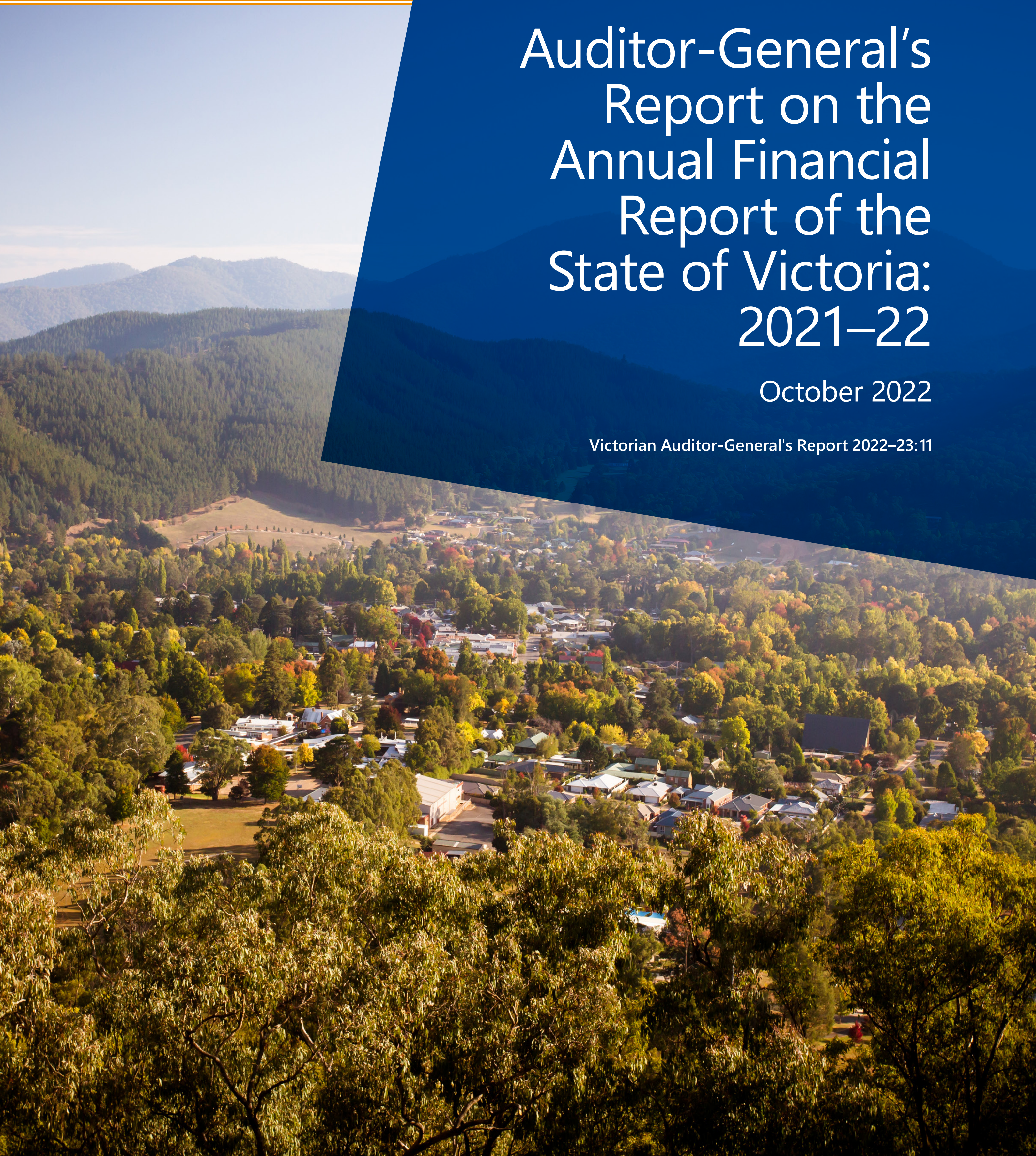
VAGO

Victorian Auditor-General's Office

# Auditor-General's Report on the Annual Financial Report of the State of Victoria: 2021–22

October 2022

Victorian Auditor-General's Report 2022–23:11



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# Auditor-General's Report on the Annual Financial Report of the State of Victoria: 2021–22

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The Hon Nazih Elasmar MLC
President
Legislative Council
Parliament House
Melbourne

The Hon Maree Edwards 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: 2021–22*.

Yours faithfully

[redacted]

Andrew Greaves
Auditor-General
28 October 2022

The Victorian Auditor-General's Office acknowledges the Wurundjeri Woi Wurrung People as the traditional custodians of the land on which our office is located. We pay our respect to their Elders past and present.

# Report snapshot

The *2021–22 Annual Financial Report of the State of Victoria* (AFR) is free from material error and we issued an unmodified audit opinion on it.

## Key audit matters

We issued clear opinions on 25 of the 28 material entities' financial reports.

We continue to modify our audit opinion on the financial report of Victorian Rail Track, a significant controlled entity of the state, because of how assets leased to the Department of Transport are accounted.

We are yet to provide audit opinions on the financial reports of the Department of Jobs, Precincts and Regions and the North East Link State Tolling Corporation.

## Financial performance

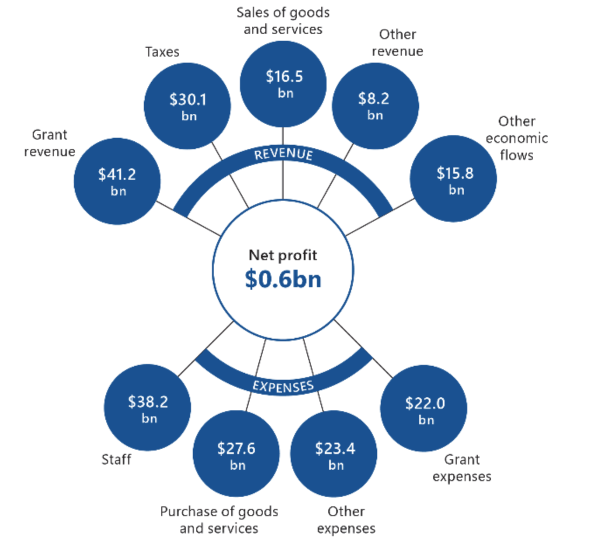
The COVID-19 pandemic continues to affect the financial performance and position of the state, with longer-term consequences for its financial sustainability.

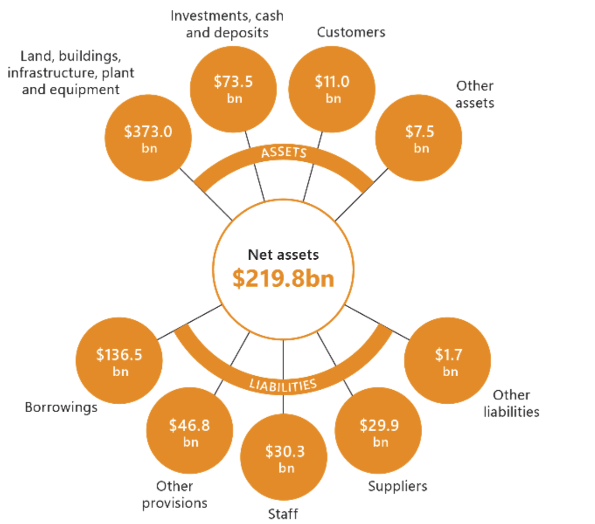
The general government sector (GGS) made an operating loss from transactions of $13.8 billion and had an operating cash deficit of $8.9 billion.

Debt increased during the year to fund planned and unplanned infrastructure investment and to finance the operating cash deficit. Net operating cashflows are estimated to remain in deficit over the short term. To be able to repay and reduce net debt, cashflows need to come into surplus. While they are in deficit, debt will continue to grow.

Delays in achieving cost-saving initiatives through targeted public sector staff reductions put at risk the return to cash and operating surpluses in the timeframes expressed in the most recent state Budget.

## Key numbers for the State of Victoria for the year ended, and as at, 30 June 2022



# 1. Audit outcomes

## 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 (GGS), as reported in the *2021–22 Annual Financial Report of the State of Victoria* (AFR), are reliable.

The separate financial reports of 25 of the 28 material entities (entities that contribute most to the consolidated financial results in the AFR) are also reliable. We found material errors in the financial report of Victorian Rail Track (VicTrack), but they were corrected on consolidation into the AFR.

At the time we prepared this report, we were yet to provide audit opinions to the Department of Jobs, Precincts and Regions (DJPR) and the North East Link State Tolling Corporation (STC).

**This chapter covers:**

- Our audit opinions
- The timeliness of financial reports

## 1.1 Audit outcomes

Each year we audit and provide opinions on the financial reports of the 284 state-controlled entities consolidated into the Annual Financial Report of the State of Victoria.

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

A **clear audit opinion** adds credibility to the AFR by 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 AFR

We provided a clear (unmodified) audit opinion on the AFR.

Our unmodified opinion provides reasonable assurance that the financial performance and position of the State of Victoria, and within that the GGS, as reported in the AFR, are reliable.

Auditors may include a description of key audit matters in the auditor's report, as described in auditing standard ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*.

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

The key audit matters highlighted in our audit report address our approach to auditing:

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

We have reproduced our audit report on the AFR in Appendix C.

### Audits of material entities

In 2021–22, 28 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 issued clear opinions on 25 of the 28 material entities' financial reports.

At the time we prepared this report, we were yet to provide our opinion to DJPR and STC.

We:

- issued an adverse audit opinion to VicTrack for the third year in a row
- included an emphasis of matter paragraph in our audit report of the Victorian Gambling and Casino Control Commission (VGCCC), which we explain below.

