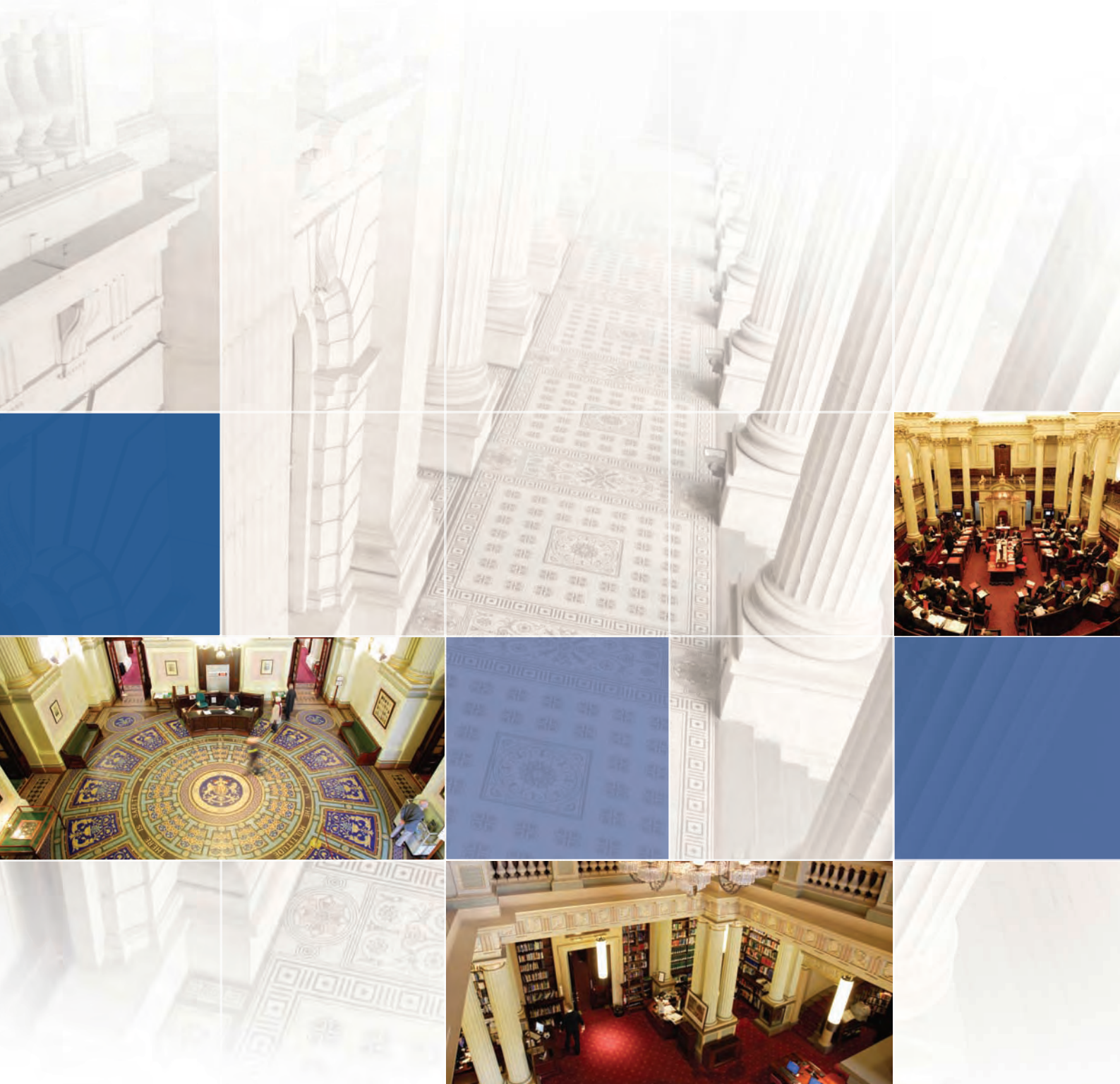


Victorian Auditor-General's Office

Annual Plan

2011-12



VAGO

Victorian Auditor-General's Office
Auditing in the Public Interest

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Annual Plan 2011–12

Prepared pursuant to the
requirements of section 7A of the *Audit Act 1994*



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

The Hon. Ken Smith MP
Speaker
Legislative Assembly
Parliament House
Melbourne

Dear Presiding Officers

I am pleased to transmit my Annual Plan for 2011–12 in accordance with section 7A of the *Audit Act 1994*.

Yours faithfully



D D R PEARSON
Auditor-General

24 May 2011

Foreword

The role of Auditor-General is one of the cornerstones of accountability in our Westminster system. Victoria is fortunate to have one of the more robust and independent public sector audit frameworks of any Australian jurisdiction. The *Constitution Act 1975* protects the independence of this role, ensuring that the Auditor-General is not subject to direction on what, when or how to audit. The *Audit Act 1994* provides the Auditor-General with wide-ranging powers to access information, which can, where necessary, override secrecy or confidentiality provisions. Few other Australian integrity or review bodies have these protections or powers.

However, with independence and power comes accountability, and the production of an Annual Plan outlining a proposed audit program and the resources required to achieve it, is one of our most important accountability mechanisms. It provides Parliament, the public sector and the community with the opportunity to assess our goals, understand our audit priorities and scrutinise our program.

Victoria is one of the first jurisdictions to have such a plan and other states have followed suit. It is gratifying that our Annual Plan has been acknowledged by statutory reviews in other states as a best practice model for public sector audit.

Since 2007, our Annual Plan has gone beyond our legislative requirements and forecast four years of prospective areas of performance audit focus. Last year, we extended this to financial audit, also providing four years notice of areas of audit focus. In 2011–12, we will be looking to agencies to capitalise on this early notice, to prepare effectively for audits and to engage with us in a timely way about our forward program.

Last year held challenges for our audit program, with a compressed time line in the lead up to the election and some difficulties accessing information held by departments and agencies. Yet in the face of these challenges, new strategies were trialed to expedite the audit process: such as self-assessment techniques for some lower risk scenarios, and intensive, tightly focused audits to respond to time-critical issues. Our 2011–12 program will, where appropriate, extend the use of these new strategies.

Last year also saw the finalisation of the Public Accounts and Estimates Committee (PAEC) review of the *Audit Act 1994*. PAEC recommended many, wide ranging changes with a view to creating a more contemporary audit function. These recommendations include measures to close the gaps that left some public sector entities outside the audit mandate, and to redress the erosion of assurance and accountability arising from new forms of service delivery and greater use of commercial contracts to deliver public services. The government's response to the PAEC report largely supported many of the necessary changes. Although there are still technical issues to be worked through in the development of any amendments, I am optimistic that the government will address the identified weaknesses in Victoria's current audit and accountability framework.

Finally, in developing this annual plan, my office has consulted extensively. This year, we increased our use of stakeholder fora, and strengthened our interaction with agency senior management and audit committees. I would like to express our thanks to the public sector staff, community members, professionals and Parliamentarians who contributed their perspectives to the planning process and helped create what I believe is a relevant, authoritative and comprehensive program of audits.

A handwritten signature in black ink, appearing to read 'D D R Pearson', written in a cursive style.

D D R PEARSON
Auditor-General

24 May 2011

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1 Our mandate and outputs

1.1 Our mandate

The *Constitution Act 1975* establishes the Auditor-General as an independent officer of the Victorian Parliament. The Auditor-General provides assurance to Parliament on the accountability and performance of the Victorian public sector.

Under the *Audit Act 1994* the Auditor-General is responsible for the audit of almost 570 public sector entities. Entities to be audited during 2011–12 include government departments and agencies, public hospitals and ambulance services, universities and other educational institutions, water authorities, public sector superannuation funds, as well as companies, trusts and joint ventures controlled by public sector agencies. The Auditor-General also has responsibility for auditing the local government sector, which comprises municipal councils and the entities they control, and regional library corporations.

Combined, the entities subject to audit have over 246 800 employees, collect income of approximately \$64.7 billion, incur about \$62.5 billion in expenditure annually, and hold net assets in excess of \$191.2 billion.

The *Audit Act 1994* provides for the Auditor-General's access to all government information, and the freedom to report findings arising from audits to Parliament. The Auditor-General is not subject to control or direction by either Parliament or the government.

The *Constitution Act 1975* and the *Audit Act 1994* are complemented by other legislation. The *Financial Management Act 1994* requires responsible ministers to provide annually to Parliament audited financial and, where applicable, performance statements of entities within their portfolios. The *Local Government Act 1989* requires each municipal council to prepare an annual report containing audited financial and performance statements.

The former government sought to consolidate accountability arrangements for public bodies under one Act. The Public Finance and Accountability Bill 2009 was introduced into Parliament in December 2009, however, the Bill lapsed without being passed through the Upper House when Parliament was prorogued in October 2010. Any further progress on these reforms will be dependent upon the new government's priorities.

1.2 Our outputs

Under the *Audit Act 1994* (the Act) the Auditor-General undertakes financial audits and performance audits. In carrying out these activities, he also considers whether there has been any wastage of public resources or any lack of probity or financial prudence in the management or application of public resources, consistent with the provisions of section 3A(2) of the Act.

Our financial audits of entities establish whether their financial statements and, where required, their non-financial performance statements, fairly present the financial position and performance of the entities. Our opinion on each set of statements is issued to the governing body of the entity. An unqualified or 'clear' audit opinion adds credibility to the statements.

Under the Act the Auditor-General must table a report in Parliament each year on the results of the financial audit of the State's Annual Financial Report. In addition the Auditor-General tables a series of reports on the results of audits of financial and performance statements undertaken during the year.

Performance audits establish whether public sector entities use resources—including those provided to non-government bodies—economically, efficiently and effectively, and in compliance with all relevant legislation. A report on the results of each performance audit is required to be tabled in Parliament.

Both financial and performance audits are undertaken using methodologies which comply with the Act and Australian auditing standards.

Under Victoria's output management system, the level of resources allocated to the Victorian Auditor-General's Office (VAGO) each year is determined on the basis of outputs that it expects to deliver, namely:

- Output 1: Parliamentary reports and services
- Output 2: Audit reports on financial statements.

Details of these outputs are presented in Appendix B.

1.3 Amendments to the *Audit Act 1994*

Over the past 20 years, Victoria has seen an increase in the 'arms-length' delivery of public services through the private and community sectors. There has been increased private sector involvement in the delivery of public services through arrangements such as outsourcing and public private partnerships. There has also been a trend to create new legal entities 'outside government', such as companies, associations and statutory bodies, allowing these entities to access broader revenue sources and more flexible governance regimes.

This has led to a steady erosion of accountability to Parliament and the public, as these services and the public monies that fund them fall outside existing accountability frameworks and the mandate of this office.

Responding to these changes in the way government delivers services, the Public Accounts and Estimates Committee (PAEC) held an inquiry last year into the Act. VAGO made several representations to the inquiry, including a formal submission.

