were not always enabled to track privileged user account activities, including changes employees made to system configurations
- weaknesses in password and other authentication controls
- staff responsibilities for the development and implementation of changes to information systems were not separated
- employees were assigned privileged access greater than their position required
- periodic user access reviews were not performed to ensure access levels align with employee roles and responsibilities.

In our 2019–20 report to Parliament we recommended departments and agencies reduce the number of users with privileged access to a minimum and explore providing such access on a per request and time limited basis. Although we have seen a drop in the number material entities with privileged access issues over the past three financial years, further work is required to resolve them.

Poor IT controls increase the risk of unauthorised access, cyber-attacks, fraud, error, data manipulation and information theft. It is important that management resolve them promptly to ensure systems are secure and financial information is reliable.

Privileged accounts, which are users who have elevated permissions to critical corporate resources, are high-value targets for cyber criminals.

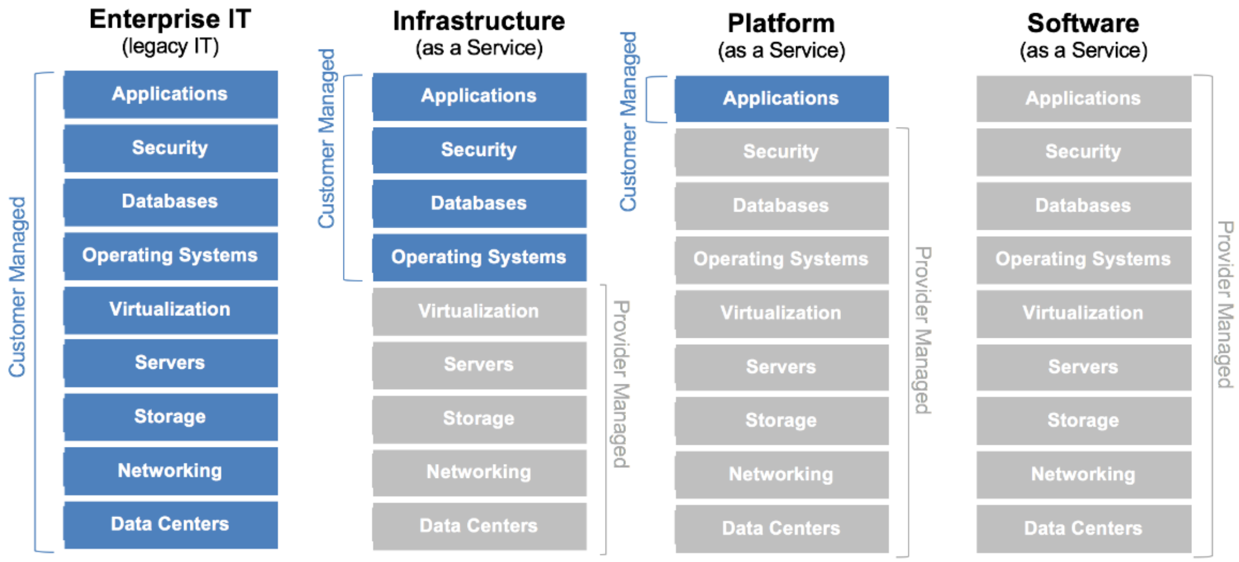
A cyber-attack is a deliberate act by a third party to gain unauthorised access to an entity's data with the objective of damaging, denying, manipulating or stealing information.

Cloud-based accounting systems

Public sector entities continued migrating to cloud-based accounting systems in 2020–21. Moving to cloud-based solutions enables entities to transfer business processes to third parties, but it does not absolve management and those responsible for governance from ensuring that controls are appropriately designed and operating effectively.

Figure 3C details the different business processes typically outsourced to a third party depending on whether an entity chooses to move to an 'Infrastructure as a Service', 'Platform as a Service', or 'Software as a Service' solution.

FIGURE 3C: **Business processes outsourced to third-party providers**



Source: The Enterprise Cloud Blog.

In 2018, the government selected Oracle as its strategic partner for the development and provision of a common financial system across departments. Two departments migrated to Oracle Fusion Cloud Services (Oracle cloud) in 2019–20, and another three migrated in 2020–21. This leaves four departments using an older, non-cloud version of Oracle.

In our financial audits of entities that have moved to Oracle cloud, we found control weaknesses across audit logging and monitoring, authentication, change management, privileged access and user-access management.

We concluded that IT general controls were deficient in one of the three departments that migrated in 2020–21 and had to perform alternate audit procedures to gain comfort over the integrity of underlying data in the financial report of that department.

The issues identified at the departments that have already migrated to Oracle cloud should be addressed before any more departments transition. The government is currently developing a common corporate services platform which may affect if and when the remaining departments transition.

Recommendations about internal controls and financial reporting

We recommend that:			Response
Department of Justice and Community Safety	1.	report gross and net administered fines and fees receivables, and the expected credit loss provision associate with those receivables, in its financial report.	**Accepted.**
All departments and relevant agencies	2.	make sure additional disaggregated information, by way of notes to the financial statements, is provided for all material administered items, as required in DTF's model report for Victorian departments.	**Noted by the Treasurer of Victoria on behalf of the sector and accepted as they specifically relate to the Department of Treasury and Finance.**
All departments and agencies transitioning to cloud-based systems	3.	ensure controls that are suitably designed, and tailored for business needs, work effectively in the new system before migrating data and transitioning to them.	
All departments and agencies	4.	prioritise the resolution of IT control deficiencies that: • pose a risk to complete and accurate financial reporting, or the ability to achieve process objectives and comply with relevant legislation; or • remain unresolved from prior reporting periods.	

APPENDIX A
Submissions and comments

We have consulted with the agencies named in this report and considered their views when reaching our audit conclusions. As required by 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 this report to DPC.

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

Responses were received as follows:

Response provided by Treasurer of Victoria

Treasurer of Victoria

Minister for Economic Development
Minister for Industrial Relations

1 Treasury Place
GPO Box 4379
Melbourne Victoria 3001
Telephone: +61 3 7005 9474
DX 210759

D21/230227

Mr Andrew Greaves
Auditor-General
Victorian Auditor-General's Office

Dear Mr Greaves

RESPONSE TO THE AUDITOR-GENERAL'S REPORT ON THE ANNUAL FINANCIAL REPORT OF THE STATE OF VICTORIA, 2020-21

Thank you for your letter of 27 October 2021, seeking my response to your Report on the Annual Financial Report (AFR) of the State of Victoria: 2020-21 (the Report) before its finalisation and transmission to Parliament.