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

#### VicTrack

We issued an adverse opinion on the financial report of VicTrack again this year. VicTrack continues to incorrectly account for the assets it leases to the Department of

Transport (DoT). This incorrect accounting is material and pervasive to VicTrack's financial report.

In 2020 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.

DoT is responsible for the operation of the transport network as a whole. In this regard, DoT:

- directs the use of transport 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.

Appendix E explains the accounting for lease arrangements of operational transport assets.

### Victorian Gambling and Casino Control Commission

VGCCC (previously the Victorian Commission for Gambling and Liquor Regulation) regulates and collects casino and gambling tax on behalf of the state and reports the associated transactions and balances in the notes to its financial report.

On 1 January 2022, the *Victorian Commission for Gambling and Liquor Regulation Act 2011* became the *Victorian Gambling and Casino Control Commission Act 2011*. At the same time, the Victorian Commission for Gambling and Liquor Regulation became the Victorian Gambling and Casino Control Commission.

In 2021, the Victorian government established a Royal Commission into the Casino Operator and Licence (Royal Commission) to inquire and report on Crown Melbourne Limited's (Crown Casino) suitability to hold its Victorian casino licence. The Royal Commission delivered its final report in October 2021, which described the approach taken and various recommendations to the regulator, manager, government and casino operator. The report is on the Royal Commission's independent website.

The Royal Commission revealed that Crown Casino may have underpaid casino tax to the state. In response, Crown Casino completed a review of casino tax payments in July 2021 and made a payment of $62 million to the state. This amount was an underpayment of casino tax that had accumulated since 2012 and included penalty interest. In its 2021 financial report, the Victorian Commission for Gambling and Liquor Regulation reported it as revenue.

We qualified our audit opinion on the financial report in 2021 because we did not have sufficient evidence to support the underpaid casino tax. In 2022 we accessed complete and accurate evidence and then removed last year's qualification.

Similar to the previous year, we included an emphasis of matter paragraph in our audit report. We drew attention to the state's ongoing engagement with Crown Casino and tax issues they are considering. These issues may lead to further payments of tax with penalty interest.

### Department of Jobs, Precincts and Regions

We have not yet provided an audit opinion for the financial report of DJPR.

DJPR paid $7.6 billion ($3.4 billion in 2020–21) to support Victorian individuals and businesses affected by the COVID-19 pandemic in 2021–22. DJPR received an unprecedented volume of grant applications for multiple support programs, all with varied eligibility criteria and conditions increasing the potential for error. Our audit work over this area is ongoing at the date of this report.

Processing grant applications occurred in a challenging environment given the increased pressure associated with the pandemic, limitations of independent source data available when processing applications, and the challenge to balance such processes against the distribution of much-needed financial support for the Victorian community.

In our *Auditor-General's Report on the Annual Financial Report of the State of Victoria: 2020–21*, we highlighted that we could not rely on the department’s controls over the COVID-19 grant programs because:

- procedures and controls were established in a short timeframe
- applicants were required to demonstrate eligibility to receive funding, with criteria differing by program
- applicant eligibility checks against independent source data were performed manually and staff had full and unrestricted editing access to the grants system
- eligibility was verified quickly so that grants could be paid.

Last year we performed alternative audit procedures to gain comfort over the validity and accuracy of grant money disbursed. We concluded that a risk remained that the state may have paid grants to ineligible recipients in light of the anomalies identified. But the anomalies we identified from these procedures were not considered material when projected over the population of grants.

In 2021–22 there were still not sufficient controls we could place reliance on. Alternative audit procedures were again executed to gain comfort over grant money disbursed. Given the weakened control environment and previous risk of ineligible payments identified, this year we determined that part of our audit testing needed to analyse and understand, after the fact, whether any payments have been made in error or outside of the eligibility criteria.

Except for this testing, all other elements of DJPR’s financial report have been audited. The outstanding work relating to the COVID-19 grant payments does not pose a material risk to the AFR. As a result, we completed our audit of DJPR after we audited the AFR.

### North East Link State Tolling Corporation

On 1 March 2021, the government established STC as a statutory corporation. STC is responsible for the North East Link road, including:

- managing and controlling its use
- access, operation and maintenance
- setting and collecting tolls on the tollway when the road opens.

We deemed STC a material entity in 2021–22 because the project is financially significant to the state. The material financial component of STC's financial report related only to the off-balance sheet commitments disclosed for the project because STC was recently established. We prioritised the audit of these STC commitments so that the Department of Treasury and Finance (DTF) could include a note in the AFR.

**Off-balance sheet** commitments are assets and liabilities that an entity has committed to but not yet included in its balance sheet.

We believe no other transaction or balance in STC’s financial report has a material risk to the AFR. As a result, we completed STC's audit after we audited the AFR.

## 1.2 The timeliness of financial reporting

DTF and controlled entities must complete tasks by the dates set in the *Financial Management Act 1994*. DTF also set dates that material entities must follow. We are required to audit entities by the dates set in the *Audit Act 1994*.

The *Financial Management Act 1994* requires entities to provide certified financial reports to VAGO within 8 weeks of the balance date (30 June), which is 25 August.

The *Audit Act 1994* requires us to provide the entity with an audit opinion within 4 weeks of receiving its certified financial report, which is 22 September. To meet this date, the year-end audit program at material entities begins in mid-July.

Financial reporting timelines are challenging in a normal year for all stakeholders involved. The 2021–22 reporting cycle was more challenging due to:

- the flow-on workforce impacts from the pandemic
- scarce resources in the accounting industry
- workforce pressure on corporate finance functions of the entities we audit
- the state election in November 2022.

Figure 1A shows the key dates for reporting requirements this year.

Under the *Financial Management Act 1994*, entities have until 31 October to table their annual reports. They must also table their annual reports when Parliament is sitting.

This year, annual report timelines were shorter because the last sitting day of Parliament was mid-September. This meant that financial reporting timelines were also shorter.

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 entities' financial reports and the AFR.

Consistent with the last 2 financial reporting periods, DTF and VAGO adopted a staged approach to the year-end financial reporting program and prioritised the preparation and audit of material entities' financial reports and the AFR.

We jointly acknowledged that during such challenging times and particularly in the lead-up to the state election, transparency and accountability of significant government expenditure is critical. Hence, the focus on these financial reports.

DTF and VAGO worked with material entities and remained agile to meet reporting timelines for the production and transmission of the AFR to Parliament.

FIGURE 1A: **Key dates for reporting requirements**

| Material entity dates | 2022 | AFR dates |
|---|---|---|
| **27 July (GGS) and 1 August (PNFC and PFC)**<br>Material entities provide trial balances to DTF | Jul | **Date set by:**<br>**DTF**<br>*Financial Management Act 1994*<br>*Audit Act 1994* |
| **10 August (GGS, PNFC and PFC)**<br>Material entities provide requested note disclosure information to DTF<br><br>**25 August**<br>Material entities provide financial reports to Auditor-General | Aug | |
| **6 September (GGS, PNFC and PFC)**<br>Material entities confirm with DTF they have received signed Auditor-General's opinions<br><br>**22 September (4 weeks following receipt)**<br>Final date for Auditor-General's opinion on material entities' financial reports | Sep | **20 September (or before)**<br>Treasurer provides a copy of AFR to Auditor-General<br><br>**30 September (a reasonable time before AFR is required to be transmitted to Parliament)**<br>Final date for Auditor-General's opinion on AFR |
| **By 31 October or on the first sitting day after that[1]**<br>Material entities' audited financial reports tabled in Parliament | Oct | **15 October**<br>Audited AFR transmitted to Parliament |
| | Nov | **3 November (minimum 10-day comment period)[2]**<br>Auditor-General provides proposed report to Treasurer for comments<br><br>**17 November[2]**<br>Treasurer provides comments to Auditor-General on proposed report<br><br>**24 November[2]**<br>Auditor-General transmits report on AFR to Parliament |

*Note:* [1]This year, material entities were required to use best endeavours to complete and table annual reports by 21 September 2022—the last parliamentary sitting day before the state election.

[2]This year, these dates were brought forward to ensure they occurred before Parliament dissolved for the state election.

Note: PFC stands for public financial corporation and PNFC stands for public non-financial corporation.

*Source*: VAGO.

In 2021–22, 5 material entities provided certified financial reports and a further 21 provided draft financial reports by 25 August. We were able to provide 25 of the 28 material entities with an audit opinion by 22 September and a further one before we provided the Treasurer with our audit opinion on the AFR.

As previously noted, the financial audits of STC and DJPR were not complete by the date of this report. This did not affect 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.

Despite the challenges and time pressures, the AFR was finalised on 29 September and we provided our audit opinion on 3 October. Agencies and our audit teams are to be commended for achieving these outcomes given the pressures faced.

As a result of our staged approach to year-end, we audited non-material entities, which are also consolidated in the AFR, later than in the past. Some audits are still occurring at the date of this report.

# 2.
# Financial outcomes for the GGS

## Conclusion

In 2021–22 the state made an operating loss from transactions of $15.3 billion (compared to $18.3 billion in 2020–21) and had an operating cash deficit of $4.8 billion (compared to $9.3 billion in 2020–21).

The GGS made an operating loss from transactions of $13.8 billion (compared to $14.6 billion in 2020–21) and had an operating cash deficit of $8.9 billion (compared to $13.0 billion in 2020–21).

The government's response to the COVID-19 pandemic continued to adversely affect the financial performance and position of the state.

Net debt for the state increased by $15.2 billion in 2021–22 and by $27.2 billion for the GGS. The state borrowed to fund the operating cash deficit and its infrastructure program.