The all-party report of this Parliamentary Inquiry made wide-ranging recommendations, seeking to prevent the erosion of public sector accountability, strengthen the independence of VAGO and update the Act to reflect contemporary trends. PAEC unanimously recommended measures to:

- 'close the gap' on entities currently outside Parliament's audit mandate
- allow access to public sector information held by private sector contractors
- introduce annual audits of performance statements and management controls
- enable joint audits with other Australian auditors-general
- improve the effectiveness of external performance audits of VAGO
- ensure agency comment included in our reports to Parliament is accurate, balanced and substantiated.

As indicated in our Annual Plan 2010–11, the Act is in urgent need of reform. In April 2011, the government tabled its response to PAEC's recommendations. The government response included support in principle for some of the key recommendations; in particular access to public sector information held by private sector contractors and 'closing the gap'. A number of other recommendations were also supported.

Given the importance of the need to repair the audit mandate, a number of technical and legal issues will need to be discussed further with government as it considers how any amendments should proceed. VAGO looks forward to a strong role in the further development of amendments to the Act.

1.4 Changes to the audit program

Section 2 of this Annual Plan sets out areas of financial and performance audit focus for the four years from 2011–12 to 2014–15. For performance audits, these multi-year programs have been included in VAGO annual plans since 2007–08. An equivalent program was included for financial audits for the first time in our 2010–11 Annual Plan.

Signalling our areas of audit focus up to four years ahead gives agencies the opportunity to prepare for, and to improve where necessary, their internal controls and resource management practices prior to an audit's conduct, and to engage more constructively with the audit process. Our aim is to encourage improvement in agency performance and to maximise the value our audits deliver.

This approach works best when there is certainty with our forward work program. However, the changing public sector environment is never entirely predictable and so, in order for our work to remain relevant and authoritative, some change is inevitable. We aim to be agile and flexible by changing the audit program as needed between one year and the next, if warranted.

Periodically we review and, if necessary, change the priority of prospective areas of audit focus in our multi-year programs as a result of our ongoing planning activities. The Auditor-General retains the discretion to replace and reschedule topics at any time to accommodate issues of higher priority that may emerge.

Changes to the audit program can be influenced by external and internal factors.

1.4.1 External influences

Our last annual plan was influenced by two major incidents affecting the Victorian community—the February 2009 bushfires and the global financial crisis. In 2011–12 recovery from these events continues to influence our audit program. The need for assurance about the quality and adequacy of the public sector response, and the need in tight fiscal times, for government to do more with less have influenced changes in our forward program.

Our scanning during development of the 2011–12 Annual Plan reconfirmed climate change and the environment; the ageing of our population; risks to sustainable development from diminishing oil supplies; population growth; and the continuing need for transparency and accountability, as major challenges for government in coming years. In addition, the Council of Australian Governments Reform Agenda continues to affect the scheduling and focus of our program of performance audits, particularly in the health sector.

The November 2010 state election and the subsequent change of government presented particular challenges to VAGO. While not contributing to changes in the content of the 2010–11 audit program, the dissolution of the Parliament in the lead up to the November state election significantly affected our tabling schedule. As a result of the change of government, both the structure and content of our performance audit program for the period 2011–12 to 2014–15 needed to reflect the change in priorities and the end of the *Growing Victoria Together* framework of the former government.

The audit program has been reviewed and revised in the context of these external influences, and this year is presented within the framework of the five goals for a stronger, fairer and safer Victoria. This framework was outlined in the Governor's speech at the opening of the 57th Parliament on 21 December 2010.

Over and above these macro-level influences, agencies are subjected to more immediate changes to the way they operate. For example, machinery-of-government changes may shift responsibilities between agencies, changes in service delivery methods can occur, or the government or agencies may choose to reschedule programs or initiatives or conduct reviews of their own operations to address performance gaps that have come to light. To determine how well agencies deal with these changes, we will need to change our audit program accordingly.

The Auditor-General also responds to concerns raised by Parliamentarians, agencies or the public about the performance of public sector agencies, and exercises his discretion whether or not to pursue such concerns.

1.4.2 Internal influences

Our financial audit program includes a focus on areas where a risk-based assessment shows that issues of governance, probity, fraud, waste and non-compliance with legislation or public sector financial management and reporting requirements can arise. Our performance audit program is increasingly focused on identifying and reporting on value for money, and on achievement against objectives.

We periodically review our assessments of risk and materiality of prospective areas of financial and performance audit focus and make necessary adjustments to our audit programs as these assessments change.

1.5 Initiatives

During development of this plan, we increased our efforts to involve secretaries, senior management of departments and departmental audit committees in discussions about the proposed multi-year program. The aim was to improve communication and allow more timely input to, and resolution of emerging concerns about, our annual planning processes and the rationale, proposed content and timing of audits. The response to this initiative by departments was positive with most taking up the offer for senior VAGO representatives to present to their executive management teams on the proposed program. A number of invitations were also taken up by audit committees for similar briefings.

We expanded the roll-out of sector fora with major stakeholders to seek further input to our developing program of performance audits. Attendees included regulators, practitioners, representatives of community organisations, people involved in direct service delivery, and recipients of government programs and initiatives.

Feedback from attendees was that these fora were valuable; not just for the opportunity to provide direct input, but also in raising their awareness of the Auditor-General's role. The fora also validated the proposed forward program in these sectors.

1.6 Input from the Public Accounts and Estimates Committee

In March 2011 we met with PAEC to discuss proposed areas of focus for financial and performance audit for 2011–12 to 2014–15. PAEC's insights and comments have helped clarify our intent and the planned coverage for many audit topics.

Under section 7A(1)(b) of the Act the draft Annual Plan must be submitted to PAEC, which may choose to provide comments under section 7A(3). Section 7A(5) of the Act requires that the Auditor-General indicate in his annual plan, the nature of any changes suggested by PAEC that have not been adopted.

The draft annual plan was provided to PAEC on 14 April 2011, and PAEC's response under section 7A(3) was received on 11 May 2011. PAEC's comments, along with our comments can be found in Appendix F.

We acknowledge and appreciate the input of PAEC and its ongoing support.

2 Proposed audit activity

2.1 Selection of areas of audit focus

2.1.1 Financial audit

The *Financial Management Act 1994*, the *Corporations Act 2001*, the *Associations Incorporation Act 1981* and the *Local Government Act 1989*, require public sector entities to report annually on their financial results and year-end balances in accordance with prescribed reporting frameworks.

Section 8 of the *Audit Act 1994* (the Act) requires the Auditor-General to provide an opinion on these financial statements. Further information about the legislative framework that applies to financial audits is set out in Appendix C.

Forming an opinion on the amounts and other matters disclosed in the financial statements and their accompanying notes, requires the auditor to examine the underlying accounts and records, including the systems and processes used to generate this information.

Australian auditing standards imposed under the Act for audits of financial reports require that:

- The auditor shall obtain an understanding of the following:
 - (a) Relevant industry, regulatory, and other external factors and the applicable financial reporting framework.
 - (b) The nature of the entity, including:
 - (i) its operations;
 - (ii) its ownership and governance structures;
 - (iii) the types of investments that the entity is making and plans to make, including investments in special-purpose entities; and
 - (iv) the way that the entity is structured and how it is financed,to enable the auditor to understand the classes of transactions, account balances, and disclosures to be expected in the financial report.
 - (c) The entity's selection and application of accounting policies, including the reasons for changes thereto. The auditor shall evaluate whether the entity's accounting policies are appropriate for its business and consistent with the applicable financial reporting framework and accounting policies used in the relevant industry.
 - (d) The entity's objectives and strategies, and those related business risks that may result in risks of material misstatement.

- (e) The measurement and review of the entity's financial performance. (Australian Auditing Standard ASA 315, *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment*, paragraph 11).
- 'As part of obtaining an understanding of the entity and its environment in accordance with ASA 315, the auditor shall obtain a general understanding of:
 - (a) The legal and regulatory framework applicable to the entity and the industry or sector in which the entity operates; and
 - (b) How the entity is complying with that framework'.

The auditor shall obtain sufficient appropriate audit evidence regarding compliance with the provisions of those laws and regulations generally recognised to have a direct effect on the determination of material amounts and disclosures in the financial report.' (Australian Auditing Standard ASA 250, *Consideration of Laws and Regulations in an Audit of a Financial Report*, paragraphs 12 and 13).

We adopt a risk-based approach to gathering and assessing audit evidence as required by the Australian auditing standards. This includes considering both the risk that a balance or disclosure is inherently likely to be materially wrong; and the risk that each entity's own systems of internal control will fail to pick up significant errors.

To address these risks we look for direct evidence to substantiate that balances and disclosures are correct and we assess the strength of the internal controls over financial reporting, periodically testing these controls to see whether they are operating as the entity intended.

The systems and the controls operating over the most significant and high-risk balances are examined and tested each year. Other systems and controls are assessed annually, but tested less frequently. Coordinating our audit coverage of these systems between entities lets us draw out and report on any systemic issues.

We analyse and categorise our planned coverage of systems and processes by aligning it with the various components of the financial statements:

- **comprehensive operating statement**—discloses revenue, expenditure, the net result and comprehensive revenue and the comprehensive result
- **balance sheet**—discloses the asset, liability and capital/equity balances
- **cash flow statement**—discloses sources and use of cash from operating, investing and financing activities
- **statement of changes in equity**—discloses the movements in capital and equity
- **the summary of significant accounting policies**—discloses the significant accounting policies used in preparing the financial statements
- **explanatory notes**—supporting detailed disclosures to expand on, and explain the balances and amounts in the statements.

Consistent with section 3A(2) of the Act, our financial audit coverage also considers public resource use, the exercise of probity, and financial prudence in the management or application of public resources.

2.1.2 Performance audit

Areas of performance audit focus are selected within a framework that considers public sector performance against the five goals for a stronger, fairer and safer Victoria. This framework was outlined in the Governor's speech at the opening of the 57th Parliament on 21 December 2010.

The five goals are:

- a growing economy
- services that work
- strong families and vibrant communities
- secure water and a healthy environment
- government you can trust.

We identify areas for audit coverage that are major contributors to the achievement of these goals. Consideration is also given to wastage and lack of probity or financial prudence in all audits undertaken.

More detail about our performance audit topic selection framework can be found in Appendix D.

2.2 Areas of audit focus 2011–12

2.2.1 Financial audit

In 2011–12 we expect to provide audit opinions on almost 570 financial statements (560 in 2010–11), and 113 performance statements (114 in 2010–11). The increase in audit opinions is the net result of removal from mandate, amalgamation, abolition and creation of financial reporting entities.

In conducting our financial audit work, we also consider whether there has been wastage of public resources, or a lack of probity or financial prudence in managing or applying public resources, as required by the Act.

The areas of focus we propose to report on in 2011–12, and the entities affected, are presented below.

Financial audit activities related to *comprehensive operating statements*

Areas of financial audit focus

- Grants administration—portfolio departments
- International student fee revenue—tertiary education entities
- Outsourcing—water entities
- Procurement—local government
- Procurement—public hospitals

Grants administration

Total grants and other transfer expenditure for the general government sector in 2009–10 was \$9.2 billion, representing 21 per cent of total general government expenditure. Of this, 67 per cent or \$6.15 billion was paid to entities and individuals outside Victoria, including private sector and not-for-profit entities.