The Report notes the considerable challenges faced by both the public sector and your officers in the preparation and audit of entity and the State's consolidated financial reports in the course of the COVID-19 pandemic. Through close collaboration, we have jointly ensured the timely completion of high quality and timely reports including the AFR, faithfully serving timely public accountability and transparency.

I welcome the opportunity to comment on your Report, which confirms the issuance of an unmodified audit opinion on the financial statements for the State of Victoria and the General Government Sector (GGS) for the financial year ended 30 June 2021. The report also provides an independent assessment of the financial outcomes and fiscal aggregates of the State for the year ended 30 June 2021, which complements the Government's own assessment as presented in the AFR.

The report acknowledges the significant impact of the COVID-19 pandemic on the State's financial performance and position. It particularly notes the increase in employee expenses in 2020-21 compared with the previous year, which was primarily due to additional resources in the health sector for the COVID-19 response and additional staff required following the establishment of COVID-19 Quarantine Victoria, as well as increases in remuneration levels (including for school employees, nurses and midwives, doctors, paramedics, public servants, and police) under enterprise bargaining agreements consistent with the Government's wages policy.

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Response provided by Treasurer of Victoria—*continued*

The report notes that $11.7 billion of net costs in 2020-21 were attributable to the government's direct COVID-19 response that contributed to the net operating deficit of $14.6 billion, with $2.9 billion not being directly attributable to the pandemic.

It is important to highlight that the $11.7 billion quoted only covers the impact of specific funding/support decisions of the Government. As the report notes, it does not include the indirect impacts of the pandemic on the State's revenues, including State taxes, GST revenues and other own-sourced revenues from hospitals, schools and TAFEs. It also does not include redirection of existing departmental budget resources.

Accordingly, it is not possible to reliably determine the overall impact (direct and indirect) of the pandemic on the general government sector's and the State's overall operating results.

As stated in the 2021-22 State Budget, the Government remains committed to delivering responsible financial management through a robust fiscal framework.

In the short-term, the Government has prioritised the use of its balance sheet to support employment, business and consumer confidence, and household budgets.

This is appropriate given the unprecedented nature of the coronavirus (COVID-19) pandemic. This approach will have short-term costs to the State's financial position, but over the longer term will result in a quicker and stronger economic recovery.

The Government's fiscal plan for the medium term involves four steps:

- Step 1: creating jobs, reducing unemployment and restoring economic growth
- Step 2: returning to an operating cash surplus
- Step 3: returning to operating surpluses
- Step 4: stabilising debt levels.

The Government will continue to review and refine its plan in light of the prevailing economic conditions.

Finally, I wish to acknowledge the recommendations made in the report to all departments and agencies, aimed towards the strengthening of their internal control environments. These recommendations are noted on behalf of the sector and supported as they specifically relate to the Department of Treasury and Finance.

Yours sincerely

TIM PALLAS MP
Treasurer

11/ 11/ 2021

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Response provided by the Secretary, DELWP

Department of Environment, Land, Water and Planning

PO Box 500, East Melbourne,
Victoria 8002 Australia
delwp.vic.gov.au

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

Ref: SEC015389

Dear Mr Greaves

AUDITOR-GENERAL'S REPORT ON THE ANNUAL FINANCIAL REPORT OF THE STATE OF VICTORIA 2020-21

Thank you for your letter dated 27 October 2021 providing the Department of Environment, Land, Water and Planning (DELWP) with the opportunity to comment on your draft Report on the Annual Financial Report of the State of Victoria 2020-21.

DELWP has reviewed the relevant content and notes the information disclosed is accurate. I would like to provide additional information and explanation relating to the material adjustments disclosed in Section 1.1.

Misclassification of the initial recognition of the financial liability as a grant expense

I acknowledge the material adjustment for the value of $200 million relating to misclassifying the initial recognition expense from financial instruments as a grant expense. This misclassification was solely within expenses from transactions and did not impact the net result from transactions or the net asset position for DELWP or the State of Victoria.

This transaction related to a new agreement signed during the financial year. DELWP's analysis of the arrangement concluded that it should be treated as a financial liability within the scope of AASB 9 *Financial Instruments*, in line with your team's view. The corresponding expense was treated as a grant expense. The expense was adjusted in the annual financial statements to an initial recognition expense from financial instruments.

I appreciate that new, complex transactions have the potential to result in classification errors. To reduce the risk of such errors, the DELWP financial reporting team will engage the VAGO financial audit team earlier in discussions on the appropriate accounting treatment to seek any feedback before releasing the draft annual financial statements. This engagement will typically occur by inviting the VAGO financial audit team to comment on position papers.

Non-cash movement included in cash transactions

The contract for difference derivative settlements were classified as cash receipts in the cash flow statement rather than derivative settlements and payments of grants and other transfers. An adjustment was made to reclassify the derivative settlements in accordance with the advice from the VAGO financial audit team. This adjustment occurred within the Net cash flows from operating activities and had no further impact on the cash flow statement, DELWP's other statements or the State of Victoria.

DELWP has implemented new internal controls to ensure future derivative payments are correctly recognised in the cash flow statement.

VICTORIA State Government

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Response provided by the Secretary, DELWP—*continued*

If you would like more information about this matter, please contact Mark Briglia, Director Financial Management and Reporting, DELWP, by emailing mark.briglia@delwp.vic.gov.au or on 0412 416 135.

Thank you for the opportunity to provide comment on your final report.

Yours sincerely

John Bradley
Secretary

10 / 11 / 2021

SEC015389 Page 2

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Response provided by the Secretary, DH

Secretary

Department of Health

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Telephone: 1300 650 172
GPO Box 4057
Melbourne Victoria 3001
www.health.vic.gov.au
DX 210081

BAC-BR-20371

Andrew Greaves
Auditor-General
Victorian Auditor-General's Office

Dear Mr Greaves

Thank you for providing the extract of the proposed report *Auditor-General's Report on the Annual Financial Report of the State of Victoria: 2020–21* and giving me the opportunity to comment on content relating to the Department of Health.

I note that a material disclosure error was identified in the draft financial reports of the Department of Health relating to the New Footscray Hospital PPP, with the information included in the wrong note. I acknowledge the collaboration between our teams to correct this in final reports enabling you to provide a clear audit opinion to the department. I am comfortable that your report accurately describes the reason for this changed disclosure.