**This chapter covers:**

- Our analysis of GGS financial measures and targets
- Managing GGS debt and expenditure
- Emerging risks

## 2.1 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 after the pandemic. The targets are now mainly qualitative rather than quantitative 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 2021–22 state Budget and the actual outcomes it reported for 2021–22 and 2020–21.

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

| Financial measure | Target | 2020–21 actual | 2021–22 Budget | 2021–22 actual |
|---|---|---|---|---|
| Net debt to gross state product (GSP)[(a)] | General government net debt as a percentage of GSP to stabilise in the medium term | 15.3 per cent | 20.3 per cent | 19.4 per cent |
| Interest expense to revenue | General government interest expense as a percentage of revenue to stabilise in the medium term | 3.6 per cent | 4.1 per cent | 3.5 per cent |
| Superannuation liabilities (contribution to the State Superannuation Fund) | Fully fund the unfunded superannuation liability by 2035 | $1.1 billion | $1.0 billion | $1.0 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 | $13.0 billion net operating cash deficit | $2.0 billion net operating cash deficit | $8.9 billion net operating cash deficit |

*Note*: [(a)]Net debt is 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.

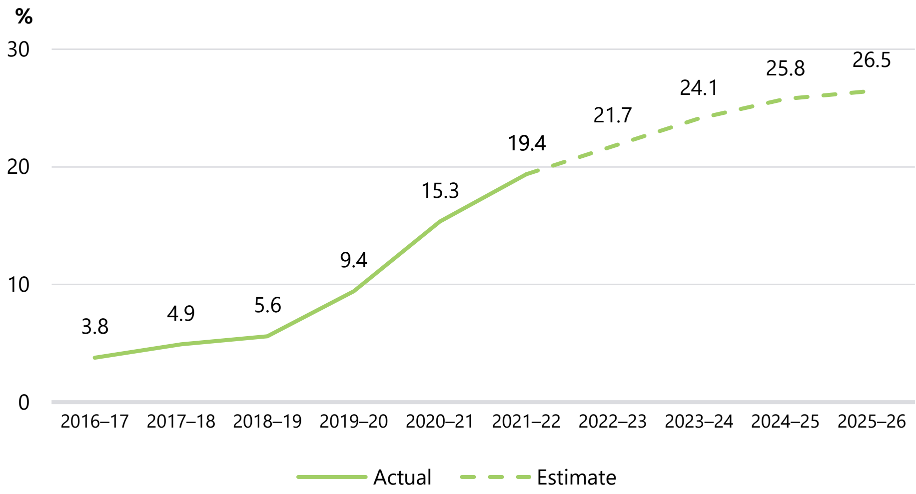
[(b)]This is represented by the net cashflows from operating activities as disclosed in the consolidated cashflow statement.

*Source:* VAGO, using data from the state Budget and the AFR.

## 2.2 Managing GGS indebtedness

Figure 2B illustrates how the state's debt burden has grown since 2016–17 and is forecast to grow relative to economic activity, as measured by GSP. The target for this metric—the government's preferred measure of financial indebtedness—has changed since 2019–20.

FIGURE 2B: **GGS net debt as a percentage of GSP**




*Source:* VAGO, using data from the state Budget and the AFR.

Before then, the government had committed to stabilising net debt at 12 per cent of GSP over the medium term. This target, previously 6 per cent, took account of the change to accounting standards, which required operating leases to be recognised as debt, and reflected the significant planned uplift in government infrastructure investment.

In the 2020–21 Budget, the measure's qualitative expression shifted from 'general government net debt as a percentage of GSP to be maintained at a sustainable level over the medium term' (set in 2015–16) to 'general government net debt as a percentage of GSP to stabilise in the medium term'.

## Gross debt to revenue

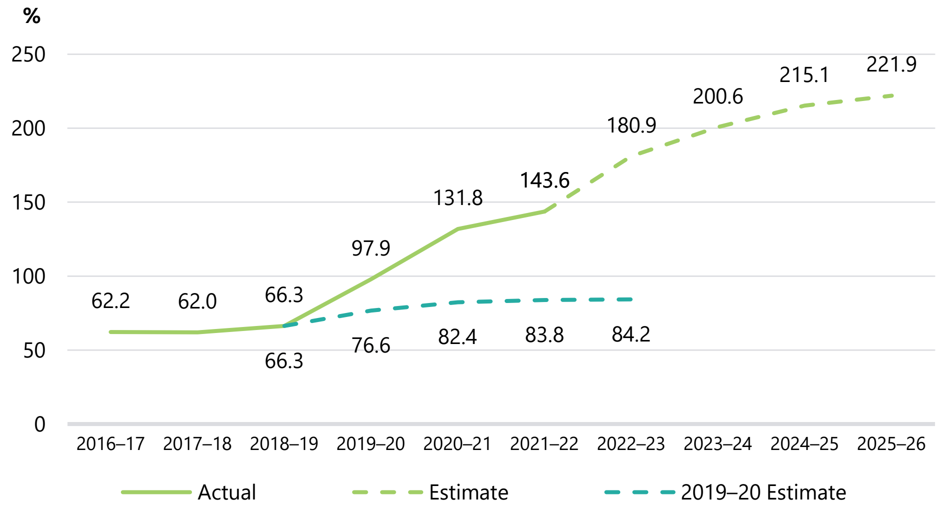
GGS gross debt increased by $23.5 billion from $95.8 billion in 2020–21 to $119.3 billion in 2021–22.

Asset sales aside, servicing this debt—paying interest and paying down principal—is funded by generating and accumulating annual operating accrual and cash surpluses.

The level of indebtedness can be compared to annual operating revenue to judge its affordability over the medium to long term.

Figure 2C shows how the ratio of GGS gross debt to revenue has grown from its previous trend around 60 per cent to 143.6 per cent this year. The state Budget estimates growth to reach 221.9 per cent in 2025–26. This rate of growth is slightly above that of the rate of growth in the net debt to GSP ratio.

FIGURE 2C: **GGS gross debt as a percentage of operating revenue**




*Note*: Gross debt is the sum of borrowings and deposits held and advances received.

We show the projected trajectory of this ratio from the 2019–20 Budget for comparison with the pre-COVID-19 situation. The sharp divergence from the 2019–20 Budget estimates reflects both the need to fund operating deficits in response to the COVID-19 pandemic and the subsequent ramping up of the government's planned infrastructure investment program.

*Source*: VAGO, using data from the state Budget and the AFR.

## 2.3 Managing GGS expenditure

The government's short-term fiscal sustainability objectives for the Budget and forward estimate period in 2022–23 are to:

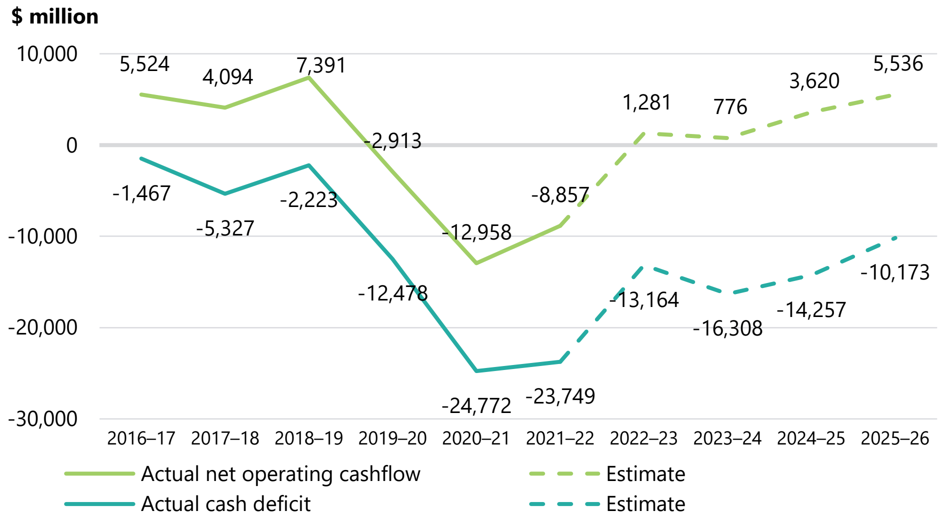
- return the net operating balance to surplus by the end of the forward estimates
- achieve an operating cash surplus by 2022–23.

### Operating cash surplus

Net operating cashflows have been negative for the last 3 years. This is because the government chose to temporarily spend more than the revenue it generated in response to the COVID-19 pandemic. Consequently, it had to borrow money or take from cash reserves to help finance its service delivery over this period.

Figure 2D shows how the net operating cashflows moved into deficit. It also shows the cash deficit, which is the net operating cashflows plus net investing cash outflows. The government estimates net operating cashflows will remain in deficit over the short term. To be able to repay and reduce net debt, cashflows need to come into surplus. While they are in deficit debt will continue to grow.

FIGURE 2D: **GGS net cashflows—operating and capital**




*Note*: The accumulated net operating cash outflows in the last 3 years total $24.7 billion.
*Source*: VAGO, using data from the state Budget and the AFR.