Controls over grants administration within portfolio departments include the policy framework, grant evaluation, approval and performance monitoring processes, and funding agreements.

International student fee revenue

In 2010, tertiary education entities received \$2.2 billion in student fees. This figure was primarily driven by international students, who provided approximately \$1.4 billion of the total student revenue. The tertiary education sector is dependent on revenue from international students and the revenue stream needs to be managed for entities to remain financially sustainable.

Trends in international student fee revenue and their impact on the financial sustainability of universities and TAFE institutes will be reviewed.

Outsourcing

The water sector incurred expenditure of \$2.3 billion in operating expenses for 2009-10 of which around 60 per cent related to operating and administration activities. A further \$2.2 billion was spent on capital works in that year. Much of the capital and maintenance work is now contracted out to external service providers. In addition, many services such as information technology and customer billing are obtained from private providers.

All water sector procurement should be undertaken within the context of Victorian Government and Victorian Government Purchasing Board policies and guidelines which have introduced 'a more strategic, data driven and analytical planning approach designed to foster informed procurement decisions that lead to better value for money outcomes'.

Controls over outsourcing arrangements will be reviewed.

Procurement

In 2009–10 total expenditure by local councils was \$6 billion. Of this, the actual spend on goods and services to support council operations, services and infrastructure was \$2.2 billion on material and services and \$1.6 billion on capital assets. In 2009–10 public hospitals procured goods and services in excess of \$1.7 billion, or 17 per cent of the \$10 billion total hospital expenditure. This represents the second largest cost to public hospitals, after spending on salaries and wages.

Depending upon the sector involved, procurement related policies may be set by legislation, for example the *Local Government Act 1998*, or under service agreements between the service provider and the funder, as is the case for public hospitals.

Procurement controls include related policies and plans, and tender receipting, recording and evaluation procedures. These controls will be reviewed.

Financial audit activities related to *balance sheets*

Areas of financial audit focus

- Asset management—local government
- Asset valuation—water entities
- Capital project management—tertiary education entities
- Management of employee leave—portfolio departments

Asset management

In 2009–10, the 79 councils controlled \$60 billion worth of fixed assets. The 2009–10 capital spend was budgeted at \$1.9 billion, but the actual spend amounted to \$1.6 billion. The *Local Government Act 1989* requires councils to manage financial risks prudently, and the definition of risks includes the management and maintenance of assets.

Asset management controls at councils include related strategies, policies, practices and procedures. Specific controls include asset stocktakes and reconciliations of asset registers.

Asset valuation

The water industry had infrastructure, property, plant and equipment valued at \$26.7 billion at 30 June 2010. Australian Accounting Standard AASB 116 *Property, Plant and Equipment* permits the use of depreciated replacement cost or an income approach (i.e. discounted cash flows) in the absence of market based evidence for determining fair value. *Financial Reporting Direction 103D Non-Current Physical Assets* requires water entities to have a full revaluation of their asset holdings in 2010–11.

The valuation methodology and the appropriateness of the assumptions adopted, given the requirements of the Australian accounting standards, will be assessed.

Capital project management

At 31 December 2010, tertiary education entities had total assets of \$15.8 billion, with property, plant and equipment accounting for \$11 billion or 70 per cent of the total asset base. In 2010 the sector spent approximately \$773.1 million on new capital projects. Given the materiality of property, plant and equipment and the capital expenditure programs the take up of capital projects should be demonstrably reliable.

Controls within the tertiary education sector over capital projects include related strategies, policies, and monitoring and approval practices.

Management of employee leave

Employee leave entitlements are a significant liability of the public sector. In 2009–10, there were approximately 31 665 full time equivalent staff across the 11 portfolio departments.

Controls over employee leave within portfolio departments include related policies, monitoring and approval practices, and leave plans and entitlements.

Financial audit activities related to *explanatory note disclosures and general internal controls*

Areas of financial audit focus

- Declarations of interest—water entities
- Information technology change management—portfolio departments
- Information technology security—portfolio departments, public hospitals and tertiary education entities
- Internal audit—local government

Declarations of interest

The *Public Administration Act 2004* and the *Code of Conduct for Victorian Public Sector Employees* require officers of public sector agencies to avoid any real or perceived conflicts of interest.

In the water sector, the *Water Act 1989* imposes legislative obligations on a water entity, including the maintenance of a register of pecuniary interests. The financial reporting framework imposes an obligation to disclose related party transactions within the annual financial report of the water entities.

Controls over declarations of interests and disclosure of related party transactions within annual financial reports will be reviewed.

Information technology change management

Spending on software and computer equipment exceeded \$400 million across the portfolio departments in 2009–10. An effective change management process means that changes to information technology (IT) applications and infrastructure are authorised and implemented efficiently and reliably in a controlled and secure environment. The *Whole of Victorian Government (WoVG) Information Security Management Framework*, which covers change management and is based on ISO 27001:2006, *Specification for Information Security Management*, is applicable to portfolio departments.

The adequacy and effectiveness of IT change management controls of the portfolio departments will be reviewed. These controls include related policies, procedures, approval and testing practices.

Information technology security

Information security is the protection of applications, infrastructure and information assets from a wide range of threats, in order to promote business continuity; minimise business risk; eliminate fraud, identity theft, privacy breaches and errors; and meet business objectives. Entities rely on the secure operation of their IT systems.

Information systems used to collect, collate, store and process financial data and statements must be secure so that integrity and confidentiality of the data are protected. The systems should be accessible by authorised people only and controls that allow only authorised changes to be made should exist.

During a financial audit we assess and, where necessary, test an entity's IT security controls so that we can assess the integrity of information handled through the systems. Password and systemic controls over IT security will be reviewed.

Internal audit

Internal audit is a key assurance mechanism available to councils to support the discharge of their governance and oversight responsibilities, and to manage risks and achieve council objectives.

We will review the policies, controls and arrangements in place over the engagement and utilisation of internal audit services by councils, as part of our cyclical assessment of internal controls.

Significant projects and developments

Each year we examine the state's whole-of-government financial statements and provide observations and analysis on the status and financial implications of significant projects and developments which occurred during the financial year and subsequent to year end. This material is included in the *Auditor-General's Report on the Annual Financial Report of the State of Victoria* report in accordance with section 16 of the Act.

2.2.2 Performance audit

This section sets out our areas of performance audit focus for 2011–12. For each prospective audit listed, the final audit approach will be determined after the completion of our detailed planning, a process that requires consultation with the Public Accounts and Estimates Committee and relevant agencies.

Performance audits relating to a *growing economy*

Areas of performance audit focus

- Business planning for major capital works and recurrent services in local government
- Investment attraction
- Management of road bridges
- Melbourne Markets redevelopment project
- Supporting changes in farming practices: Sustainable irrigation

Business planning for major capital works and recurrent services in local government

Councils provide a wide range of services and infrastructure within their municipalities. Annual expenditure on capital works and recurrent services by councils is collectively, around \$3.8 billion, and the value of council assets is estimated at around \$60 billion.

Under the *Local Government Act 1989*, all councils are required to implement principles of sound financial management. These principles include the requirement for councils to manage financial risks prudently having regard to economic circumstances, to ensure that decisions and actions take into consideration financial effects on future generations, and to ensure full, accurate and timely disclosure of financial information. Councils, therefore, need effective business planning and budgeting for capital works and recurrent services in order to achieve these principles.

The audit will examine the effectiveness of council business planning and budgeting for major capital works and recurrent services.

Investment attraction

The Department of Business and Innovation is responsible for promoting Victoria as a world class investment location. It provides investment and facilitation services to attract new international or interstate investment, and to encourage additional investment by businesses operating within the state. The principal objectives in investment attraction are to build the state's business base and to assist local businesses to grow and increase their exports.

Initiatives include facilitation services that provide labour market information, planning advice, access to industry networks and site location, as well as 'in-kind' assistance such as rate relief, land or other infrastructure development, and direct cash payments.

The audit will examine the extent of industry assistance provided and coordinated by the Department of Business and Innovation to attract new investment. It will also evaluate the effectiveness of investment attraction and facilitation programs in achieving their stated objectives, and the adequacy of performance monitoring and evaluation processes to determine program effectiveness.

Management of road bridges

VicRoads manages the arterial road network, including approximately 6 000 bridges in Melbourne and regional Victoria. Managing the demands on arterial road bridges represents a significant challenge because the volume of traffic and the size of freight vehicles have and are expected to increase. Over the last decade VicRoads has spent between \$20 and \$30 million annually on bridge maintenance and renewal. Approximately \$300 million of bridge construction and strengthening projects are now in progress, including major works on the West Gate Bridge.

With larger vehicles being used to transport goods throughout the state, municipal councils also need to manage the risks to bridges in their local road networks.

The audit will determine whether VicRoads and councils are effectively managing road bridges to deliver an accessible, efficient and safe road network.

Melbourne Markets redevelopment project

Melbourne's wholesale fruit and vegetable market is an important part of the state's economic infrastructure, with an annual turnover of more than \$1.6 billion. The market is being relocated from its current site in Footscray to a new site in Epping in Melbourne's north, with the intention of creating a modern, innovative and efficient fresh produce trading and distribution precinct. It is expected to be fully operational in 2012.

The redevelopment, incorporating the market's core trading facility, warehousing, distribution centres and value-added business, is expected to drive over \$1 billion of combined public and private investment on the site. Relocation is also expected to provide substantial economic benefits through a more efficient market precinct, and by freeing up the existing Footscray Road site for port and rail development over the next 20 years.

This audit will assess how well the project was planned and managed and whether the broad objectives of the relocation and redevelopment were achieved.

Supporting changes in farming practices: Sustainable irrigation

Climate change, drought and reduced rainfall place the viability of farming at risk. It is essential for farmers and farm businesses to have access to the latest research and technology and adopt sustainable irrigation practices to minimise water use, and remain profitable and competitive in domestic and overseas markets.

The audit will examine the efficiency, effectiveness and economy of programs designed to increase water savings from on-farm water use.

Performance audits relating to *services that work*

Areas of performance audit focus

- Access to public housing
- Addressing the ageing of the teacher workforce
- Casual relief teacher arrangements
- Compliance with building permits
- Individualised funding for disability services
- Learning technologies in government schools
- Maternity services: Capacity
- Public transport performance

Access to public housing

Housing is a basic need. While waiting for public housing people face homelessness, difficulty gaining or keeping employment or attending study, and also impacts on health including mental wellbeing and family stress. These issues have broader effects on the prosperity and productivity of the community.

With a housing supply and demand imbalance, and high private rental prices, the demand for public housing is strong. In June 2010, the waiting list for public housing was more than 41 000 and the priority housing waiting list comprised almost 9 000 people. To manage demand, access to public housing is targeted at those with greatest need. Those with priority access to public housing wait an average of eight months while applicants without priority can wait seven or more years.