Kind regards

Yours sincerely

Professor Euan M Wallace AM
Secretary

03/11/2021

Copy: Timothy Maxfield, Director, Victorian Auditor-General's Office

Response provided by the Secretary, DJCS

Department of Justice and Community Safety

Secretary

Level 26
121 Exhibition Street
Melbourne Victoria 3000
Telephone: (03) 9915 3759
www.justice.vic.gov.au
DX: 210077

Our ref: 21112383

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

Dear Mr Greaves

Thank you for your letter dated 27 October 2021 regarding your proposed *Report on the Annual Financial Report of the State of Victoria: 2020-21* (Report), and the invitation to provide a formal response.

I note that your proposed Reports references the Department of Justice and Community Safety's (the department) internal controls relating to the administered fines and fees receivables the department collects as well as employee expenses and revenue at COVID-19 Quarantine Victoria (CQV).

The Report acknowledges that in order to support the government's response to the COVID-19 pandemic the department was required to establish new process in a very short time frame to support critical public health requirements. On 27 July 2020 the Hotel Quarantine functions transferred to the department until the establishment of CQV as an independent Administrative Office on 1 December 2020.

Since identification of the control issues significant work has been undertaken to strengthen the internal controls and mitigate future risks. In particular, the Report highlights DJCS' effectiveness in improving reporting on administered fines and fees income and receivables. Further enhancements of the solutions for each component above is underway to achieve continuous improvement.

The department is committed to reviewing and implementing a sustainable best practice model for the calculation of the expected credit loss relating to the administered fines and fees receivables. The method previously used to calculate the estimated credit loss allowance has formed the basis for the estimation since at least 2006, however it is

Response provided by the Secretary, DJCS—*continued*

recognised that the method should be reviewed regularly to ensure it remains accurate, relevant, and fit for purpose.

I acknowledge the recommendations made in the Report and provide specific responses below:

Recommendation	DJCS Response
Report gross and net administered fines and fees receivables, and the expected credit loss provision associated with those receivables, in its financial report.	The department accepts this recommendation and will work with the Department of Treasury and Finance and VAGO to implement this recommendation.

During 2020-21, the department worked closely with VAGO and is committed to continuing to strengthen our internal control environment. The department will continue to work closely with your office to implement future improvements.

Thank you again for the opportunity to comment on your report.

Yours sincerely

Rebecca Falkingham
Secretary

12/11/2021

Response provided by the Secretary, DJPR

Department of Jobs, Precincts and Regions

GPO Box 4509
Melbourne,
Victoria 3001 Australia
Telephone: +61 3 9651 9999
DX 210074

Ref: CSEC-2-21-12868

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

Dear Mr Greaves

Proposed report *Auditor-General's Report on the Annual Financial Report of the State of Victoria: 2020-21*

Thank you for your letter of 27 October 2021, providing the department with an extract of the proposed report *Auditor-General's Report on the Annual Financial Report of the State of Victoria: 2020-21* (the Report).

As the report highlights, the exceptional circumstances created by the pandemic required the Department of Jobs, Precincts and Regions (DJPR) to provide rapid and appropriate support to protect businesses and jobs across the State. In 2020–21, DJPR created new COVID-19 grant programs and processed an unprecedented amount of grant applications, paying $6.0 billion in grants, including $3.4 billion to support Victorian individuals and businesses affected by the COVID-19 pandemic. New procedures and controls were established for these programs in a short time frame.

The department has reviewed the extract of the Report. While the Report identified anomalies in a sample of grant applications, it concluded that these anomalies were not material when projected to the total grant population, and that the grant expenditure amounts in the DJPR financial report were materially correct.

Since the outset of the pandemic, procedures and internal controls for COVID-19 grants programs have been continually reviewed and refined. The deficiencies in controls identified by VAGO in the Report are being addressed and DJPR remains committed to continuing to strengthen our control environment, including through implementation of a revised Grants Framework.

Thank you for the opportunity to comment on the extract of the proposed report.

Yours sincerely

Simon Phemister
Secretary

Response provided by the Secretary, DoT

Department of Transport

GPO Box 2392
Melbourne, VIC 3001 Australia
Telephone: +61 3 9651 9999
www.transport.vic.gov.au
DX 210074

Ref: BSEC-1-21-9591R

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

Dear Mr Greaves

PROPOSED REPORT AUDITOR-GENERAL'S REPORT ON THE ANNUAL FINANCIAL REPORT OF THE STATE OF VICTORIA: 2020–21 - DOT RESPONSE LETTER

Thank you for the opportunity to comment on the extract of the proposed *Auditor-General's Report on the Annual Financial Report of the State of Victoria: 2020–21*.

The Department recognises the significance of the matters raised and the implications of issues with the quality of asset information at a whole of government level. As noted in your report, the Department has been working closely with the relevant agencies and authorities on this issue and a significant amount of work has been undertaken to address the concerns raised.

The main focus of the work undertaken has been the development of a new rail asset attribute framework and an associated template for the detailed identification of assets being constructed in the Big Build program. This will assist in the provision of comprehensive information to enable VicTrack to correctly record the assets on its register.

Over the last twelve months DoT and MTIA were able to provide over $4 billion of asset attribute information to VicTrack to address issues raised in last year's report and this significant work, as recognised in your report, represents considerable progress in the collection of rail asset attribute data.

Specifically, work is well underway to address assets not able to be verified by your Office as at 30 June 2021, with investigations into asset details held in source systems and also data retained by the various associated entities and alliances.

There are significant challenges to the implementation of the framework due to the complexity and scale of the projects underway and the historical information available on some older completed projects. DoT, MTIA and VicTrack will continue to work together to improve the timing, quality, and completeness of rail asset information.

DoT and VicTrack are cognisant of the requirements of the resources, skills and capability of the people needed to deliver, implement and drive the framework in the Transport portfolio.

VICTORIA State Government

Response provided by the Secretary, DoT—*continued*

There are also challenges in relation to the asset valuation methodology used by the Valuer General when compared to asset accounting standards and methodology. This disparity causes anomalies to asset values that has implications across the whole of government.

With this work and the collaboration across the various transport entities, it is anticipated that the quality and level of asset information will significantly improve for next year's reporting and continue to be progressively enhanced over the coming years of the Big Build program.