## Operating balance

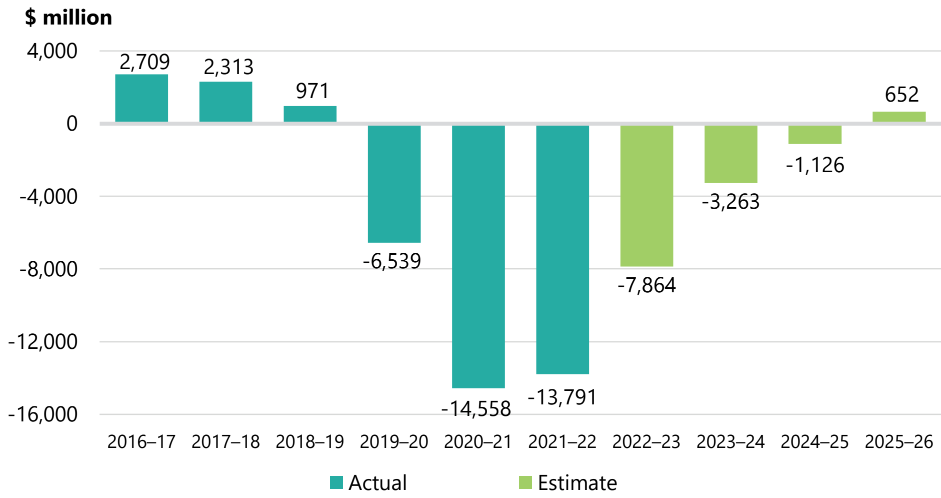
The GGS continued to incur operating deficits in 2021–22, with an operating deficit of $13.8 billion. This was an improvement of $767 million compared to last year, but $2.2 billion worse than budgeted.

An operating surplus indicates sound financial performance. Before the COVID-19 pandemic, the government expressed this measure in qualitative terms: 'A net operating surplus consistent with maintaining general government net debt at a sustainable level over the medium term'.

Figure 2E shows how the GGS net operating balance has begun to recover after deteriorating for 4 years. The decline was steepest in 2019–20 and 2020–21 during the COVID-19 pandemic. The cumulative deficit for the last 3 years is $34.9 billion.

The net operating balance, or net result from transactions, 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 and is a key measure of GGS financial performance and operating sustainability.

FIGURE 2E: **GGS net operating balance**




*Source*: VAGO, using data from the state Budget and the AFR.

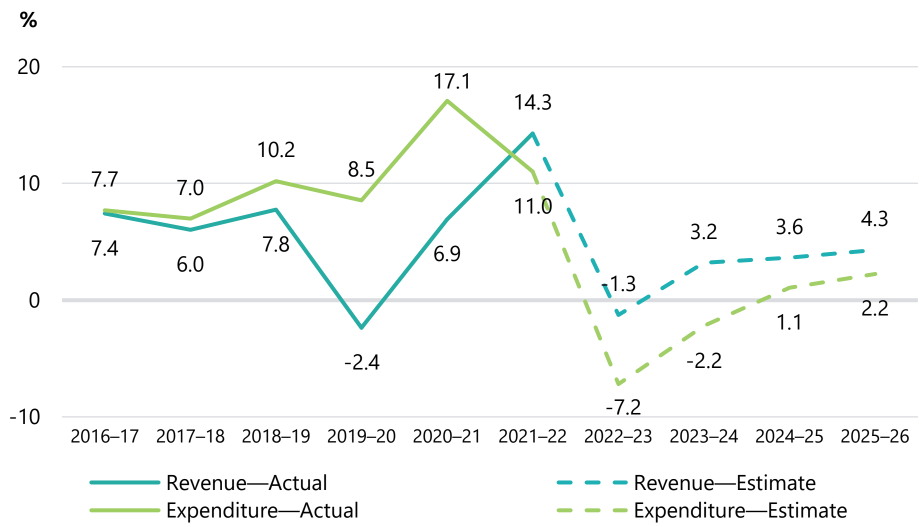
## 2.4 Managing emerging financial risks

### Operating expenditure growth

To achieve its short and medium-term financial GGS objectives the government will need to ensure that the rate of growth in recurrent expenditure falls and stays below revenue growth.

Figure 2F illustrates the deteriorating financial performance of the GGS over the last 6 financial years. It shows that operating expenditure annual growth outpaced operating revenue annual growth from 2016–17 until 2020–21.

FIGURE 2F: **Annual growth in GGS operating revenue and expenditure**




*Source:* VAGO, using data from the Budget and the AFR.

The current budget and forecast revenue targets are increasingly at risk largely because of the sustained increases in interest rates and the flow-on effect of this on the property market and the broader economy. It is incumbent on the government therefore to manage its own expenditure, over which it has more control.

After a 2019 review of GGS expenditure, the government determined that departments needed to achieve cost savings of $2.4 billion across 4 years from 2021–22, and $959.3 million each year thereafter. In its 2021–22 state Budget the government also announced efficiency dividends that require departments to achieve a further $1.9 billion savings over the same period.

### Employee costs

Employee costs are the state's largest single operating expense.

The last significant reduction in the Victorian public service (approximately 4,200 full-time-equivalent (FTE) employees) was in and before 2014–15. Since then, a steady rise in the number of FTE employees, and year-on-year wages, have caused costs to increase.

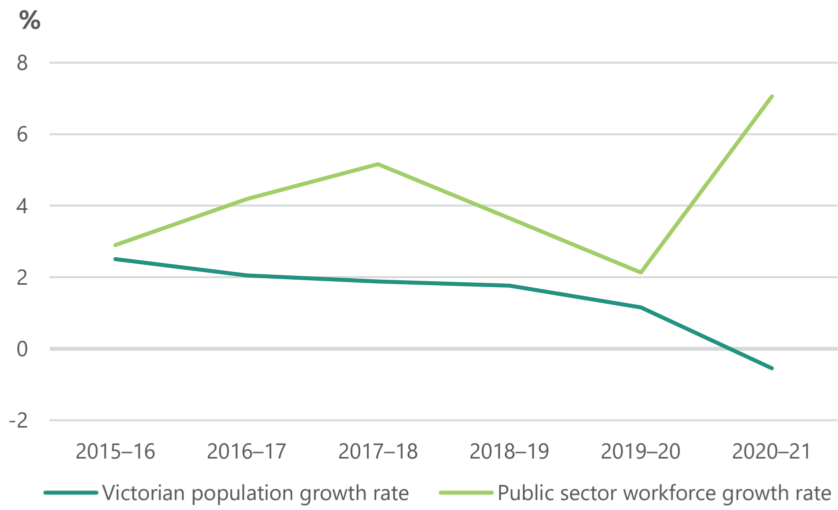
In 2021–22, the state paid its employees $33.6 billion, or 30.3 per cent of its total operating expenses (compared to 31.3 per cent in 2020–21). Most of these costs are incurred in the GGS, where they account for 33.3 per cent of sector expenditure. In the last year, GGS employee expenses grew by $2.2 billion (7.3 per cent) to $32.2 billion.

More than 12 per cent of the state's total liabilities relate to employees. They include unfunded superannuation obligations and employee benefits, such as long service leave and recreation leave. Valuation techniques for these obligations are complex. The calculations are sensitive to changes in assumptions. Small changes in inputs, such as discount rates, can materially impact the valuation of these liabilities.

To serve a growing Victorian population, we should expect public sector employee numbers to grow proportionately. However, Figure 2G shows that while the Victorian population growth rate declined in the last 5 years, the rate of growth of the Victorian public sector workforce fluctuated. In 2020–21, the workforce increased significantly in response to the pandemic.

The Parliamentary Budget Office noted in its analysis of the 2022–23 Budget that Victoria's population declined in 2020–21 because international and interstate migration were disrupted by COVID-19 and related public health restrictions. The Parliamentary Budget Office observed this was the first population decline for Victoria in a financial year since World War I.

FIGURE 2G: **Rate of growth in Victorian public sector FTE workforce compared to Victorian population growth**




*Note*: The Victorian Public Sector Commission has not yet released public sector FTE for 2021–22.
*Source:* VAGO, using data from the Australian Bureau of Statistics and the Victorian Public Sector Commission.

The government determined that workforce transition, including staff reductions, is required to achieve its targeted cost reductions. The government's workforce transition policy is focused on the Victorian public service and ensures a consistent and compliant approach across the public service.

Departmental secretaries manage this workforce transition with regular oversight by the Victorian Secretaries' Board. Each departmental secretary was required to develop a workforce transition plan and provide it to the secretary of the Department of Premier and Cabinet for approval before proceeding with any changes.

Departments planned to deliver total estimated workforce reductions of 3,136 FTE in 2021–22 and 1,504 FTE in 2022–23 through:

- natural attrition and vacancy management (915 FTE)
- early retirement packages (2,885 FTE)
- targeted separation packages (840 FTE).

We analysed the unaudited FTE numbers that will be reported in the 9 departmental annual reports. Our analysis excludes frontline staff including teachers, hospital staff and police. We found the departments reported a collective net reduction of 393 FTE (1.0 per cent) during 2021–22. As at 30 June 2022, the Victorian public sector's departmental workforce was 38,889 FTE.

The audited employee expenses reported by departments in their financial reports increased by $300 million (4.9 per cent), from $6.1 billion in 2020–21 to $6.4 billion in 2021–22. This compares favourably to GGS employee expense growth of 7.3 per cent in 2021–22.

Any significant delays in achieving targeted FTE reductions will put at risk the return to cash and operating surpluses in the timeframes expressed in the most recent Budget.

## Infrastructure investment net overspends

The GGS spent $15.2 billion on physical assets this year, which is an increase of $3.3 billion compared to last year's cash outlays of $11.9 billion.

We have tracked the performance of major capital projects—those expected to cost more than $100 million—for the last 2 years because of the current and planned scale of infrastructure investment and its reliance on debt.

In our *Major Projects Performance Reporting 2022* report (tabled on 21 September 2022) we noted that in the 2022–23 Budget, the government had committed to investing $184 billion in capital projects. This was a net increase of $40 billion from the same time last year.