This audit will examine access to public housing with a particular focus on the effectiveness of planning and asset management; and the fairness and transparency of waiting list allocation and management.

Addressing the ageing of the teacher workforce

Ageing of the teacher workforce has been identified by the Organisation for Economic Co-operation and Development as one of the top 10 risks in education; and therefore, to economic growth and sustainability.

In 2008, the average age of staff in the state's government schools was 44, and 36 per cent of all teachers were over 50. By 2018 the majority of the workforce will be eligible for retirement. Particularly concerning is that those in senior leadership positions are close to retirement.

The Department of Education and Early Childhood Development's (DEECD) 2008 *Blueprint for education and early childhood development* identifies workforce reform as one of its three strategic priority directions. DEECD has been trialling initiatives aimed at improving the quality of the school workforce and is undertaking work in conjunction with the Commonwealth on attracting, training, placing and retaining quality teachers.

This audit will assess the effectiveness of DEECD's actions to address the ageing of the teacher workforce.

Casual relief teacher arrangements

Casual relief teachers (CRTs) are employed by schools on a fixed-term or casual basis for a variety of purposes, including replacing staff who are temporarily on leave, undertaking other duties, or attending professional development. A CRT may be appointed for up to 30 working days. However, where required to work beyond the 30-day period, they may be offered employment on a fixed-term basis to the end of the school year.

Each school has an annual CRT budget and is responsible for engaging and managing CRTs. In some areas, engagement of CRTs is facilitated through informal 'banks' which link teachers interested in undertaking CRT work with schools.

The audit will assess whether the use of CRT's in government schools is managed efficiently and effectively. In particular, it will assess whether the expenditure of CRT funds and appointment of CRTs comply with policy and the impact of their use on the quality of teaching services.

Compliance with building permits

Building permits play an important role in regulating proposed building works, and in assuring that minimum building and safety standards are met. Poor administration and enforcement of the building permit system may result in major risks to life and property. During 2009–10, there were 113 670 building permits issued in the state, for works valued at almost \$24 billion.

Historically, building permits were issued by municipal building surveyors on behalf of municipal councils. Following the introduction of the Competitive Building Permit System in 1994, building permits can now also be issued by private building surveyors. In recent years there has been a significant increase in the number of permits issued by the private sector. In 2009–10 private building surveyors issued 84 per cent of the total number of building permits, representing 92 per cent of the total value of approved building work.

The audit will examine how effectively councils enforce compliance of approved works with building permits and the *Building Act 1993*. It will also determine how effectively the Building Commission regulates the activities of municipal and private building surveyors.

Individualised funding for disability services

Recent reforms of the disability service system aim to better support people's individual needs and choices, and the needs of their families and carers. Central to this is the individualised planning and support framework under which funding is 'attached' to the person rather than the service. The reorientation to individual funding empowers recipients to choose and change the nature of their supports or service provider in response to their needs. It also presents challenges in assuring that government funds are used appropriately, and that service provision remains sustainable across Victoria.

This audit will determine the effectiveness of individualised funding for disability services, including whether it meets client needs, provides choice and control, and supports the provision of high quality services, and sector sustainability and capacity.

Learning technologies in government schools

DEECD aims to increase student participation, engagement and learning achievement in education by providing 24/7 access to information and communication technology (ICT) environments. Investment in ICT also aims to provide students with more personalised feedback from teachers and access to learning facilities while away from school. In recent years \$12 million from the state, and \$497 million from the Commonwealth's Digital Education Revolution initiative, have been provided to secondary schools to purchase or replace personal computers. DEECD developed the Ultranet—an on-line teaching and learning environment for students, staff and parents—and allocated a total of \$60.5 million for rollout to every state government school by the third quarter of 2010.

The audit will determine whether the investment in learning technologies is increasing student participation, engagement and learning achievements. It will also assess the adequacy of performance monitoring and evaluation for these activities, and the adequacy of ongoing maintenance, upgrades, modernisation and other resource management aspects aimed at sustaining the technologies in schools.

Maternity services: Capacity

Maternity services are a core component of acute health services. Demand for maternity services, while falling slightly during 2010, increased by more than 14 per cent between 1998 and 2009. Enhanced consumer expectations and new models of care are challenging existing services. Older mothers and rising obesity have also increased the level of complexity of maternity services.

Recent policy direction has focused on increasing local services for women with low-risk pregnancies, and improving the availability of tertiary services for high-risk patients. Additional considerations include continuity of care, reduction in unnecessary interventions, workforce development and increasing options for women.

This audit will examine the capacity of maternity services, focusing on whether effective planning meets demand and service provision is accessible and timely.

Public transport performance

An effective public transport system is important to the state's economic prosperity and liveability. Metropolitan train, tram and bus services, and most regional bus services are provided through contracts with private operators, while regional train services are run by a state authority, V/Line Passenger. The Department of Transport and the proposed Victorian Public Transport Development Authority oversee the arrangements under which the services are provided, and for investing in new infrastructure and services.

While the cost of providing public transport has increased, the performance of metropolitan train and tram services has stagnated or fallen. As such, improving public transport performance is a high priority for the responsible agencies.

The audit will examine the adequacy of the performance of the state's public transport services, and in particular will analyse performance trends and their underlying causes.

Performance audits relating to strong families and vibrant communities

Areas of performance audit focus

- Arts Victoria collections management
- Developing cycling as a safe and appealing mode of transport
- Effectiveness of Justice strategies in preventing and reducing alcohol-related harm

Arts Victoria collections management

Arts Victoria is responsible for advising on and implementing arts policy, developing artists and cultural industries across the state, ensuring the arts are available and accessible to all Victorians, and promoting cultural assets. However, public access is limited to only a small part of its collection.

Arts Victoria manages an asset base of land, buildings and collections totalling around \$5.6 billion, of which collections comprise \$3.9 billion, and has an annual turnover of \$379 million.

This audit will assess the efficiency and effectiveness of the management of Arts Victoria's collections with regard to acquisitions, collection storage, online presence and public access.

Developing cycling as a safe and appealing mode of transport

Cycling has increased in popularity and offers benefits over other forms of transport because it reduces congestion, is environmentally friendly and improves riders' health and wellbeing. Cyclists, however, are vulnerable road users because they have little protection if involved in a crash. The objective of the 2009 *Victorian Cycling Strategy* was to grow cycling into a major form of personal transport. The strategy prioritises actions that target areas with high demand and high growth potential and focuses on cycling to work within the inner 10 kilometres of Melbourne and in Central Activity Districts such as Footscray, Box Hill and central Dandenong.

The audit will assess the effectiveness of agencies in developing cycling as a safe and appealing mode of transport.

Effectiveness of Justice strategies in preventing and reducing alcohol-related harm

Harm caused by alcohol misuse is significant and wide-ranging, affecting individuals, families and the community. Research shows that a significant proportion of Victorians drink too much, either regularly or through binge drinking. It is estimated that 25 out of every 1 000 deaths in the state are caused by alcohol. In 2009–10, 20 522 people were taken into custody for being drunk.

Restoring the balance—Victoria's Alcohol Action Plan 2008–13 included strategies aimed at preventing and reducing harm associated with alcohol misuse, and combating the consequences of excessive alcohol consumption. Responsibility for its implementation rested primarily with the Department of Justice (DOJ) and the Department of Health. The DOJ component focused on enforcing controls over licensed premises and the sale and marketing of alcohol, and preventing and reducing the effects of alcohol misuse, such as alcohol-fuelled violence.

The audit will assess the effectiveness of DOJ's initiatives in preventing and reducing the impact of alcohol-related harm on the community.

Performance audits relating to secure water and a healthy environment

Areas of performance audit focus

- Agricultural food safety
- Management of contaminated sites
- Municipal solid waste management

Agricultural food safety

The food industry is a significant contributor to the Victorian and Australian economies, with an annual turnover of more than \$25 billion. Its success in delivering premium-quality food to domestic and international markets hinges on its reputation as a 'clean and green' supplier with effective agricultural and supply chain systems to regulate food safety.

This audit will examine how effectively agricultural food production and supply is being regulated in order to provide assurance to the community and the market about the safety of our food.

Management of contaminated sites

Contaminated sites are parcels of land and, in some instances, groundwater, where chemical concentrations produced through industrial and commercial waste are above those that naturally occur or 'background' levels. These sites pose a problem when the chemical concentrations affect the intended use of the site or risk the health of people or the environment in its vicinity.

Contaminated sites are increasingly being rezoned and redeveloped for use by the community, particularly residential developments. As the extent of the contamination of these sites and their location is often unknown—a symptom of poor record keeping or regulatory activity—there are potential health impacts to those exposed to the sites, or water or soil affected by leaked or escaping chemicals.

This audit will examine how effectively the Environmental Protection Authority and planning authorities regulate contaminated sites to mitigate the potential health impacts on the community.

Municipal solid waste management

Victoria is one of the highest waste generating states in Australia. In 2006–07, its population generated around 10.3 million tonnes of solid waste, with about 38 per cent sent to landfill and 62 per cent recycled. Around 7.2 million tonnes or 74 per cent of this waste was produced in metropolitan Melbourne. Increased demand for products and services due to population growth, changes to population density and distribution, and lifestyle factors, have increased the amount of waste produced.

Municipal solid waste includes garbage, recyclable and organic materials collected by councils from kerbsides. It contributes around 44 per cent of Victoria's total waste sent to landfill. Landfills contribute 3–4 per cent of Australia's total greenhouse gases, and result in degraded land of reduced value. Landfills also pose risks associated with the pollution of groundwater and surface water, production of combustible gases, and can affect community health and safety.

The audit will examine whether waste management and resource recovery actions have been effective and efficient in achieving objectives and targets for municipal solid waste.

Performance audits relating to *government you can trust*

Areas of performance audit focus

- Fraud prevention strategies in local government
- Government advertising and communication
- Management of trust funds in the Justice portfolio
- Personal expense reimbursement, travel expenses and corporate credit cards
- Procurement practices in the health sector
- Quality of Freedom of Information reporting
- Road safety camera program
- TAFE governance
- Victorian Institute of Teaching
- Visiting medical officer payments in public hospitals

Fraud prevention strategies in local government

Municipal councils manage billions of dollars in community resources. Recent surveys indicate that the incidence and cost of fraud remains a significant concern for all organisations, including councils. To protect their resources from fraud, each council needs a robust control framework to effectively manage and respond to fraud risks and incidents.

The 2008 VAGO report on the results of audits in the local government sector identified a number of weaknesses in council internal control frameworks critical for managing the risk of fraud. The 2008 audit conducted a high level review of fraud management practices and found that around one-third of all councils did not have a robust fraud control system in place.

This audit will assess the effectiveness of fraud prevention strategies within selected councils. This will involve examining the internal control environment, including mechanisms for preventing, detecting and responding to incidents of fraud.

Government advertising and communication

Advertising and communications can play a significant role in efficiently achieving government objectives. Government departments and agencies employ these as key elements in informing the community of new policies, legislation, programs or projects.