Yours sincerely

Paul Younis
Secretary
Department of Transport

12 November 2021

Response provided by the Deputy Chief Executive, VicTrack

Our Ref: D/21/47345
11 November 2021

Andrew Greaves
Auditor-General
Victorian Auditor-General's Office
Level 31/35 Collins Street
Melbourne VIC
3000

Dear Mr Greaves

Re: Proposed report: Auditor-General's Report on the Annual Financial Report of the State of Victoria: 2020-21

Thank you for your letter dated 27 October 2021, which included extracts pertaining to the Victorian Rail Track (VicTrack) for the proposed *Auditor-General's Report on the Annual Financial Report of the State of Victoria 2020-21.*

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

Should you require any further information please contact me on 0438 561 891.

Yours sincerely

Chris Olds
Deputy Chief Executive

VicTrack
Level 8, 1010 La Trobe St Docklands VIC 3008
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T 1300 VICTRACK (1300 842 872)
victrack.com.au

VicTrack

ATTACHMENT A - *Response to issues raised by the Auditor-General's Report on the Annual Report of the State of Victoria 2020-21*

VicTrack continues to have a difference of opinion with the Victorian Auditor General's Office (**VAGO**) on the classification of its operating leases, which resulted in the adverse qualification in 2019-20 for VicTrack and its consolidated entities.

VicTrack's position as lessor in relation to these leases as part of the 2020-21 financial statements has been informed by professional accounting advice and remains unchanged from 2019-20. There has been no contractual change that allows VicTrack to change this historical classification under the accounting standards.

We note that VicTrack's treatment as lessor is not connected to the position adopted by the Department of Transport **(DoT)** as lessee, as the adoption of the new Lease accounting standard treats lessor and lessee's differently.

Unadjusted material errors – VicTrack

Maintenance costs

VicTrack agrees with VAGO that these costs should not have been transferred but rather, should have been expensed in the DoT accounts upon construction of the asset.

VicTrack however has followed the Financial Reporting Directions process which requires that the assets are transferred and recorded at fair value as per the capital allocation statements.

As a part of the asset attribute project a portion of transferred costs were identified to be operating expenses in nature. As these assets were recorded on VicTrack's asset register for a number of years VicTrack accounted for the asset write down as an impairment.

Deferred tax losses

Despite the longstanding audited treatment of these balances, the issue was raised late in the 2020-21 audit. Given the quantum of the requested adjustment by VAGO, VicTrack has committed to review this in 2021-22, supported by appropriate modelling and analysis.

Accounts and asset records

VicTrack appreciates VAGO's acknowledgment of the significant work already performed in the assets space and will continue to work collaboratively with DoT to investigate and resolve legacy asset attribute issues in order to identify assets and continuously improve asset records.

The co-developed DoT and VicTrack framework is designed to address the identification and collection issues of asset attributes at the inception of the asset project delivery build across the transport sector. Once this framework is successfully implemented the ongoing issues experienced in relation to poor asset identification and quality will be addressed.

Asset write-offs and write downs

VicTrack facilitated a subsequent valuation process to improve asset information, measurement and quality of reporting for the 2020-21. During this process an anomaly between the valuation methodology and that required by the Australian accounting standards was discovered. VicTrack agrees that resolution of this issue is necessary to ensure proper record keeping is maintained.

VicTrack

APPENDIX B

About this report, the AFR and our financial audits

About this report

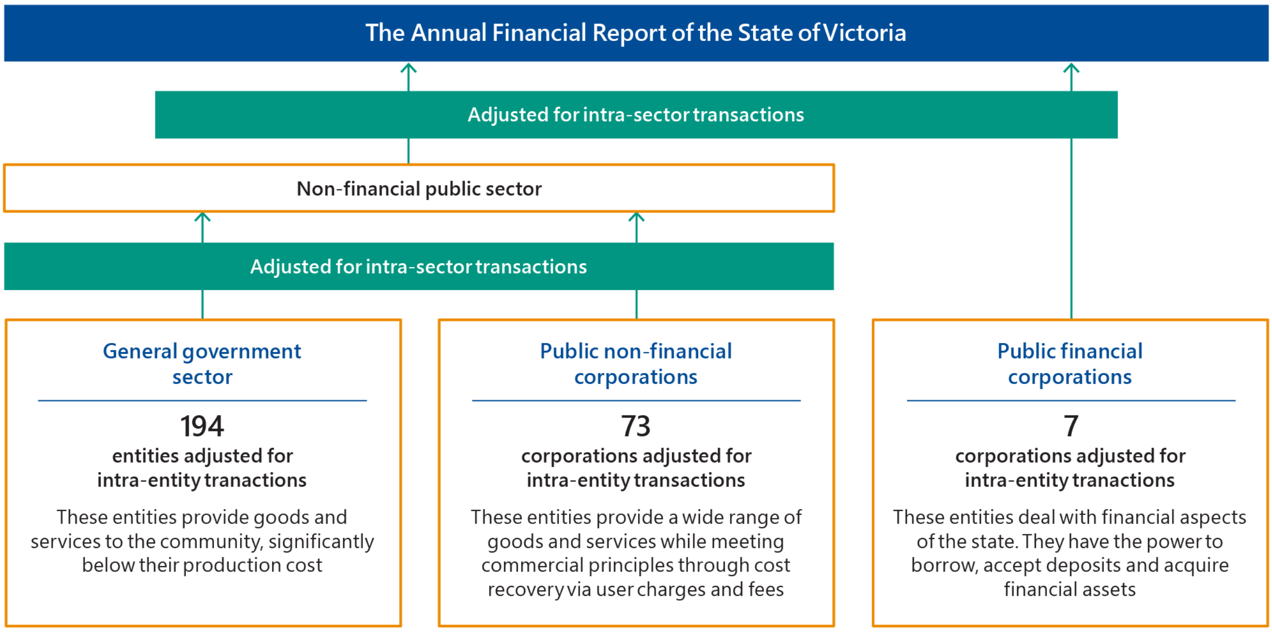
The Auditor-General provides this report to the Parliament of Victoria as required under section 57 of the *Audit Act 1994*. It contains matters we judge as significant and which arise from the audit and pertain to either the effective and efficient management of public resources or the keeping of proper accounts and records.

About the AFR

The AFR presents the financial statements of the state of Victoria and the GGS. It is a consolidation of the financial results of 274 state-controlled entities. Each year we audit and provide opinions on the financial statements of each of the state-controlled entities. We also audit and provide an opinion on the AFR.