In our analysis of completed and active major projects we found that the total estimated investment (TEI) of the 91 projects in our study had increased by $11.2 billion, or 12 per cent, since they first appeared in the Budget (Budget Paper No. 4: State Capital Program). This was because:

- the TEI of 42 (or 46 per cent of) projects increased by $13.6 billion
- the TEI of 16 (18 per cent of) projects decreased by $2.4 billion
- the TEI of 33 (or 36 per cent of) existing and complete projects did not change.

This net increase in the TEI for major projects has grown year on year. The previous year we reported an increase in budgeted costs of $4.9 billion, or 4.9 per cent.

Our *Major Projects Performance Reporting 2022* report explains the many reasons TEI changes and why the government should transparently report on major project performance.

If adverse cost outcomes continue, further additional unplanned debt will occur or the announced capital program may need to be curtailed.

## Insurance liabilities

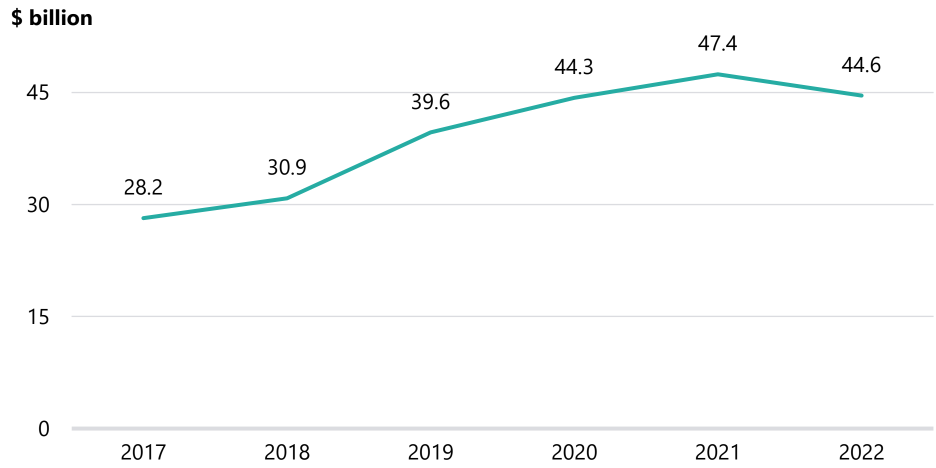
Three of the 7 public financial corporations (PFCs) are insurers—Victorian WorkCover Authority (WorkSafe), Transport Accident Commission and Victorian Managed Insurance Authority. These entities, which are not in the GGS, have a considerable influence on the net result and balance sheet of the PFC sector.

At 30 June 2022, these state insurance entities held $47.2 billion of total assets and had $48.7 billion of total liabilities. Of those total liabilities, $44.4 billion (91.2 per cent) related to outstanding insurance claims.

Figure 2H shows that the value of the total insurance claims for the state grew in the 5 years to 2021.

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 2H: **Provision for insurance claims for the state at 30 June**




*Source*: VAGO, using data from the AFR.

Changes in the insurance claims liability result from claims experience, remeasurements and payments. The decline this year is primarily an artefact of the change in discount rate used to value the liability.

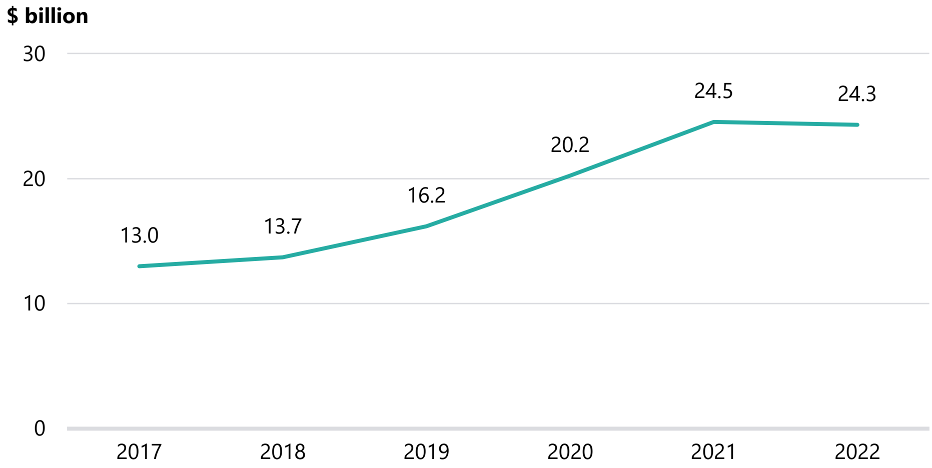
### WorkSafe

The performance of WorkSafe remains the primary driver of the insurance claim growth over time.

Figure 2I shows the value of the provision for WorkSafe insurance claims has almost doubled over the last 6 years. In 2021–22, the provision decreased by $215 million, following an increase of $4.3 billion in 2020–21.

The **outstanding claims liability** is calculated by reference to expected future payments. These payments are discounted to adjust for the time value of money. An increase or decrease in the assumed discount rate will have an opposing impact on claims expense.

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




*Source:* VAGO, using data from the AFR.

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

FIGURE 2J: **Components of movement in outstanding WorkSafe insurance claims liability**

| Component | 2020–21 ($ million) | 2021–22 ($ million) |
|---|---|---|
| **Outstanding claims liability—opening balance 1 July** | **20,232** | **24,527** |
| Current year claims cost | 4,925 | 4,959 |
| Prior year claims cost | 214 | 307 |
| **Net operating balance impact** | **5,139** | **5,266** |
| Changes in economic assumptions (discount rate and inflation rate movements) | –542 | −2,345 |
| Remeasurement of previously recognised claims | 2,702 | 192 |
| Other remeasurements | –523 | −601 |
| **Net result impact** | **6,776** | **2,512** |
| Claims payments and recoveries/GST | –2,481 | −2,727 |
| **Outstanding claims liability—closing balance 30 June** | **24,527** | **24,312** |

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

In 2021–22, the value and number of WorkSafe claims continued to grow, with the proportion relating to mental injury increasing. Changes to economic assumptions, which were largely a result of an increase in the discount rate used to value the liability, favourably offset the increase this year.

In our *Auditor-General's Report on the Annual Financial Report of the State of Victoria: 2020–21*, we noted that an independent review of the financial sustainability of WorkSafe's scheme occurred in 2020–21. The review concluded that the current financial trajectory was unsustainable because of the following continued financial pressures:

- increase in the number and complexity of mental health-related claims. Current trends show mental injury will comprise 50 per cent of annual weekly benefit costs in 2022–23, up from 38 per cent in 2020–21
- increase in the duration injured workers remain on the scheme
- softer application of capacity tests after recent Victorian Ombudsman reports
- poor and declining return-to-work outcomes
- sustained and unchanged average premium rates
- volatility of investment returns owing to market conditions.

The 2021–22 financial year presented similar financial challenges and WorkSafe expects these challenges to continue in 2022–23 and beyond.

WorkSafe's insurance funding ratio (IFR) (a long-term measure of sustainability) was 106 per cent at 30 June 2022. To prevent it from falling below the preferred target range of 100 to 140 per cent, the government provided WorkSafe with $450 million in 2021–22 to support its financial position over the short term. This is in addition to $550 million it provided in 2020–21. These payments were recorded as a grant expense by the GGS and grant revenue in the PFC sector. The inter-sector transactions were eliminated upon consolidation at the State of Victoria level.

Based on current projections, and without further government financial support, WorkSafe's IFR is expected to be below 100 per cent at 30 June 2023 and decline further over the following 3 financial years.

The key driver behind the estimated decline is an increase in the gap between the premium charged and claims costs. At 30 June 2022, this gap was $1.1 billion. Expected investment returns being below WorkSafe's long-term investment objective will further impact the ratio (the investment portfolio recorded a negative net return of 1.8 per cent in 2021–22 compared to a long-term investment objective of 6.85 per cent).

As a result of the financial pressures on the scheme and the subsequent outlook, in 2021–22 WorkSafe developed a capital response plan for internal management purposes to outline the required actions that aim to keep WorkSafe's IFR within the preferred range. This plan's suggested actions include:

- increasing premiums
- reviewing investment risk acceptance
- suspending dividend payments to government
- transforming the scheme design
- strategic interventions on prevention and return to work
- financial support from the state.

While the plan refers to suspending dividend payments to the government, WorkSafe has not made any dividend payments since 2014–15. The state Budget indicates it also is not expected to make any over the next 4 financial years.

The government established a WorkCover scheme sustainability interdepartmental 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 continues its work and deliberations.

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 the Department of Premier and Cabinet.

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

**Responses were received as follows:**

## Response provided by the Treasurer of Victoria

Treasurer of Victoria

Minister for Economic Development
Minister for Industrial Relations
Minister for Trade

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

D22/171930

Mr Andrew Greaves
Auditor-General
Victorian Auditor-General's Office
[redacted]

Dear Mr Greaves

**RESPONSE TO THE AUDITOR-GENERAL'S REPORT ON THE ANNUAL FINANCIAL REPORT OF THE STATE OF VICTORIA, 2021-22**

Thank you for your letter of 11 October 2022, seeking my response to your Report on the Annual Financial Report (AFR) of the State of Victoria: 2021-22 (the Report) before its finalisation and transmission to Parliament.

The report 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 2022, assuring the Parliament that the report reliably presents the Government's financial performance and position in the AFR.

The report also provides an independent assessment of the financial outcomes and fiscal aggregates of the State for the year ended 30 June 2022, which complements the Government's own assessment as presented in the AFR.