Government advertising and communication activities need to be conducted in ways that are accountable, deliver value-for-money and avoid promoting the incumbent government. The December 2009 *Victorian Government Advertising and Communication Guidelines* provide that the government has the responsibility to ensure 'equity, fairness, appropriateness and accountability in all of its communications with Victorians'.

This audit will assess whether there are appropriate levels of accountability in government advertising and communication expenditure and processes, and whether selected campaigns comply with government guidelines.

Management of trust funds in the Justice portfolio

The Department of Justice manages a significant amount of money held in trust and is accountable for managing those funds in the interests of the beneficiaries. The department's 2009–10 annual report stated that the balance of all trust accounts was approximately \$1.6 billion.

The largest trust fund is administered by the Senior Master of the Supreme Court. This trust is managed on behalf of people awarded money through the court. These people may be either deemed unable to manage their own financial affairs, or not presently entitled to the funds. Other significant trust funds include the Statutory Deposit Accounts and Public Purpose Fund, the Residential Bonds Account and Residential Tenancies Fund and the Victorian Property Fund.

The audit will examine whether trust funds managed within the Justice portfolio are operated transparently and governed effectively in the interests of beneficiaries and consistent with legislation.

Personal expense reimbursement, travel expenses and corporate credit cards

Public servants are reimbursed by departments for expenses incurred in carrying out their duties, such as for transport and meals associated with official travel. They may also have access to corporate credit cards for purchasing work-related goods and services. Due to the high number and small value of individual transactions dispersed across the public sector, the level of scrutiny over such transactions may be diminished, increasing the risk of error or fraud.

Ministerial directions under the *Financial Management Act 1994*, specify that public sector agencies must implement and maintain effective internal controls over expenditure to ensure that disbursements are appropriately authorised and incurred in accordance with business needs, and captured in the financial records.

The audit will examine whether departments are managing reimbursement of personal and travel expense claims and the use of corporate credit cards in accordance with legislative requirements.

Procurement practices in the health sector

In 2009–10 public hospitals procured in excess of \$1.7 billion in goods and services, representing 17 per cent of total hospital operating expenditure. Goods and services are the second largest cost to public hospitals, after salaries and wages.

In 2001, Health Purchasing Victoria (HPV) was established under the *Health Services Act 1988* as the health sector's central procurement agency. HPV's focus is on delivering savings and other benefits to the health sector by using its collective purchasing power. Hospitals and health services also retain the flexibility to buy locally. HPV manages around 19 per cent of health sector procurement and has a broader role in developing and monitoring compliance with procurement policies to promote best value and probity.

This audit will examine whether procurement practices in the health sector deliver best value and are conducted with probity and transparency.

Quality of Freedom of Information reporting

Access to information about government decision-making and publicly funded activities is a fundamental tenet of democracy. Freedom of information legislation is one of the cornerstones of good governance. It aids public participation and can provide assurance that the public sector and governments are held to account for their actions.

In 2009–10, more than 31 000 freedom of information (FOI) requests were received by the state's public sector agencies. This is an almost 600 per cent increase since the *Freedom of Information Act 1982* was introduced. Eighty-four per cent of the requests were made to 30 agencies. The remaining 16 per cent were made to 947 other public sector agencies.

The audit will examine FOI data collected and reported by the Department of Justice for accuracy, completeness and integrity, and determine whether it fairly represents agency and government performance in responding to FOI requests.

Road safety camera program

According to the Department of Justice, speeding is a major cause in around one-third of road trauma contributing to approximately 100 deaths and 2 000 serious injuries a year. The cost of road trauma to the state is estimated at \$3.8 billion per year.

Speed and red light cameras are an integral part of the road safety camera program. Speeding offences can result in fines and demerit points. Fines issued from road safety cameras amounted to around \$211 million in 2009–10. However, there is significant community concern about the integrity and validity of the camera program.

The audit will assess whether the road safety camera program is current and reflects better practice, tactical deployment of cameras optimises road safety outcomes, integrity is adequately assured, and the extent to which cameras contribute to achieving road safety outcomes.

TAFE governance

Victoria has 18 Tertiary and Further Education Institutes (TAFEs) established under the *Education and Training Reform Act 2006* which aims to provide for a high standard of education and training for all Victorians. TAFE boards are accountable to the Minister for Higher Education and Skills for the effective and efficient governance and oversight of these TAFEs. The boards receive government funding for delivering education and training services. The funding is administered by the Victorian Skills Commission, under delegation to Skills Victoria. In 2010, the boards received around \$680 million under performance agreements with Skills Victoria.

The audit of the Holmesglen TAFE 2010 financial statements identified a financially material loan made by it to a private registered training organisation in late 2010.

The audit will examine the legality, propriety and financial prudence of the financial arrangement in terms of the statutory powers and established operational remit of Holmesglen and the TAFE sector. It will also examine the effectiveness of oversight by the Holmesglen Board of material investments made by the TAFE, and the adequacy and effectiveness of coordination and oversight by Skills Victoria and the Victorian Skills Commission of Holmesglen and the TAFE sector.

Victorian Institute of Teaching

The Victorian Institute of Teaching (VIT) is the statutory authority for the regulation and promotion of the teaching profession in the state. It was established in December 2002 and operates under the *Education and Training Reform Act 2006*. VIT's responsibilities include establishing common professional standards and codes of conduct, registering all teachers so that only qualified people are employed in the state's schools, promoting and supporting continuous professional learning, approving teacher education courses and conducting disciplinary hearings.

At June 2010 there were 113 022 teachers listed on VIT's public register, an increase of 3 273 from the previous year.

The audit will assess the efficiency and effectiveness of VIT in regulating and promoting the teaching profession in government schools.

Visiting medical officer payments in public hospitals

Medical services in the public health system are provided by salaried medical officers and private practitioners engaged by hospitals. The latter are generally referred to as visiting medical officers (VMOs) and are engaged on a fee for service or sessional basis with payment reflecting each medical service provided to public patients. VMOs can also receive a 'standard' payment for participation in teaching, governance or on-call roster activities.

In 2009–10 public hospitals paid in excess of \$130 million to VMOs.

Health services have a variety of systems in place for paying VMO claims, and previous audits have identified concerns around the rigour of internal controls relating to VMO payments. There are substantial and ongoing public interest issues in how public hospitals manage VMO arrangements.

This audit will review the appropriateness and transparency of health service payments by public hospitals to VMOs.

2.3 Reporting the results of 2011–12 audits

Section 16 of the *Audit Act 1994* (the Act) empowers the Auditor-General to report to Parliament on the results of audits and he may include such information as he thinks pertinent. In 2011–12 we intend to table 34 reports on the results of our financial and performance audits. During the year we will also table our Annual Report for 2010–11 and our 2012–13 Annual Plan.

2.3.1 Financial audit

Parliamentary reports on the results of financial audits routinely comment on:

- the effectiveness of internal controls
- the timeliness of financial reporting
- financial sustainability
- financial reporting developments.

In October 2011 we propose tabling the Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2010–11 as required under the Act.

We propose to table four reports on the results of our 2010–11 financial audits covering local government, portfolio departments, public hospitals, and water entities, across October and November 2011. We plan to also table the report on the results of the 2011 audits of the tertiary education sector and other entities, in May 2012.

Our sector and portfolio reports will include analysis of indicators of financial sustainability, reflecting non Budget funded entity's revenue raising performance and expenditure control, and indicate whether the revenue and expenditure trends and policies are sustainable.

The Act requires the Auditor-General to prepare a review report on the Estimated Financial Statements for the general government sector. As is the usual practice, this report will be included with the 2012–13 Budget Papers to be presented to Parliament in May 2012.

Further information about the reports proposed for tabling during 2011–12 is detailed in Figure 2A.

Figure 2A
Parliamentary reports on results of financial audits to be tabled in 2011–12

Report title	Proposed report topics
Whole-of-government	
<i>Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2010–11</i>	The results of the audit of the state's annual financial report and addressing the quality and timeliness of financial reporting, explanation of significant financial results for the state and observations on the status and financial implications of significant projects and developments that occurred during 2010–11 and subsequent to year end.
Portfolio or sector specific	
<i>Local Government: Results of the 2010–11 Audits</i>	The results of the audits of approximately 100 entities in the local government sector addressing the timeliness of their financial and performance reporting, their financial sustainability, their utilisation of internal audit and aspects of how they manage assets and procurement.
<i>Portfolio Departments and Associated Entities: Results of the 2010–11 Audits</i>	The results of the annual financial statement audits of approximately 210 entities. The report will include comment on the timeliness of their financial reporting, financial sustainability and reporting developments, and aspects of how they manage grants administration, employee leave, information technology change, and information technology security.
<i>Public Hospitals: Results of the 2010–11 Audits</i>	The results of the audits of approximately 110 entities, addressing the timeliness of their financial reporting, their financial sustainability, and aspects of how they manage procurement and information technology security.
<i>Water Entities: Results of the 2010–11 Audits</i>	The results of the audits of 20 water entities addressing the timeliness of their financial and performance reporting, their financial sustainability and aspects of how they manage declarations of interests, asset valuations and outsourcing.
<i>Tertiary Education and Other Entities: Results of the 2011 Audits</i>	The results of the annual financial audits of approximately 120 entities with a financial year end other than 30 June 2011, addressing the timeliness of their financial and performance reporting, their financial sustainability and aspects of how they manage capital projects, information technology security, and international student fee revenue.

Source: Victorian Auditor-General's Office.

2.3.2 Performance audit

In 2011–12 we plan to table 28 reports addressing the areas of performance audit focus outlined in section 2.2.2 of this plan.

A list of our Parliamentary reports tabled from 2008–09 to 2010–11 can be found in Appendix E.

2.4 Current and prospective areas of audit focus 2011–12 to 2014–15

2.4.1 Financial audit

A financial audit involves far more than verification of the numbers. Australian auditing standards impose a responsibility to comprehend the operational context, to assess the reliability and integrity of related systems, processes and the control environment and to consider compliance with laws and regulations.

Australian Auditing Standard 315 (ASA 315), *Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment* requires the auditor to obtain an understanding of the audited entity and its environment, including its internal control, sufficient to identify and assess the risks of material misstatement of the financial report whether due to fraud or error, and sufficient to design and perform further audit procedures. Auditors assess 'materiality' by dollar value and by nature.

ASA 315 outlines the internal controls over the accuracy and reliability of an entity's financial reporting. This includes the entity's:

- governance
- risk assessment
- information systems and related business processes.

We examine and test the systems and the controls operating over the most significant and high-risk balances and amounts each year.

Other systems and controls are assessed annually, but tested less frequently.

Coordinating our audit coverage of these systems between entities enables us to identify, draw out and report on systemic issues. Figure 2B presents these areas of financial audit focus for 2011–12, and prospective areas of financial audit focus for the period 2012–13 to 2014–15, by report for each major financial statement component.

The prospective areas of focus for 2012–13 to 2014–15 form an indicative program from which we will develop our future annual plans. While they indicate our current assessments of audit risks, we may need to revise our plans over time to respond to emerging developments so that our audit coverage remains relevant and appropriate.