The government classifies these entities into three sectors, as shown in Figure B1.

FIGURE B1: Categories of state-controlled entities



Source: VAGO.

Entities not included in the AFR

The AFR only includes state-controlled entities. Other public sector entities that we audit are excluded from the AFR because the state does not control them for financial reporting purposes. These entities prepare separate financial statements.

FIGURE B2: Sectors and entities not included in the AFR

Sectors and entities	Exclusion rationale
Local government	Local government is a separate tier of government, with councils elected by and accountable to their ratepayers.
Universities	The Australian Government is the main sector funder. The state only directly appoints a minority of university council members.
Denominational hospitals	Denominational hospitals are private providers of public health services. Each one has its own governance arrangements.
State superannuation funds	State superannuation funds' net assets are members' property. However, any net asset shortfalls related to certain defined benefit scheme entitlements are a state obligation and are reported in the AFR as a liability.
Registered community health centres and aged-care providers	These providers have various funding streams. Each one has its own governance arrangements.

Source: VAGO.

About our financial audits

We conduct our financial audits in accordance with the *Audit Act 1994* and the Australian Auditing Standards.

For each financial report we:

Evaluate the ...	and design and perform audit procedures that are ...	and form an opinion ...
risks of material misstatement — whether due to fraud or error	responsive to those material risks	based on audit evidence that is sufficient and appropriate.
internal controls relevant to the audit	appropriate in the circumstances	on the appropriateness of using the going concern basis of accounting.
appropriateness of accounting policies used and the reasonableness of accounting estimates and disclosures		on whether the report fairly represents the underlying transactions and events.
overall presentation, structure and content of the financial report		

As part of our audit of the AFR we also:

- obtain evidence regarding the completeness and accuracy of the financial information of the 26 material entities within the AFR
- obtain an understanding of the consolidation process and evaluate the appropriateness, completeness and accuracy of consolidation adjustments, such as intra-agency and intra-sector eliminations.

Internal controls

The *Standing Directions 2018 under the Financial Management Act 1994* require each accountable officer to establish an effective internal control system for their entity's financial management, performance and sustainability.

Effective internal controls help entities to reliably and cost-effectively meet their objectives. Good financial reporting controls are also a prerequisite for delivering sound, accurate and timely external financial reports.

In our annual financial audits, we consider the internal controls most relevant to financial reporting and assess whether entities have managed the risk that their financial reports will not be complete and accurate. Poor internal controls make it more difficult for management to comply with relevant legislation and increase the risk of fraud and errors. They also increase audit risk and cost.

As part of our AFR audit, we assess the impacts of the internal control deficiencies we find at material entities on their and DTF's ability to prepare complete and accurate financial reports.

We report any significant control issues we find to management of each entity and their audit committees as required by auditing standards.

Cost of our audits and this report

The cost of our audit of the AFR was $390 000. The combined cost of our audits of the 26 material entities was approximately $8.2 million. These costs are met by the audited agencies. We receive no other revenue from, and did not carry out non-assurance services for, these entities.

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

Our independence

The Auditor-General is:

- an independent officer of the Parliament of Victoria
- appointed under legislation to examine, on behalf of Parliament and taxpayers, the management of resources within the public sector
- not subject to the control or direction of either Parliament or the government.

The Auditor-General and staff of VAGO are required to meet the ethical requirements of:

- the Australian Auditing Standards and the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants*
- the Code of Conduct for Victorian Public Sector Employees of Special Bodies and the *Public Administration Act 2004*
- the *Standing Directions Under the Financial Management Act 1994*, which provide policies on the acceptance and provision of gifts, benefits, and hospitality.

APPENDIX C

Audit opinion on the AFR

VAGO
Victorian Auditor-General's Office

Independent Auditor's Report

To the Treasurer of the State of Victoria

Opinion	I have audited the consolidated financial report of the State of Victoria (State) and the Victorian General Government Sector (General Government Sector), which comprises the: • consolidated State and General Government Sector balance sheets as at 30 June 2021 • consolidated State and General Government Sector comprehensive operating statements for the year then ended • consolidated State and General Government Sector statements of changes in equity for the year then ended • consolidated State and General Government Sector cash flow statements for the year then ended • notes to the financial statements, including significant accounting policies • certification by the Treasurer and the Department of Treasury and Finance. In my opinion, the consolidated financial report presents fairly, in all material respects, the financial positions of the State and the General Government Sector as at 30 June 2021 and their financial performance and cash flows for the year then ended in accordance with the financial reporting requirements of Section 24 of the *Financial Management Act 1994* and applicable Australian Accounting Standards.
Basis for opinion	I have conducted my audit in accordance with the *Audit Act 1994*, which incorporates the Australian Auditing Standards. I further describe my responsibilities under that Act and those standards in the *Auditor's responsibilities for the audit of the financial report* section of my report. My independence is established by the *Constitution Act 1975*. My staff and I are independent of the State and the General Government Sector in accordance with the ethical requirements of the Accounting Professional and Ethical Standards Board's APES 110 *Code of Ethics for Professional Accountants* (the Code) that are relevant to my audit of the consolidated financial report in Victoria. My staff and I have also fulfilled our other ethical responsibilities in accordance with the Code. I believe that the audit evidence I have obtained is sufficient and appropriate to provide a basis for my opinion.
Key audit matters	Key audit matters are those matters that, in my professional judgement, were of most significance in my audit of the consolidated financial report of the current period. These matters were addressed in the context of my audit of the consolidated financial report as a whole and in forming my opinion thereon, and I do not provide a separate opinion on these matters.