Importantly, the Report notes the COVID-19 pandemic continued to adversely affect the State during 2021-22, including the financial performance and position of the State as the Government continued to use its balance sheet to support the Victorian community and the public health response.

As set out in the AFR and the previous Budget publications, the Government remains committed to delivering responsible financial management through the robust fiscal framework as first set out in November 2020 – and is demonstrating clear progress in delivering that four step fiscal strategy:

- 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.

Finally, I wish to thank you again for the opportunity to comment on the Report.

Yours sincerely

[redacted]

**Treasurer**
17/10/2022

VICTORIA State Government

OFFICIAL

## Response provided by the Acting Chief Executive, VicTrack

Our Ref: D/22/59581
25 October 2022

Tim Maxfield
Sector Director, Financial Audit
Victorian Auditor-General's Office
Level 31/35 Collins Street
Melbourne VIC
3000

Dear Mr Maxfield

**Re: Auditor-General's Report on the *Annual Financial Report of the State of Victoria: 2021-22***

Thank you for the opportunity for Victorian Rail Track (VicTrack) to provide comments to the *Auditor-General's Report on the Annual Financial Report of the State of Victoria 2021-22*.

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 first issued in 2019-20 for VicTrack and its consolidated entities.

VicTrack's position as lessor in relation to these leases as part of the 2021-22 financial statements has been informed by refreshed professional accounting advice and remains unchanged from 2019-20 and 2021-21.

There has been no contractual change in the franchise arrangements 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.

Yours sincerely

[redacted]

Chris Olds
**Acting Chief Executive**

**VicTrack**
Level 8, 1010 La Trobe St Docklands VIC 3008
GPO Box 1681 Melbourne VIC 3001
T 1300 VICTRACK (1300 842 872)
victrack.com.au

VicTrack

## Response provided by the Secretary, DJPR

OFFICIAL: Sensitive

Department of Jobs, Precincts and Regions

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

Ref: CSEC-2-22-17247

Mr Andrew Greaves
Auditor-General of Victoria
Victorian Auditor-General's Office
Level 31, 35 Collins Street
MELBOURNE VIC 3000
By email: timothy.maxfield@audit.vic.gov.au

Dear Mr Greaves

**AUDITOR-GENERAL'S REPORT ON THE 2021-22 ANNUAL FINANCIAL REPORT OF THE STATE OF VICTORIA - REQUEST FOR COMMENT**

Thank you for your letter of 11 October 2022 inviting the Department of Jobs, Precincts and Regions (the department) to respond to an extract of the proposed *Auditor-General's Report on the Annual Financial Report of the State of Victoria: 2021-22* (the report).

The extraordinary circumstances created by the COVID-19 pandemic and associated lockdowns required the department to provide urgent support to Victorian businesses and individuals. Throughout 2021-22, the department successfully delivered an unprecedented volume of grant payments through programs calibrated to provide support to Victorians in dire need as quickly as possible.

Notwithstanding the circumstances within which these programs were delivered, the department significantly strengthened its program controls during this period, including through implementing actions recommended by the Auditor-General in his 2020-21 report. These actions included:

- Engaging KPMG to conduct assurance for COVID-19 grant programs and application outcomes. Every grant application was subject to independent checking by KPMG, using different algorithms, to ensure accuracy. The rate of discrepancy between the department's checks and KPMG's checks was extremely small – below 0.2% across all assessment points. Whenever discrepancies were identified, these were then subject to further review on a case-by-case basis to ensure an appropriate outcome.

- Implementing a range of technological control and automation enhancements, such as automatic address, ABN and bank validation tools, business name and GST status confirmation tools, and the use of 'captcha' on application forms to improve the integrity of information captured. This reduced the level of manual intervention required and improved program speed and integrity.

- The development and implementation of a *Quality Assurance Model* and a *Strategic Assurance Framework*, which were presented to VAGO in 2022. The *Quality Assurance Model* uses a data repository to automate aspects of eligibility

VICTORIA State Government

## Response provided by the Secretary, DJPR—*continued*

assessment and minimises the need for manual data extraction during the assessment process. The *Strategic Assurance Framework* underpins grant oversight and helps to check compliance with assurance requirements at each stage of the grant lifecycle.

- Enhanced integrity training for grants administration staff, to increase awareness of grants integrity risks and train staff on improved processes for triage and escalation where integrity risks are identified.

The pandemic posed unprecedented challenges. By necessity, the grant programs that the department managed during this period prioritised the rapid delivery of urgently needed assistance to Victorians – and this involved a higher than usual degree of accepted risk in the control environment. However, I am confident that the department got the balance right, and I am proud of the support that we provided to Victorians and Victorian businesses during a time of critical need.

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

Yours sincerely

[redacted]

**Simon Phemister**
Secretary

Date: 25/10/2022

# APPENDIX B
# About this report, the AFR and our financial audits

## About this report

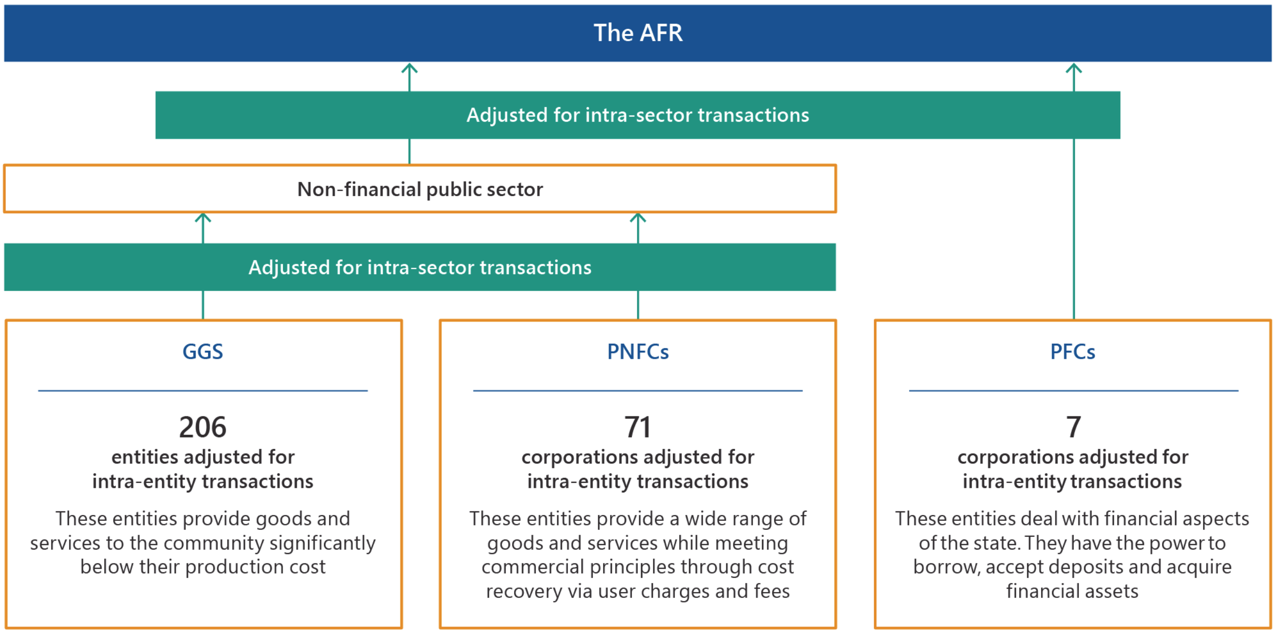
The Auditor-General provides this report to the Parliament of Victoria as required under section 57 of the *Audit Act 1994*. It contains matters we judge as significant and which arise from the audit and pertain to either the effective and efficient management of public resources or the keeping of proper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

## About the AFR

The AFR presents the financial report of the State of Victoria and the GGS. It is a consolidation of the financial results of 284 state-controlled entities. Each year we audit and provide opinions on the financial reports of each of the state-controlled entities. We also audit and provide an opinion on the AFR.

The government classifies these entities into 3 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 reports.

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 communities. |
| 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 28 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.

## Cost of our audits and this report

The cost of our audit of the AFR was $395,000. The combined cost of our audits of the 28 material entities was approximately $8.1 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 $108,000, 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 2018 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:<br>• consolidated State and General Government Sector balance sheets as at 30 June 2022<br>• consolidated State and General Government Sector comprehensive operating statements for the year then ended<br>• consolidated State and General Government Sector statements of changes in equity for the year then ended<br>• consolidated State and General Government Sector cash flow statements for the year then ended<br>• notes to the financial statements, including significant accounting policies<br>• certification by the Treasurer and the Department of Treasury and Finance.<br>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 2022 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.<br>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.<br>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. |