Financial audit focus areas link directly to an entity's internal controls which we are required by the auditing standards to assess. For example:

- focus areas of audit committees, declarations of interest and internal audit concern an entity's governance, which ASA 315 requires us to assess
- focus areas of asset management concerns the controls on asset valuations and depreciation in the financial report. ASA 540 *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures* requires this assessment
- focus areas of student fees revenue in tertiary education is part of an assessment of whether the entity is a going concern and its use of that assumption when it prepares its financial report under AASB 101 *Presentation of Financial Statements*. ASA 570 *Going Concern* requires this assessment.

Figure 2B
Current and prospective areas of financial audit focus 2011–12 to 2014–15

Comprehensive operating statement				
Report title	2011–12	2012–13	2013–14	2014–15
Local Government: Results of Audits	• Procurement	• Outsourcing	• Rate revenue	• Credit card usage
Portfolio Departments and Associated Entities: Results of Audits	• Grants administration	• Credit card usage	• Management of contractors and consultants	• Outsourcing
Public Hospitals: Results of Audits	• Procurement	• Public hospital revenue	• Private patient fees	• Government revenue
Tertiary Education and Other Entities: Results of Audits	• International student fee revenue	• Credit card usage	• Procurement	• Student fee revenue
Water Entities: Results of Audits	• Outsourcing	• Water tariff revenue	• Procurement	• Revenue

Figure 2B
Current and prospective areas of financial audit focus 2011–12 to 2014–15 – continued

Balance sheet				
Report title	2011–12	2012–13	2013–14	2014–15
Local Government: Results of Audits	<ul style="list-style-type: none"> Asset management 			<ul style="list-style-type: none"> Management of creditors
Portfolio Departments and Associated Entities: Results of Audits	<ul style="list-style-type: none"> Management of employee leave 		<ul style="list-style-type: none"> Asset management 	
Public Hospitals: Results of Audits		<ul style="list-style-type: none"> Capital project management 		<ul style="list-style-type: none"> Asset management
Tertiary Education and Other Entities: Results of Audits	<ul style="list-style-type: none"> Capital project management 			<ul style="list-style-type: none"> Asset management
Water Entities: Results of Audits	<ul style="list-style-type: none"> Asset valuation 		<ul style="list-style-type: none"> Treasury management 	
Explanatory note disclosures and general internal controls				
Report title	2011–12	2012–13	2013–14	2014–15
Local Government: Results of Audits	<ul style="list-style-type: none"> Internal audit 	<ul style="list-style-type: none"> Budget management 	<ul style="list-style-type: none"> Audit committees Internal audit 	<ul style="list-style-type: none"> Risk management
Portfolio Departments and Associated Entities: Results of Audits	<ul style="list-style-type: none"> Information technology change management Information technology security 	<ul style="list-style-type: none"> Risk management 	<ul style="list-style-type: none"> Information technology business continuity and disaster recovery planning 	<ul style="list-style-type: none"> Internal audit
Public Hospitals: Results of Audits	<ul style="list-style-type: none"> Information technology security 	<ul style="list-style-type: none"> Audit committees 	<ul style="list-style-type: none"> Risk management 	<ul style="list-style-type: none"> Internal audit
Tertiary Education and Other Entities: Results of Audits	<ul style="list-style-type: none"> Information technology security 	<ul style="list-style-type: none"> Internal audit 	<ul style="list-style-type: none"> Financial policies and delegations 	<ul style="list-style-type: none"> Risk management
Water Entities: Results of Audits	<ul style="list-style-type: none"> Declarations of interest 	<ul style="list-style-type: none"> Risk management 	<ul style="list-style-type: none"> Information technology business continuity and disaster recovery planning 	<ul style="list-style-type: none"> Audit committees

Source: Victorian Auditor-General's Office.

2.4.2 Performance audit

Figure 2C presents the areas of performance audit focus for 2011–12, and prospective areas of performance audit focus for the period 2012–13 to 2014–15, by portfolio for each of the five goals. The prospective areas of focus for 2012–13 to 2014–15 form an indicative program from which we will develop our future annual plans.

The program will be reassessed periodically and our audit program modified to reflect emerging issues and changed risk assessments.

Figure 2C
Current and prospective areas of performance audit focus 2011–12 to 2014–15

A growing economy				
Portfolio	2011–12	2012–13	2013–14	2014–15
Business and Innovation	<ul style="list-style-type: none"> Investment attraction Melbourne Markets redevelopment project 	<ul style="list-style-type: none"> Tourism strategy 	<ul style="list-style-type: none"> Export development 	<ul style="list-style-type: none"> Support to the automotive industry
Education and Early Childhood Development				<ul style="list-style-type: none"> Skills Victoria – including reform of the skills system
Primary Industries	<ul style="list-style-type: none"> Supporting changes in farming practices: Sustainable irrigation 			
Sector-wide and central agencies		<ul style="list-style-type: none"> Planning, delivery and benefits realisation of major asset investment VicForests 	<ul style="list-style-type: none"> Changing profile of the public sector workforce 	
Transport	<ul style="list-style-type: none"> Management of road bridges 	<ul style="list-style-type: none"> Fare evasion on public transport Managing traffic congestion Port of Melbourne channel deepening project: Achievement of objectives 	<ul style="list-style-type: none"> Developing transport infrastructure and services for population growth areas SmartBus competitively tendered contracts 	
Local Government	<ul style="list-style-type: none"> Business planning for major capital works and recurrent services in local government 	<ul style="list-style-type: none"> Asset management and maintenance by councils 	<ul style="list-style-type: none"> Shared services in local government 	<ul style="list-style-type: none"> Organisational sustainability of small councils

Figure 2C
Current and prospective areas of performance audit focus 2011–12 to 2014–15 – *continued*

Services that work				
Portfolio	2011–12	2012–13	2013–14	2014–15
Education and Early Childhood Development	<ul style="list-style-type: none"> Addressing the ageing of the teacher workforce Casual relief teacher arrangements Learning technologies in government schools 	<ul style="list-style-type: none"> Implementation of school infrastructure programs Out of school hours care program Science and maths participation rates and initiatives Students with special learning needs 	<ul style="list-style-type: none"> Integrated children's centres School governance Student completion rates Management of staff safety in schools TAFE institutes: Student Management Solution 	<ul style="list-style-type: none"> Equitable access to education for rural students Allocation of capital funding to TAFE institutes Transitioning from pre-school to prep
Health	<ul style="list-style-type: none"> Maternity services: Capacity 	<ul style="list-style-type: none"> Infection control in hospitals Planning for Melbourne's health infrastructure 	<ul style="list-style-type: none"> Consumer participation in the health system HealthSMART clinical and patient health systems 	<ul style="list-style-type: none"> Department of Health workforce Occupational Health and Safety risk in public hospitals
Human Services	<ul style="list-style-type: none"> Access to public housing Individualised funding for disability services 			<ul style="list-style-type: none"> Department of Human Services workforce Redevelopment of the Aids and Equipment Program
Justice		<ul style="list-style-type: none"> Consumer protection Court backlogs 	<ul style="list-style-type: none"> Appropriate dispute resolution Management of unplanned leave in Victoria Police, Metropolitan Fire Brigade and Ambulance Victoria Prisons: Health and transportation 	<ul style="list-style-type: none"> Asset confiscation scheme Transition support for prisoners
Planning and Community Development				<ul style="list-style-type: none"> Accessibility of mainstream services for Aboriginal Victorians
Sector-wide and central agencies			<ul style="list-style-type: none"> Emergency response ICT (incorporating Project 000) 	
Transport	<ul style="list-style-type: none"> Public transport performance 			<ul style="list-style-type: none"> Public transport coordination
Local Government	<ul style="list-style-type: none"> Compliance with building permits 			<ul style="list-style-type: none"> Emergency management for fire, flood and other potential disasters

Figure 2C
Current and prospective areas of performance audit focus 2011–12 to 2014–15 – continued

Strong families and vibrant communities				
Portfolio	2011–12	2012–13	2013–14	2014–15
Health				<ul style="list-style-type: none"> Heatwave management
Human Services		<ul style="list-style-type: none"> Crisis housing and homelessness response Carer support program 	<ul style="list-style-type: none"> Access for culturally and linguistically diverse communities Early intervention for children at risk 	
Justice	<ul style="list-style-type: none"> Effectiveness of Justice strategies in preventing and reducing alcohol-related harm 	<ul style="list-style-type: none"> Effectiveness of volunteer management strategies in emergency services 	<ul style="list-style-type: none"> Control of drug use in prisons Operation of the Charter of Human Rights and Responsibilities 	<ul style="list-style-type: none"> Gambling industry reform: Realisation of intended outcomes Justice Mental Health Strategy
Planning and Community Development		<ul style="list-style-type: none"> Provincial Victoria Growth Fund 	<ul style="list-style-type: none"> Implementation of the <i>Aboriginal Heritage Act 2006</i> Implementation of the Strengthening Community Organisation Action Plan 	<ul style="list-style-type: none"> Encouraging participation in sport and recreation
Sector-wide and central agencies	<ul style="list-style-type: none"> Arts Victoria collections management 		<ul style="list-style-type: none"> Social identity and inclusion 	
Transport	<ul style="list-style-type: none"> Developing cycling as a safe and appealing mode of transport 	<ul style="list-style-type: none"> Marine safety 		<ul style="list-style-type: none"> Improving safety on Victoria's roads

Figure 2C
Current and prospective areas of performance audit focus 2011–12 to 2014–15 – *continued*

Secure water and a healthy environment				
Portfolio	2011–12	2012–13	2013–14	2014–15
Primary Industries	<ul style="list-style-type: none"> • Agricultural food safety 	<ul style="list-style-type: none"> • Effectiveness of enforcement activities: Primary Industries and Sustainability and Environment • Managing marine fisheries resources 	<ul style="list-style-type: none"> • Implementing the Timber Industry Strategy 	<ul style="list-style-type: none"> • Managing freshwater fisheries • Implementing the Climate Change White Paper: Progress of actions
Sustainability and Environment	<ul style="list-style-type: none"> • Management of contaminated sites • Municipal solid waste management 	<ul style="list-style-type: none"> • Foodbowl modernisation project, including the Sugarloaf Interconnector • Protecting the environment: Monitoring compliance with project approval conditions • Reducing household, business and government energy consumption 	<ul style="list-style-type: none"> • Effectiveness of outsourced infrastructure: Water sector • Managing the demand and supply of urban and regional drinking water 	<ul style="list-style-type: none"> • Emergency management of environmental incidents • The safe use of alternate water supplies
Transport				<ul style="list-style-type: none"> • Reducing transport greenhouse gas emissions
Local Government			<ul style="list-style-type: none"> • Land use planning: Preparing for rising sea levels 	

Figure 2C
Current and prospective areas of performance audit focus 2011–12 to 2014–15 – *continued*