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Key audit matter	How I addressed the matter
Significant COVID-19 grant programs Refer to Note 3.3 *Grant expense*	
Grant expense – $16.4 billion (2019–20 – $11.3 billion) Several grant programs were delivered this financial year to support Victorian individuals and businesses in response to the economic impact of the coronavirus (COVID-19) pandemic. The Department of Jobs, Precincts and Regions processed an unprecedented volume of grant applications and payments across the financial year, including $3.4 billion in COVID-19 support grants. I considered COVID-19 grant programs and the resultant expenditure to be a key audit matter because: • the significant growth in grant distribution compared to prior years required scaling up of government resources, processes and functions in short time frames • varying programs, eligibility criteria and conditions increased the potential for error • there was increased pressure associated with managing and distributing funds during a pandemic • grant payments are susceptible to fraud.	My key procedures included: • gaining an understanding of the COVID-19 grant programs, their eligibility criteria and conditions, and the control environment supporting them, including IT systems and monitoring controls • placing reliance on internal audit and the work of management experts. Due to the evolving design of controls over the COVID-19 grant programs at the Department of Jobs, Precincts and Regions, there was not sufficient controls in operation which I could place reliance on for my audit. In response, I changed my audit approach to: • increase the number of grant payments I conducted detailed substantive testing over • obtain external confirmations on eligibility criteria from independent partner agencies • reperform dataset matching using external data sources • verify bank payment details.
Recognition and measurement of transport assets Refer to Note 4.1 *Land, buildings, infrastructure plant and equipment* and Note 7.5 *Fair value determination of non-financial assets*	

Significant spending on capital projects in the transport sector results in large additions to the State's asset base each year.
The State is ultimately responsible for ensuring proper accounts and records are maintained to sufficiently explain the financial impact these assets have on the financial operations and financial position of the State.
I considered this to be a key audit matter because:
• transport assets are financially significant
• capital projects in the transport sector are complex, and each project results in multiple assets being constructed
• a significant degree of management judgement is required to:
    ○ determine individual assets within a project
    ○ determine which expenses should be capitalised
    ○ allocate capital expenses to individual assets
    ○ determine the fair value of individual assets.
• multiple agencies are involved in the management and delivery of capital projects in the transport sector which makes the timely recognition and derecognition of assets challenging
• Victorian Rail Track (VicTrack) is the custodial owner of a large portion of the State's transport assets. Significant asset accounting issues are being addressed at VicTrack.
	My key procedures included:
	• assessing management's process to identify individual assets within a project, and the costs directly attributable to those assets
	• assessing the results of the work undertaken by management to review work in progress balances and capitalise completed projects
	• reviewing management's assessment of the existence of assets, and the completeness and accuracy of asset records
	• reviewing the accounting treatment for asset additions, disposals and replacements against the requirements of Australian Accounting standards
	• assessing the results of fair value assessments, challenging assumptions contained within, and investigating significant variances
	• assessing the potential impact of identified issues on the financial statements.

Audit opinion on the AFR—*continued*

Key audit matter	How I addressed the matter
Recognition and measurement of service concession assets and liabilities Refer to Note 4.1 *Land, buildings, infrastructure, plant and equipment*, Note 4.2 *Other non-financial assets,* Note 5.1 *Borrowings*, Note 5.3 *Service concession arrangements,* and Note 6.4 *Payables and contract liabilities*	

Service concession assets – $27.7 billion
Service concession financial liabilities – $6.5 billion
Service concession grant of a right to the operator (GORTO) liabilities – $9.6 billion
There are three types of service concession arrangements:
• arrangements where the State has contractual obligations to make payments and other contributions to the operators for the construction and operation of the assets
• arrangements where the State has granted the operators the right to charge the public directly for the use of the assets
• hybrid arrangements where the State has granted the operators the right to charge the public for use of the asset and the State makes contractual payments and other contributions to the operator.
I considered this to be a key audit matter because:
• service concession assets and liabilities are financially significant
• the requirements of AASB 1059 *Service Concession Arrangements: Grantors* are complex, and their application requires significant management estimation and judgement
• service concession arrangements and the financial models used to value the assets and liabilities are complex
• a significant degree of management judgement is required to determine the key assumptions used in valuing the assets and liabilities
• the required disclosures for service concession assets and liabilities are extensive.
	My key procedures included:
	• reviewing all contracts, supporting schedules, financial models and professional accounting advice received by the State, where applicable
	• engaging appropriately qualified independent subject matter experts to review certain valuation methodologies and financial models and assess the:
	  ○ appropriateness of fair value methodologies
	  ○ reasonableness and consistency of assumptions
	  ○ reasonableness of inputs against underlying data and supporting documentation
	  ○ accuracy of models.
	• reviewing all other financial models and confirming the judgements applied by management to independent expert reports
	• assessing the completeness and accuracy of service concession assets and liabilities against the contracts and underlying financial models for each project
	• comparing the reasonableness of asset amounts against actual costs incurred
	• assessing the accounting treatment against the requirements of AASB 1059, and the reasonableness of management judgements made in the application of the standard
	• assessing the adequacy of financial report disclosures against the requirements of Australian Accounting Standards.

Key audit matter	How I addressed the matter
Valuation of defined benefit superannuation liability Refer to Note 6.5 *Superannuation*	
Defined benefit superannuation liability – $27.2 billion. I considered this to be a key audit matter because: • the defined benefit superannuation liability is financially significant • the underlying model used to value the liability is complex • a significant degree of management judgement is required to determine the method, the model and key assumptions used in valuing the liability • a small adjustment to an assumption may have a significant effect on the total value of the liability • extensive disclosures are required by Australian Accounting Standards which are critical to the users understanding of the valuation of this liability. Management engage an actuary to value the liability as at 30 April, then adjust the value of the liability to account for actual market performance and movements in key assumptions up to 30 June.	My key procedures included: • testing the operating effectiveness of key controls supporting the membership data used in the model • reconciling membership data in the model to the data in the Emergency Services Superannuation Scheme (ESSS) system • obtaining management's actuarial report and year-end adjustments, and engaging an appropriately qualified independent actuary to: ○ assess the appropriateness of management's selection and application of the method, significant assumptions and data used in valuing the liability ○ assess the appropriateness of the model used to value the liability ○ challenge the reasonableness of key assumptions by comparing against accepted industry benchmarks ○ assess the reasonableness of the reported liability value. • assessing the adequacy of financial report disclosures against the requirements of Australian Accounting Standards.
Valuation of provision for insurance claims Refer to Note 6.6 *Other provisions*	
Provision for insurance claims – $47.4 billion. I considered this to be a key audit matter because: • the provision for insurance claims is financially significant • there are several insurance claims categories at the Victorian WorkCover Authority, Transport Accident Commission and Victorian Managed Insurance Authority which make up the provision and must be valued • the underlying models used to value the provision are complex • the valuation of the provision is subject to significant management assumptions and estimation uncertainty • a small adjustment to an assumption may have a significant effect on the total value of the provision • extensive disclosures are required by Australian Accounting Standards which are critical to the users understanding of the valuation of this provision. Management engage actuaries to value the provision as at 30 June.	My key procedures included: • testing the operating effectiveness of key controls supporting the underlying claims data used in the models • reconciling claims data in the models to the data in the Victorian WorkCover Authority, Transport Accident Commission and Victorian Managed Insurance Authority systems • obtaining management's actuarial reports, and engaging an appropriately qualified independent actuary to: ○ assess the appropriateness of management's selection and application of the methods, significant assumptions and data used in valuing the provision ○ assess the appropriateness of the models used to value the provision ○ challenge the reasonableness of key assumptions by comparing against claims history and accepted industry benchmarks ○ assess the reasonableness of the reported provision value. • assessing the adequacy of financial report disclosures against the requirements of Australian Accounting Standards.