Level 31 / 35 Collins Street, Melbourne Vic 3000
T 03 8601 7000 enquiries@audit.vic.gov.au www.audit.vic.gov.au

| Key audit matter | How I addressed the matter |
|---|---|
| **Significant COVID-19 grant programs**<br>Refer to Note 3.3 *Grant expense* | |
| Grant expense – $22.0 billion<br>Several grant programs were delivered this financial year to support Victorian individuals and businesses in response to the ongoing economic impact of the coronavirus (COVID-19) pandemic.<br>The Department of Jobs, Precincts and Regions (DJPR) processed $7.6 billion in COVID-19 support grants in 2021–22.<br>Due to DJPR continuing the design of controls over COVID-19 grant programs, there were not sufficient controls on which I could place reliance for financial reporting purposes.<br>I considered COVID-19 grant programs and the resultant expenditure to be a key audit matter because:<br>• a significant volume of grant applications and payments were processed and distributed in short time frames<br>• programs varied in eligibility criteria and conditions increasing the potential for error<br>• there was increased pressure associated with managing and distributing funds during a pandemic<br>• grant payments are susceptible to fraud. | My key procedures included:<br>• 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<br>• placing reliance on internal audit<br>• detailed testing of grant payments through extended sample sizes. Testing included external confirmations on eligibility criteria, reperforming dataset matching using external data, and verifying bank payments. |

| Key audit matter | How I addressed the matter |
|---|---|
| **Recognition and measurement of transport assets**<br>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.<br>The State is ultimately responsible for ensuring proper accounts and records are maintained to sufficiently explain the financial impact of these assets on the financial operations and financial position of the State.<br>I considered this to be a key audit matter because:<br>• transport assets are financially significant<br>• capital projects in the transport sector are complex, and each project results in multiple assets being constructed<br>• a significant degree of management judgement is required to:<br>○ determine individual assets within a project<br>○ determine which expenses should be capitalised<br>○ allocate capital expenses to individual assets<br>○ determine the fair value of individual assets.<br>• 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<br>• 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:<br>• assessing management's process to identify individual assets within a project, and the costs directly attributable to those assets<br>• assessing the results of the work undertaken by management to review work in progress balances and capitalise completed projects<br>• reviewing management's assessment of the existence of assets, and the completeness and accuracy of asset records<br>• reviewing the accounting treatment for asset additions, disposals and replacements against the requirements of Australian Accounting standards<br>• assessing the results of fair value assessments, challenging assumptions contained within, and investigating significant variances<br>• assessing the potential impact of identified issues on the financial statements. |

| Key audit matter | How I addressed the matter |
|---|---|
| **Recognition and measurement of service concession assets, liabilities and commitments**<br>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,* Note 5.4 *Public private partnerships* and Note 6.4 *Payables and contract liabilities* | |
| Service concession assets – $33.9 billion<br>Service concession financial liabilities – $6.9 billion<br>Service concession financial liability commitments – $49.3 billion (nominal value)<br>Service concession grant of a right to the operator (GORTO) liabilities – $10.3 billion<br>Service concession hybrid arrangements commitments – $2.4 billion (nominal value)<br>There are three types of service concession arrangements:<br>• arrangements where the State has contractual obligations to make payments and other contributions to the operators for the construction and operation of the assets<br>• arrangements where the State has granted the operators the right to charge the public directly for the use of the assets<br>• 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.<br>I considered this to be a key audit matter because:<br>• service concession assets, liabilities and commitments are financially significant<br>• the requirements of AASB 1059 *Service Concession Arrangements: Grantors* are complex, and their application requires significant management estimation and judgement<br>• service concession arrangements and the financial models used to value the assets, liabilities and commitments are complex<br>• a significant degree of management judgement is required to determine the key assumptions used in valuing the assets, liabilities and commitments<br>• extensive disclosures are required by Australian Accounting Standards which are critical to the users understanding of service concession assets, liabilities and commitments. | My key procedures included:<br>• reviewing all contracts, supporting schedules, financial models and professional accounting advice received by the State, where applicable<br>• engaging appropriately qualified independent subject matter experts to review certain valuation methodologies and financial models and assess the:<br>  ○ appropriateness of fair value methodologies<br>  ○ reasonableness and consistency of assumptions<br>  ○ reasonableness of inputs against underlying data and supporting documentation<br>  ○ accuracy of models<br>• reviewing all other financial models and confirming the judgements applied by management to independent expert reports<br>• assessing the completeness and accuracy of service concession assets, liabilities and commitments against the contracts and underlying financial models for each project<br>• comparing the reasonableness of asset amounts against actual costs incurred<br>• assessing the accounting treatment against the requirements of AASB 1059, and the reasonableness of management judgements made in the application of the standard<br>• 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**<br>Refer to Note 6.5 *Superannuation* | |
| Defined benefit superannuation liability – $19.8 billion<br>The Emergency Services and State Super funds account for $18.6 billion (93.9 per cent) of the State's defined benefit superannuation liability (the liability). The Emergency Services Superannuation Board (ESSB) manage these funds.<br>I considered this to be a key audit matter because:<br>• the liability is financially significant<br>• the underlying model used to value the liability is complex<br>• a significant degree of management judgement is required to determine the method, the model and key assumptions used in valuing the liability<br>• a small adjustment to an assumption may have a significant effect on the total value of the liability<br>• during the year ESSB transitioned core member administration and fund accounting to an outsourced service provider. An independent assurance auditor was engaged by ESSB to report on the design, implementation and operating effectiveness of controls at the service provider<br>• extensive disclosures are required by Australian Accounting Standards which are critical to the users understanding of the valuation of the liability.<br>Management engaged 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:<br>• gaining an understanding of the design and implementation of key controls over the outsourced arrangement, and then testing their operating effectiveness, including those:<br>o supporting the completeness and accuracy of membership data pre and post migration<br>o assisting with the management and oversight of the arrangement<br>• obtaining the independent assurance auditors report over the outsourced service provider's controls and:<br>o assessing the adequacy of the scope of work agreed between management and the assurance auditor<br>o assessing the professional competence and independence of the assurance auditor<br>o considering the relevance of the stated control objectives and controls covered by the assurance report<br>o assessing the testing performed by the assurance auditor and the results of the tests<br>o assessing the sufficiency and appropriateness of the audit evidence provided by the assurance report<br>• assessing the professional competence and independence of the actuary<br>• obtaining the actuarial report and year-end adjustments, and engaging an appropriately qualified independent actuary to assist in obtaining sufficient appropriate audit evidence for the liability and disclosures, including to:<br>o assess the appropriateness of the model used to value the liability<br>o review the reasonableness of membership data in the model by comparing it to the data in the service provider's system<br>o assess the appropriateness of management's selection and application of the method, significant assumptions and data used to value the liability<br>o challenge the reasonableness of key assumptions by comparing against accepted industry benchmarks<br>o assess the reasonableness of the reported liability value<br>• assessing the adequacy of financial report disclosures against the requirements of Australian Accounting Standards. |

| Key audit matter | How I addressed the matter |
|---|---|
| **Valuation of provision for insurance claims**<br>Refer to Note 6.6 *Other provisions* | |
| Provision for insurance claims – $44.6 billion<br>I considered this to be a key audit matter because:<br>• the provision for insurance claims is financially significant<br>• there are several insurance claim categories at the Victorian WorkCover Authority, Transport Accident Commission and Victorian Managed Insurance Authority which make up the provision and must be valued<br>• the underlying models used to value the provision are complex<br>• the valuation of the provision is subject to significant management assumptions and estimation uncertainty<br>• a small adjustment to an assumption may have a significant effect on the total value of the provision<br>• extensive disclosures are required by Australian Accounting Standards which are critical to the users understanding of the valuation of the provision.<br>Management engaged actuaries to value the provision as at 30 June. | My key procedures included:<br>• testing the operating effectiveness of key controls supporting the underlying claims data used in the models<br>• reconciling claims data in the models to the data in the Victorian WorkCover Authority, Transport Accident Commission and Victorian Managed Insurance Authority systems<br>• assessing the professional competence and independence of management's actuaries<br>• obtaining management's actuarial reports, and engaging an appropriately qualified independent actuary to:<br>  ○ assess the appropriateness of management's selection and application of the methods, significant assumptions and data used to value the provision<br>  ○ evaluate the appropriateness of the models used to value the provision<br>  ○ challenge the reasonableness of key assumptions by comparing against claims history and accepted industry benchmarks<br>  ○ assess the reasonableness of the reported provision value.<br>• assessing the adequacy of financial report disclosures against the requirements of Australian Accounting Standards. |

| | |
|---|---|
| **Other information** | The Treasurer of Victoria is responsible for the Other Information, which comprises the information in chapters 1–3 and 5 of the 2021–22 Financial Report but does not include the consolidated financial report in chapter 4 and my auditor's report thereon.<br>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.<br>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
- 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.

[redacted]

MELBOURNE
3 October 2022

Andrew Greaves
*Auditor-General*

APPENDIX D

# Results of material entity audits

FIGURE D1: **Audit opinions issued for material entities**

| Entity | Benefit | Revenue ($ million) | Expenses ($ million) | Assets ($ million) | Liabilities ($ million) | Certified | Opinion | Type |
|---|---|---|---|---|---|---|---|---|
| **General government sector (GGS)** | | | | | | | | |
| Department of Education and Training | Controlled | 15,760.6 | 15,276.4 | 40,627.2 | 3,349.1 | 6/9/22 | 8/9/22 | Unmodified |
| | Administered | 4,388.1 | 4,339.8 | 52.2 | - | | | |
| Department of Environment, Land, Water and Planning | Controlled | 3,246.5 | 3,114.8 | 12,210.2 | 894.1 | 30/8/22 | 8/9/22 | Unmodified |
| | Administered | 2,213.2 | 2,115.1 | 5,429.0 | 5,900.1 | | | |
| Department of Families, Fairness and Housing | Controlled | 8,021.4 | 7,669.5 | 38,113.8 | 1,337.6 | 6/9/22 | 12/9/22 | Unmodified |
| | Administered | 2,567.6 | 2,661.0 | 105.6 | 105.6 | | | |
| Department of Health | Controlled | 21,813.1 | 21,094.3 | 7,554.8 | 2,691.6 | 1/9/22 | 7/9/22 | Unmodified |
| | Administered | 15,989.7 | 15,945.4 | 1,056.6 | 1,056.6 | | | |
| Department of Jobs, Precincts and Regions | The financial report and the audit of this entity had not been finalised at the date of this report. | | | | | | | |
| Department of Justice and Community Safety | Controlled | 10,804.5 | 10,765.3 | 7,737.7 | 3,007.8 | 8/9/22 | 9/9/22 | Unmodified |
| | Administered | 1,810.7 | 1,401.8 | 1,722.4 | 509.0 | | | |
| Department of Premier and Cabinet | Controlled | 694.9 | 675.1 | 1,118.7 | 106.9 | 2/9/22 | 7/9/22 | Unmodified |
| | Administered | 14.6 | 14.6 | 31.6 | 31.7 | | | |
| Department of Transport | Controlled | 7,558.0 | 7,701.8 | 121,226.7 | 17,285.9 | 7/9/22 | 8/9/22 | Unmodified |
| | Administered | 3,296.0 | 3,339.7 | 33,970.5 | 829.1 | | | |