Government you can trust				
Portfolio	2011–12	2012–13	2013–14	2014–15
Business and Innovation			<ul style="list-style-type: none"> Demonstrating outcomes from innovation related programs 	
Education and Early Childhood Development	<ul style="list-style-type: none"> TAFE governance Victorian Institute of Teaching 			<ul style="list-style-type: none"> The State of Victoria's Children: Performance reporting
Health	<ul style="list-style-type: none"> Procurement practices in the health sector Visiting medical officer payments in public hospital 	<ul style="list-style-type: none"> Your hospitals: Performance reporting 		
Justice	<ul style="list-style-type: none"> Management of trust funds in the Justice portfolio Road safety camera program 	<ul style="list-style-type: none"> Implementation of LINK system in Victoria Police Racing industry: Boards of management 		
Primary Industries			<ul style="list-style-type: none"> Regulating the retail energy market 	
Sector-wide and central agencies	<ul style="list-style-type: none"> Quality of Freedom of Information reporting Government advertising and communication Personal expense reimbursement, travel expenses and corporate credit cards 	<ul style="list-style-type: none"> CenITex Effectiveness of regulators Obsolescence of frontline ICT Prudential supervision 	<ul style="list-style-type: none"> Bushfire recovery: Effectiveness of implementation Implementation of the Government Risk Management Framework Reducing the regulatory burden Shared services 	<ul style="list-style-type: none"> Effectiveness of probity practitioners in procurement Government 2.0 Public consultation in decision making WoVG Information Security Management Framework
Sustainability and Environment			<ul style="list-style-type: none"> Environment and Sustainability sector: Performance reporting 	<ul style="list-style-type: none"> Management of environmental levies and charges
Transport			<ul style="list-style-type: none"> Registration and licensing system project 	
Local Government	<ul style="list-style-type: none"> Fraud prevention strategies in local government 	<ul style="list-style-type: none"> Rating practices in local government 		

Source: Victorian Auditor-General's Office.

Appendix A.

Our *Strategic Plan 2010–11 to 2014–15*

Our vision over the life of our *Strategic Plan 2010–11 to 2014–15*, is for VAGO to be a catalyst for continuous improvement in the accountability and performance of the public sector.

Our Strategic Plan was developed using staff input, and listening to the views of our stakeholders—Parliamentarians, audit clients, the public sector, community and peers. We discerned that we need to work smarter, to continue to work on better targeting our audits and to align our resources to achieve a more consistent flow of reports and advice.

By aligning our organisational structures and leadership we aim to create a strong culture where our values—integrity, personal accountability, teamwork, learning and being outcome focused—encourage an environment of teamwork and a ‘one office’ approach. In line with our values we will continue our commitment to engaging professionally and transparently with the entities as we go about our purpose of providing independent assurance to Parliament.

We aim to remain abreast with the changing expectations of audit and accountability, and to act to keep our mandate relevant and our reports authoritative and relevant. We continue to foster productive relationships with our clients—both the Parliament and our audit clients—and to better inform them about our activities. Crucially, we remain focused on the health and sustainability of our organisation and our people, creating and maintaining a positive and stimulating work environment for all.

Appendix B.

Our outputs for 2011–12

The level of resources allocated to VAGO each year through Victoria's annual Budget process is determined in consultation with Parliament's Public Accounts and Estimates Committee. Under the Budget framework, our resourcing is based upon two output groups, namely:

- Output 1: Parliamentary reports and services
- Output 2: Audit reports on financial statements.

Output 1: Parliamentary reports and services

Our Parliamentary reports

We inform Parliament, our primary client, of the results of our work through our reports. The reports provide Parliament with independent assurance on the adequacy of accountability and resource management practices in the public sector and include:

- performance audits, that focus on the effectiveness, efficiency and economy of publicly funded activities, or probity and compliance
- an annual assessment of the state's finances
- reports of observations from the previous June and December financial statement audit rounds.

We also table the Auditor-General's Annual Plan and the VAGO Annual Report to inform Parliament of our planned activity and actual performance respectively.

In 2011–12 we intend to table 36 reports in Parliament (target of 37 in 2010–11).

Services we provide to Parliament

We complement our reports by providing a range of other services for Parliament. These services foster enhanced accountability and performance, while promoting better practice resource management in the public sector.

Services we provide include:

- advice and assistance to Parliament, including submissions to Parliamentary committees on matters relevant to their inquiries
- responding to inquiries from Members of Parliament, government agencies and the public, which sometimes leads to the conduct of audits
- advice to central agencies and other public sector agencies, in such areas as draft legislation, financial management proposals, and the development of accountability frameworks

- guidance to public sector agencies, arising from our audit work, in specific areas of governance, management and accountability to support their improved future performance
- advice to external bodies on emerging developments associated with the public sector, including commentary on draft accounting and auditing pronouncements.

In providing this range of services, we seek to use the skills and experience of VAGO to encourage sustained improvement in the management of public resources.

Performance measures

Figure B1 outlines the performance measures we will be accountable for in 2011–12 as part of our delivery of the Parliamentary reports and services output.

Figure B1
Output 1: Parliamentary reports and services

Major outputs/deliverables <i>Performance measures</i>	Unit of measure	2011–12 target	2010–11 expected outcome	2010–11 target	2009–10 actual
Quantity					
Auditor-General's reports ^(a)	number	36	40	37	34
Quality					
Overall level of external satisfaction with audits—audit clients	score ^(b)	75	75	75	69
Average score of audit reports by external assessors ^(c)	per cent	80	nm	nm	nm
Overall level of external satisfaction with audit reports and services—Parliamentarians ^(d)	per cent	85	92	85	nm
Timeliness					
Inquiries from Members of Parliament and the public responded to within 28 days	per cent	95	95	95	93
Reports completed on time	per cent	90	90	90	81
Cost					
Total output cost ^(e)	\$ million	14.4 ^(f)	14.9 ^(f)	14.1	14.5

(a) The 2010–11 expected outcome is higher than the 2010–11 target due to three reports carried over from 2009–10, plus the newly-commissioned Electronic Gaming Machines report, less one report carried back into 2009–10.

(b) The score is a rating out of 100, and represents the average rating by all respondents.

(c) New performance measure for 2011–12 which more directly reflects the quality of the audit report.

(d) The 2010–11 expected outcome is higher than the 2010–11 target due to the measure being new for 2010–11. The target was informed by results received in earlier years.

(e) The 2010–11 expected outcome is higher than the 2010–11 target due to a number of newly-commissioned reports, together with the deferral of a number of reports from 2009–10 (refer note (a) above). These costs are partly funded by a \$200 000 carryover of funds from the prior year. The gross costs have also been affected by the secondment of staff to other agencies; these costs are recovered directly from those agencies.

(f) The 2011–12 target and 2010–11 expected outcome differ from the figures stated in the 2011–12 Budget Papers. The latest figures have been used in the Annual Plan.

Note: nm = new measure.

Source: 2011–12 Budget Papers.

Output 2: Audit reports on financial statements

Key attest functions

A core statutory responsibility of the Auditor-General is to undertake an annual examination of the financial statements, and in some areas performance statements, of departments and public bodies, including municipal councils, and to issue an audit opinion on the presentation of those statements.

The main products from the exercise of this mandatory responsibility are the:

- independent review of the government's Estimated Financial Statements and provision of a report for inclusion in its annual Budget papers presented to Parliament
- audit opinions (also referred to as audit reports) on the financial statements of public sector agencies and on the government's Annual Financial Report
- audit opinions on non-financial performance indicators prepared by local government, certain water bodies, and technical and further education institutes
- letters to management of audited agencies conveying the findings of audits.

Examination and certification by the Auditor-General of warrants authorising the expenditure of public funds by government

The preparation of warrants in Victoria is required under the provisions of the *Constitution Act 1975* and the *Financial Management Act 1994*. Warrants provide the constitutional authority for the Treasurer to spend the funding allocated in the annual Budget and must be signed by the Auditor-General and approved by the Governor. Warrants examined and certified by the Auditor-General during 2010–11 have an aggregate expenditure value of more than \$41.7 billion as at 17 May 2011 (\$43.6 billion in 2009–10).

Performance measures

Figure B2 outlines the performance measures which we will be held to account for in 2011–12 as part of our delivery of the audit reports on financial statements output.

Figure B2
Output 2: Audit reports on financial statements

Major outputs/deliverables <i>Performance measures</i>	Unit of measure	2011–12 target	2010–11 expected outcome	2010–11 target	2009–10 actual
Quantity					
Audit opinions issued on non-financial performance indicators	number	113	113	114	113
Audit opinions issued on the financial statements of agencies	number	567	551	541	557
Quality					
Overall level of external satisfaction with audits—audit clients	score ^(a)	75	75	75	75
External/peer reviews finding no material departures from professional and regulatory standards ^(b)	per cent	100	nm	nm	nm
Timeliness					
Audit opinions issued within statutory deadlines	per cent	98	99	98	100
Management letters and reports to Ministers issued within established time frames	per cent	90	88	90	94
Cost					
Total output cost ^(c)	\$ million	20.8	21.4 ^(d)	20.3	20.4

(a) The score is a rating out of 100, and represents the average rating by all respondents.

(b) New performance measure for 2011–12 which more directly reflects the quality of the audit report.

(c) The 2010–11 expected outcome is higher than the 2010–11 target due to increased audit fees being paid to audit service providers. These costs are recovered via audit fee revenue.

(d) The 2010–11 expected outcome differs from the figure stated in the 2011-12 Budget Papers. The latest figures have been used in the Annual Plan.

Note: nm = new measure.

Source: 2011–12 Budget Papers.

Appendix C.

Financial audit framework

The legislative reporting framework makes it clear that agency heads are responsible for the preparation and content of their financial statements. Our financial audits focus on providing reasonable assurance that the certification given by each agency head on their financial statements can be relied upon by the users of those statements.

Figure C1 sets out the legislative frameworks for both financial reporting and auditing, and shows how they relate to each other.