Key audit matter	How I addressed the matter
Other information	The Treasurer of Victoria is responsible for the Other Information, which comprises the information in chapters 1–3 and 5 of the 2020–21 Financial Report but does not include the consolidated financial report in chapter 4 and my auditor's report thereon. My opinion on the consolidated financial report does not cover the Other Information and accordingly, I do not express any form of assurance conclusion on the Other Information. However, in connection with my audit of the consolidated financial report, my responsibility is to read the Other Information and in doing so, consider whether it is materially inconsistent with the consolidated financial report or the knowledge I obtained during the audit, or otherwise appears to be materially misstated. If, based on the work I have performed, I conclude there is a material misstatement of the Other Information, I am required to report that fact. I have nothing to report in this regard.
Treasurer's responsibilities for the consolidated financial report	The Treasurer of Victoria is responsible for the preparation and fair presentation of the consolidated financial report in accordance with Australian Accounting Standards and the *Financial Management Act 1994*, and for such internal control as the Treasurer determines is necessary to enable the preparation of a consolidated financial report that is free from material misstatement, whether due to fraud or error. In preparing the consolidated financial report, the Treasurer is responsible for assessing the State and the General Government Sector's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless it is inappropriate to do so.
Auditor's responsibilities for the audit of the consolidated financial report	As required by the *Audit Act 1994*, my responsibility is to express an opinion on the consolidated financial report based on the audit. My objectives for the audit are to obtain reasonable assurance about whether the consolidated financial report as a whole is free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes my opinion. Reasonable assurance is a high level of assurance but is not a guarantee that an audit conducted in accordance with the Australian Auditing Standards will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this consolidated financial report. As part of an audit in accordance with the Australian Auditing Standards, I exercise professional judgement and maintain professional scepticism throughout the audit. I also: • identify and assess the risks of material misstatement of the consolidated financial report, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for my opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control • obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the State and the General Government Sector's internal control • evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by the Treasurer • conclude on the appropriateness of the Treasurer's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the State and the General Government Sector's ability to continue as a going concern. If I conclude that a material uncertainty exists, I am required to draw attention in my auditor's report to the related disclosures in the consolidated financial report or, if such disclosures are inadequate, to modify my opinion. My conclusions are based on the audit evidence obtained up to the date of my auditor's report. However, future events or conditions may cause the State and the General Government Sector to cease to continue as a going concern

Audit opinion on the AFR—*continued*

Key audit matter	How I addressed the matter
Auditor's responsibilities for the audit of the consolidated financial report (continued)	• evaluate the overall presentation, structure and content of the consolidated financial report, including the disclosures, and whether the consolidated financial report represents the underlying transactions and events in a manner that achieves fair presentation • obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the State and the General Government Sector to express an opinion on the consolidated financial report. I remain responsible for the direction, supervision and performance of the audit of the consolidated financial report. I remain solely responsible for my audit opinion. I communicate with the Treasurer regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that I identify during my audit. From the matters communicated with the Treasurer, I determine those matters that were of most significance in the audit of the consolidated financial report of the current period and are therefore key audit matters. I describe these matters in the auditor's report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, I determine that a matter should not be communicated in the auditor's report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

MELBOURNE
6 October 2021

Andrew Greaves
Auditor-General

APPENDIX D

Results of material entity audits

FIGURE D1: Audit opinions issued for material entities

Entity	Sector	Benefit	Revenue ($ million)	Expenses ($ million)	Assets ($ million)	Liabilities ($ million)	Certified	Opinion	Type
Department of Education and Training	GGS	Controlled	16 731.6	16 121.4	33 535.4	3 302.9	31/8/21	8/9/21	Unmodified
		Administered	4 004.5	3 963.9	42.9	–			
Department of Environment, Land, Water and Planning	GGS	Controlled	3 157.2	3 184.0	10 344.7	741.0	30/9/21	4/10/21	Unmodified
		Administered	2 045.0	1 963.9	5 218.6	6 035.6			
Department of Health[a]	GGS	Controlled	25 698.4	25 170.7	40 433.6	3 157.7	30/9/21	5/10/21	Unmodified
		Administered	15 000.5	15 140.3	717.3	717.3			
Department of Jobs, Precincts and Regions	GGS	Controlled	7 193.8	7 169.0	3 185.8	1 348.8	29/9/21	30/9/21	Unmodified
		Administered	994.9	959.8	394.9	546.8			
Department of Justice and Community Safety	GGS	Controlled	10 604.8	10 541.9	6 695.2	2 711.9	14/10/21	18/10/21	Unmodified
		Administered	1 358.3	962.1	1 411.6	201.2			
Department of Premier and Cabinet	GGS	Controlled	642.8	632.2	881.2	95.7	22/9/21	29/9/21	Unmodified
		Administered	18.3	18.3	24.4	24.5			
Department of Transport	GGS	Controlled	10 127.0	10 345.0	103 657.2	16 513.0	9/9/21	14/9/21	Unmodified
		Administered	3 241.0	3 244.8	29 871.2	29 858.8			
Department of Treasury and Finance	GGS	Controlled	604.0	569.9	1 392.3	150.8	4/10/21	6/10/21	Unmodified
		Administered	69 204.3	86 030.1	196 542.9	118 577.5			