| Entity | Benefit | Revenue ($ million) | Expenses ($ million) | Assets ($ million) | Liabilities ($ million) | Certified | Opinion | Type |
|---|---|---|---|---|---|---|---|---|
| Department of Treasury and Finance | Controlled | 607.0 | 585.5 | 1,676.0 | 195.2 | 29/9/22 | 3/10/22 | Unmodified |
| | Administered | 75,013.2 | 91,302.1 | 206,968.1 | 136,183.3 | | | |
| Eastern Health | Controlled | 1,447.9 | 1,435.6 | 1,627.7 | 559.5 | 1/9/22 | 6/9/22 | Unmodified |
| Melbourne Health | Controlled | 1,652.1 | 1,681.9 | 1,490.8 | 686.0 | 31/8/22 | 2/9/22 | Unmodified |
| Monash Health | Controlled | 2,987.2 | 2,843.8 | 3,132.0 | 1,074.4 | 1/9/22 | 6/9/22 | Unmodified |
| National Gallery of Victoria | Controlled | 134.9 | 122.5 | 4,675.6 | 48.0 | 24/8/22 | 31/8/22 | Unmodified |
| Office of the Chief Commissioner of Police | Controlled | 4,102.4 | 4,100.6 | 4,804.2 | 2,831.2 | 1/9/22 | 2/9/22 | Unmodified |
| | Administered | 77.1 | 77.6 | 73.5 | 72.8 | | | |
| The Royal Children's Hospital | Controlled | 989.7 | 1,014.8 | 1,704.4 | 1,164.8 | 16/8/22 | 19/8/22 | Unmodified |
| Victorian Gambling and Casino Control Commission | Controlled | 46.8 | 46.9 | 23.4 | 12.6 | 8/9/22 | 9/9/22 | Unmodified |
| | Administered | 1,975.6 | 1,941.9 | 291.1 | 489.9 | | | |
| **Total GGS[(a)]** | | **83,023.0** | **96,814.0** | **347,367.0** | **168,839.0** | | | |
| **Public non-financial corporations (PNFC)** | | | | | | | | |
| Goulburn–Murray Rural Water Corporation | Controlled | 163.9 | 240.5 | 4,845.4 | 636.7 | 7/9/22 | 7/9/22 | Unmodified |
| Greater Western Water | Controlled | 884.4 | 1,633.9 | 3,552.8 | 2,487.4 | 23/8/22 | 30/8/22 | Unmodified |
| Melbourne Port Lessor Pty Ltd | Controlled | 189.1 | 93.6 | 10,890.7 | 8,709.4 | 7/9/22 | 8/9/22 | Unmodified |
| Melbourne Water Corporation | Controlled | 1,935.9 | 1,722.1 | 16,829.6 | 9,794.0 | 26/8/22 | 6/9/22 | Unmodified |
| South East Water Corporation | Controlled | 1,054.5 | 943.3 | 4,855.9 | 2,932.7 | 29/8/22 | 1/9/22 | Unmodified |
| North East Link State Tolling Corporation | The financial report and the audit of this entity had not been finalised at the date of this report. | | | | | | | |
| Victorian Rail Track | Controlled | 222.8 | 1,736.5 | 41,822.4 | 2,989.1 | 6/9/22 | 8/9/22 | Modified |

| Entity | Benefit | Revenue ($ million) | Expenses ($ million) | Assets ($ million) | Liabilities ($ million) | Certified | Opinion | Type |
|---|---|---|---|---|---|---|---|---|
| Yarra Valley Water Corporation | Controlled | 1,087.2 | 975.3 | 5,856.3 | 4,150.1 | 29/8/22 | 2/9/22 | Unmodified |
| **Total PNFC**[(a)] | | **10,703.0** | **9,989.0** | **118,742.0** | **41,019.0** | | | |
| **Public financial corporations (PFC)** | | | | | | | | |
| Transport Accident Commission | Controlled | 3,398.9 | 1,117.3 | 19,242.8 | 19,315.4 | 25/8/22 | 9/9/22 | Unmodified |
| Treasury Corporation of Victoria | Controlled | 135.7 | 43.4 | 117,912.2 | 117,677.4 | 16/8/22 | 18/8/22 | Unmodified |
| Victorian Managed Insurance Authority | Controlled | 588.8 | 838.0 | 3,531.1 | 3,794.0 | 29/8/22 | 2/9/22 | Unmodified |
| Victorian WorkCover Authority | Controlled | 3,302.7 | 3,470.8 | 24,465.9 | 25,548.7 | 24/8/22 | 1/9/22 | Unmodified |
| **Total PFC**[(a)] | | **11,737.0** | **13,217.0** | **164,876.0** | **154,956.0** | | | |

*Note*: [(a)]Amounts include transactions between sectors. These are eliminated on consolidation in the AFR.
*Source*: VAGO.

# APPENDIX E
# VicTrack lease arrangements

FIGURE E1: **Accounting for lease arrangements for operational transport assets**

VicTrack is the legal custodian of the state's transport-related assets. It reported total property, infrastructure, plant and equipment assets of $41.8 billion at 30 June 2022.

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 *Leases*.<br>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). |
| 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 again 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 2022. This meant that for 2021–22, 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's and the GGS's financial reports. No change to this temporary relief occurred in 2021–22. This will adversely affect their net result from transactions because the depreciation expenses from the assets will also need to be recognised.

*Source:* VAGO.

APPENDIX F

# Acronyms, abbreviations and glossary

## Acronyms

| | |
|---|---|
| AFR | *2021–22 Annual Financial Report of the State of Victoria* |
| DJPR | Department of Jobs, Precincts and Regions |
| DoT | Department of Transport |
| FTE | full-time equivalent |
| GGS | general government sector |
| GSP | gross state product |
| IFR | insurance funding ratio |
| PFC | public financial corporation |
| PNFC | public non-financial corporation |
| STC | North East Link State Tolling Corporation |
| TEI | total estimated investment |
| VGCCC | Victorian Gambling and Casino Control Commission |

## Abbreviations

| | |
|---|---|
| Crown Casino | Crown Melbourne Limited |
| Royal Commission | *Royal Commission into the Casino Operator and Licence* |
| 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 |
| Asset | An item or resource controlled by an entity that will be used to generate future economic benefits |
| Clear audit opinion | A clear audit opinion adds credibility to the financial report by providing reasonable assurance that reported information is reliable and accurate and complies with the requirements of relevant Australian Accounting Standards and applicable legislation |
| Emphasis of matter | A paragraph included in the auditor's report that refers to a matter appropriately presented or disclosed in the financial report that in the auditor's judgement, is of such importance that it is fundamental to users' understanding of the financial report |
| Insurance funding ratio | A funding ratio of available assets to estimated liabilities used to monitor the long-term financial sustainability of an insurance scheme |
| Intra-sector or intra-entity transactions | Financial transactions that occur between 2 entities in the same sector, or between 2 sectors of government. When an annual financial report is prepared, the accounts are adjusted so these transactions are not counted twice |
| Key audit matters | Auditors may include a description of key audit matters in the auditor's report, as described in auditing standard ASA 701 *Communicating Key Audit Matters in the Independent Auditor's Report*<br>Key audit matters are determined by the auditor as the matters of most significance to the audit. We voluntarily adopt key audit matter 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. Key audit matters 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 report. 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 |
| Material entities | The entities that account for most of the state's assets, liabilities, revenue and expenditure. In forming our opinion on the AFR, we focus on the financial transactions and balances of these entities |
| Net operating balance | 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 and is a key measure of GGS financial performance and operating sustainability. Also known as net result from transactions |
| Off-balance sheet | Off-balance sheet commitments are assets and liabilities that an entity has committed to but not yet included in its balance sheet |
| Outstanding insurance claim | 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 |

# Auditor-General's reports tabled during 2022–23

| Report title | |
|---|---|
| *Results of 2021 Audits: Technical and Further Education Institutes* (2022–23: 1) | July 2022 |
| *Results of 2021 Audits: Universities* (2022–23: 2) | July 2022 |
| *Follow-up of Protecting Victoria's Coastal Assets* (2022–23: 3) | August 2022 |
| *The Effectiveness of Victoria Police's Staff Allocation* (2022–23: 4) | September 2022 |
| *Quality of Major Transport Infrastructure Project Business Cases* (2022–23: 5) | September 2022 |
| *Major Projects Performance Reporting 2022* (2022–23: 6) | September 2022 |
| *Quality of Child Protection Data* (2022–23: 7) | September 2022 |
| *Follow-up of Maintaining the Mental Health of Child Protection Practitioners* (2022–23: 8) | September 2022 |
| *Regulating Victoria's Native Forests* (2022–23: 9) | October 2022 |
| *Victoria's Alcohol and Other Drug Treatment Data* (2022–23: 10) | October 2022 |
| *Auditor-General's Report on the Annual Financial Report of the State of Victoria: 2021–22* (2022–23: 11) | October 2022 |

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

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