Entity	Sector	Benefit	Revenue ($ million)	Expenses ($ million)	Assets ($ million)	Liabilities ($ million)	Certified	Opinion	Type
National Gallery of Victoria	GGS	Controlled	128.6	123.8	4 529.6	44.1	26/8/21	1/9/21	Unmodified
Office of the Chief Commissioner of Police	GGS	Controlled	4 110.7	4 107.8	4 651.6	2 809.0	15/9/21	21/9/21	Unmodified
		Administered	63.9	73.7	77.6	87.2			
Victoria Commission for Gambling and Liquor Regulation	GGS	Controlled	Not complete	Not complete	Not complete	Not complete	Not complete	Not complete	Not complete
		Administered							
Monash Health	GGS	Controlled	2 719.2	2 536.3	2 751 3	1 887.2	30/8/21	16/9/21	Unmodified
Melbourne Health	GGS	Controlled	1 560.2	1 576.0	1 407.5	575.2	25/8/21	31/8/21	Unmodified
Eastern Health	GGS	Controlled	1 288.4	1 317.2	1 502.2	478.8	23/8/21	13/9/21	Unmodified
The Royal Children's Hospital	GGS	Controlled	900.2	934.1	1 738.4	1 200.3	16/8/21	9/9/21	Unmodified
Victorian Rail Track	PNFC	Controlled	2 764.1	3 656.8	39 174.4	2 165.5	16/9/21	21/9/21	Modified
Melbourne Port Lessor Pty Ltd	PNFC	Controlled	188.8	1 556.2	11 662.6	9 576.8	22/9/21	27/9/21	Unmodified
Goulburn–Murray Rural Water Corporation	PNFC	Controlled	184.5	298.6	4 912 .5	669.0	25/8/21	3/9/21	Unmodified
Melbourne Water Corporation	PNFC	Controlled	1 988.7	1 696.1	16 330.1	9 675.4	27/8/21	2/9/21	Unmodified
City West Water Corporation	PNFC	Controlled	703.1	646.3	2 728.2	1 927.5	24/8/21	2/9/21	Unmodified
South East Water Corporation	PNFC	Controlled	1 055.4	927.5	4 767.3	2 774.1	30/8/21	3/9/21	Unmodified
Yarra Valley Water Corporation	PNFC	Controlled	1 311.4	995.7	5 600.1	3 929.0	27/8/21	7/9/21	Unmodified
Transport Accident Commission	PFC	Controlled	4 450.8	926.2	20 007.6	21 588.2	26/8/21	6/9/21	Unmodified
Treasury Corporation of Victoria	PFC	Controlled	172.1	40.4	97 096.8	96 795.8	12/8/21	27/8/21	Unmodified

Entity	Sector	Benefit	Revenue ($ million)	Expenses ($ million)	Assets ($ million)	Liabilities ($ million)	Certified	Opinion	Type
Victorian WorkCover Authority	PFC	Controlled	6 585.2	7 605.3	24 276.9	25 402.4	25/ 8/ 21	8/ 9/ 21	Unmodified
Victorian Managed Insurance Authority	PFC	Controlled	994.3	732.8	3 268.7	3 282.3	30/8/21	6/9/21	Unmodified
Total GGS[(b)]			**72 649**	**87 207**	**304 415**	**150 617**			
Total PNFC[(b)]			**12 603**	**11 882**	**113 351**	**40 398**			
Total PFC[(b)]			**9 871**	**13 172**	**136 109**	**141 547**			

Notes: [(a)] Effective from 1 February 2021, the Department of Health and Human Services was renamed the Department of Health (DH) and the new Department of Families, Fairness and Housing (DFFH) was created. Figures include DH and DFFH

[(b)] Amounts include transactions between sectors. These are eliminated on consolidation in the AFR.

Source: VAGO.

APPENDIX E
Acronyms, abbreviations and glossary

Acronyms

AFR	*2020–21 Annual Financial Report of the State of Victoria*
CQV	COVID-19 Quarantine Victoria
DELWP	Department of Environment, Land, Water and Planning
DFFH	Department of Families, Fairness and Housing
DH	Department of Health
DJCS	Department of Justice and Community Safety
DJPR	Department of Jobs, Precincts and Regions
DoT	Department of Transport
DTF	Department of Treasury and Finance
GGS	general government sector
GSP	gross state product
GST	goods and services tax
IT	Information technology
KAM	Key audit matters
PFC	Public Financial Corporations
TAC	Transport Accident Commission
VAGO	Victorian Auditor-General's Office
VCGLR	Victorian Commission for Gambling and Liquor Regulation
VMIA	Victorian Managed Insurance Authority

Abbreviations

Crown	Crown Melbourne Limited
Oracle Cloud	Oracle Fusion Cloud Services
VicTrack	Victorian Rail Track
WorkSafe	Victorian WorkCover Authority

Glossary

Accountability	Responsibility of public sector entities to achieve their objectives in the reliability of financial reporting; effectiveness and efficiency of operations; compliance with applicable laws; and reporting to interested parties.
Clear audit opinion	A clear audit opinion adds credibility to the financial statements by providing reasonable assurance that reported information is reliable and accurate and complies with the requirements of relevant Australian accounting standards and applicable legislation.
Intra-sector or intra-entity transactions	Financial transactions that occur between two entities in the same sector, or between two sectors of government. When an annual financial report is prepared, the accounts are adjusted so these transactions are not counted twice.
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.
Key audit matters	Auditors may include a description of key audit matters (KAMs) in the auditor's report, as described in auditing standard ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*. KAMs are determined by the auditor as the matters of most significance to the audit. We voluntarily adopt KAM reporting for the AFR and material entities to enhance the value of our audit reports by providing greater transparency and insights about our audit process. KAMs are not opinions and are not necessarily adverse findings.
Material	Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions that users make on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances. The size or nature of the item, or a combination of both, could be the determining factor.
Quality financial reporting	Quality financial reports reliably represent an entity’s financial performance and position. The nature, frequency, and size of any errors in financial reports are direct measures of the quality of financial reports submitted for auditing. When presented for an audit there should be no errors in the in draft financial reports. The auditor raises any errors we identify with the entity. Entities must correct material errors before we can issue a clear audit opinion.

APPENDIX F

Auditor-General's reports tabled during 2020–21

Report title	
Integrated Transport Planning (2021–22: 01)	August 2021
Major Infrastructure Program Delivery Capability (2021–22: 02)	August 2021
Clinical Governance: Department of Health (2021–22: 03)	September 2021
Managing Conflicts of Interest in Procurement (2021–22: 04)	September 2021
Major Projects Performance (2021–22: 05)	September 2021
Administration of Victorian Courts (2021–22: 06)	October 2021
Protecting Victoria's Biodiversity (2021–22: 07)	October 2021
Management of Spending in Response to COVID-19 (2021–22: 08)	October 2021
Supplying and Using Recycled Water (2021–22: 09)	November 2021
Auditor-General's Report on the Annual Financial Report of the State of Victoria: 2020–21 (2021–22: 10)	November 2021

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

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