Figure C1
Legislative framework for financial reporting and auditing

Public sector entities	Victorian Auditor-General's Office
Purpose	
Manage entities and prepare financial statements in compliance with legislative and reporting requirements.	Examine the underlying accounts and records of almost 570 public sector entities (560 in 2010–11), including the systems and processes they use to generate financial statements, to provide assurance by expressing an opinion on fairness of presentation.
Legislation	
<p>Financial Management Act 1994 (for public sector entities including departments)</p> <p>or</p> <p>Corporations Act 2001 (for incorporated entities)</p> <p>or</p> <p>Associations Incorporations Act 1981 (for incorporated associations)</p> <p>or</p> <p>Local Government Act 1989 (for local councils and regional library corporations)</p>	Audit Act 1994
Standards	
<p>Accounting standards issued by the Australian Accounting Standards Board for public and private sector entities, for example:</p> <ul style="list-style-type: none"> Property, Plant and Equipment (AASB 116) Accounting for Government Grants and Disclosure of Government Assistance (AASB 120) Employee Benefits (AASB 119) 	<p>Auditing standards issued by the Auditing and Assurance Standards Board for audits of public and private sector entities, for example:</p> <ul style="list-style-type: none"> Identifying and Assessing the Risks of Material Misstatement through Understanding the Entity and Its Environment (ASA 315) The Auditor's Responses to Assessed Risks (ASA 330) Going Concern (ASA 570)

**Figure C1
Legislative framework for financial reporting and auditing – *continued***

Public sector entities	Victorian Auditor-General's Office
Directions	
<p>Standing directions of Minister for Finance under the <i>Financial Management Act 1994</i>, for example:</p> <ul style="list-style-type: none"> • <i>Financial Governance</i> (2.2) • <i>Information Technology Management</i> (3.2.1) • <i>Physical and Intangible Assets</i> (3.4.9) <p>Financial Reporting Directions under the <i>Financial Management Act 1994</i>, for example:</p> <ul style="list-style-type: none"> • <i>Responsible Person and Executive Officer Disclosures in the Financial Report</i> (FRD 21A) • <i>Standard Disclosures in the Report of Operations</i> (FRD 22B) • <i>Non-Current Physical Assets</i> (FRD 103D) 	<p>Guidance statements issued by the Auditing and Assurance Standards Board for the purpose of understanding and complying with the auditing standards.</p>
Tools	
<p>Model financial statements (for relevant entity type—water bodies, departments) generally comprising:</p> <ul style="list-style-type: none"> • Comprehensive operating statement • Balance sheet • Cash flow statement • Statement of changes in equity • Summary of significant accounting policies • Explanatory notes 	<p>Risk based audit methodology to:</p> <ul style="list-style-type: none"> • understand the entity and its environment, including its internal controls • identify and assess the key risks facing the entity; the risk mitigation strategies; significant recent developments; and the governance and management control framework • assess processes and controls over management, accounting and information technology systems • test controls • examine in detail balances and underlying transactions; assess the reasonableness of balances, and review the presentation and disclosure in the financial statements • express an opinion on the financial statements
Annual report of entity incorporating Auditor-General's Report on the Financial Report	

Source: Victorian Auditor-General's Office.

The risk-based audit methodology we apply to financial audits meets Australian auditing standards. It requires us first to gain an understanding of each entity, and its underlying systems of internal control, so that we target our evidence gathering and assessment activities to areas of greatest risk of material misstatement.

We annually assess the systems and processes used to generate the information in the financial statements, including the financial reporting internal controls. We also focus on areas where experience shows that issues of governance, probity, fraud, waste, and non-compliance with legislation or public sector financial management and reporting requirements can arise.

These areas are examined with reference to the applicable legislation, accounting and auditing standards, and where applicable, the standing and financial reporting directions issued under the *Financial Management Act 1994*.

Figure C2 shows how the major financial statement components relate to the underlying systems and processes.

Figure C2
Relationship between financial statements and supporting systems

Cycle	Financial statement components			Related systems and processes
	Comprehensive operating statement	Balance sheet	Explanatory notes	
Revenue	Appropriations and transfer payments such as grants	Statutory receivables	Departmental outputs, summary of compliance with annual Parliamentary and special appropriations, annotated revenue agreements	Cash receipting and banking
	Sales revenue	Inventory trade receivables	Cost of sales	Sales, credit and billing
	Fees and charges revenue	Unearned fees and charges		Cash receipting and banking
Expenditure	Investment income such as interest and dividends	Cash, deposits and other investments, accrued interest	Financial instruments	Treasury management
	Depreciation expense	Property, plant and equipment Intangible assets		Fixed asset management
	Interest expense	Interest bearing liabilities	Financial instruments	Treasury management
	Grants and other transfers	Payables		Grant management
	Supplies and services	Payables	Commitments and contingencies	Procurement—purchasing and payment, banking
	Employee benefits	Employee provisions	Executive remuneration/related party: responsible persons, superannuation	Payroll and human resources
Cash and financing	Interest income, loss/gain on financial assets	Cash, deposits and other investments	Cash flow information	Banking, treasury management
	Interest expense	Interest bearing liabilities	Financial instruments	Banking, treasury management
Property plant and equipment	Depreciation expense, gain/loss on non-financial assets	Property, plant and equipment Intangible assets	Goodwill	Fixed asset management, capital project management
	Rental income, gain/loss on non-financial assets	Investment properties	Financial instruments	Investment management

Source: Victorian Auditor-General's Office.

Our coverage of supporting systems and processes depends on the relative risk and materiality of the associated financial statement items. We are required to assess the controls in each system each year, but test their operational effectiveness less frequently, based on our risk assessment.

Section 2.4.1 sets out our prospective areas of focus for 2011–12 to 2014–15 from which we will develop our future financial audit annual plans. It indicates the prospective program based on our current assessment of audit risks. However, we may need to revise our plans over time to respond to emerging developments so that our audit remains relevant and appropriate.

We expect that publishing our areas of financial audit focus for the next four years in the Annual Plan will be a catalyst for the self-assessment and enhancement of internal controls by public sector entities to facilitate the full, accurate and timely disclosure of information on the expenditure of taxpayers' monies. It also increases the transparency of our program in providing independent assurance to the Parliament on the accountability and performance of the Victorian public sector.

Appendix D.

Performance audit topic selection framework

Figure D1 sets out the framework we use for selecting performance audit topics.

Figure D1
Performance audit topic selection framework



(a) Five goals for a stronger, fairer and safer Victoria. This framework was outlined in the Governor's speech at the opening of the 57th Parliament on 21 December 2010.

Source: Victorian Auditor-General's Office.

As part of our approach to identifying public sector programs and initiatives to be audited, we consult widely with: departmental secretaries individually and in agency management fora; agency senior management and line managers; departmental audit committees; industry regulators; other statutory office bearers and commissioners; sector experts and industry representatives; community organisations; academics; other stakeholders such as the recipients of government services; Parliamentarians; and other interested parties.

Through these discussions we enhance our knowledge of emerging issues; performance gaps; risks to efficient, effective and economic service delivery or public sector initiatives; incidents of non-compliance and potential waste; and gather contextual information. We also review and respond to correspondence and representations to the Auditor-General from the public and Parliamentarians and consider matters warranting further attention during our planning processes.

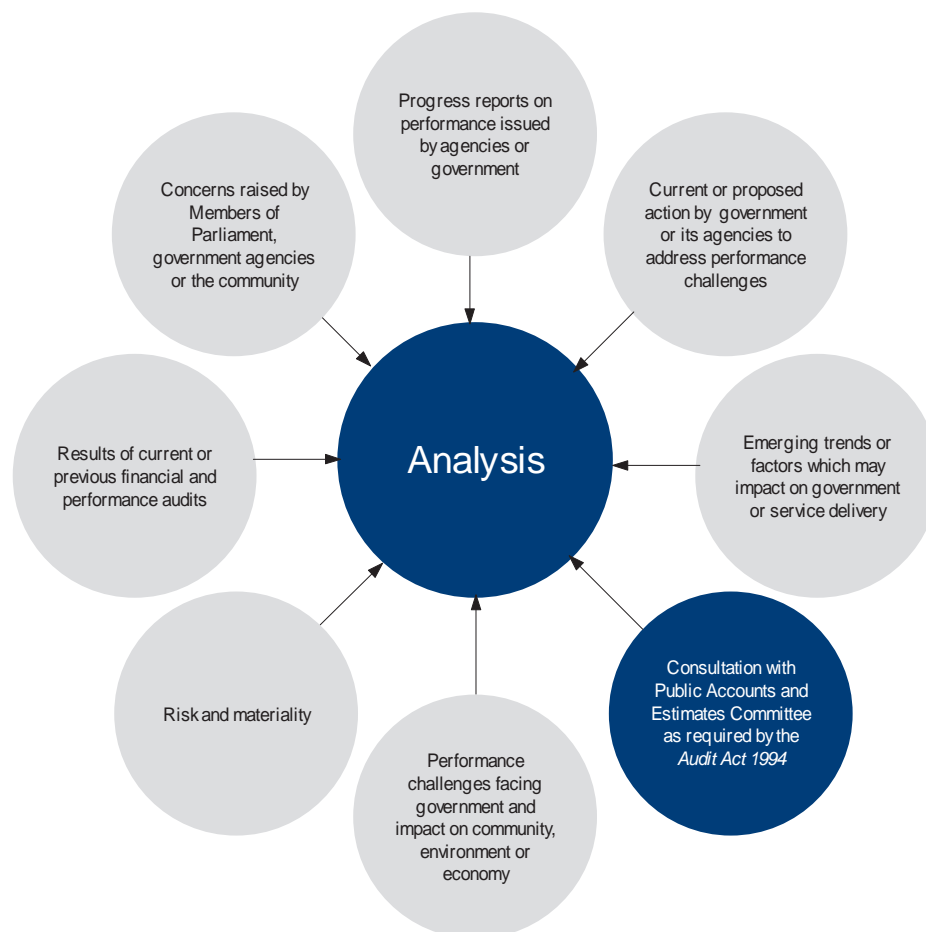
In previous years, our identification and analysis of potential topics was also conducted with reference to:

- the government's *Growing Victoria Together* visions and goals. These visions and goals represented the then government's framework for priority setting, including legislation and spending decisions to 2010 and beyond
- the *Statement of Government Intentions*, a forward plan that sets out the challenges and opportunities ahead, highlighted issues to be addressed, outlined the then government's priorities in detail for the calendar year, and provided a progress report against the previous year's statement.

Following the change of government, as a result of the November 2010 state election, we have adopted the five goals for a stronger, fairer and safer Victoria. This framework was outlined in the Governor's speech at the opening of the 57th Parliament on 21 December 2010. Accordingly our multi-year strategy has been refreshed and restructured to align with this new framework. We will continue to monitor developments so that our program continues to move with changes in government policy and priority setting.

The identification and analysis of potential topics also takes into account a range of other factors set out in Figure D2.

Figure D2
Factors considered during the analysis stage



Source: Victorian Auditor-General's Office.

The analysis focuses on emerging trends, inherent risks and challenges that could influence the achievement of the established visions and goals. Inherent risks include constraints to the efficient and economic allocation of resources, the effective achievement of objectives, and compliance with relevant legislation. We identify initiatives and programs with significant inherent risks, underperformance issues, or which are not meeting community expectations or where there is strong public interest. These are identified as potential areas of audit focus.

These newly identified areas together with those from the 'out-years' of the previous year's published multi-year strategy, are assessed in terms of risk and materiality. This assessment considers the program's, or activity's, potential economic, social and environmental impact and categorises the likely impact of its failure or non-performance into one of five risk categories, ranging from 'negligible' to 'catastrophic'.

Based on this assessment, prospective audit topics are prioritised, and areas of performance audit focus for the upcoming year determined. Prospective areas of performance audit focus for the ensuing three years are also prioritised and incorporated into a multi-year strategy to be published in the annual plan.

For each prospective area of audit focus, the final audit approach will be determined following detailed planning to develop an audit specification—a process requiring consultation with the Public Accounts and Estimates Committee and relevant agencies.

While this framework is the main method applied for selecting topics, the Auditor-General retains the discretion to respond to emerging and unforeseen issues and to report on these to Parliament.



Appendix E.

Parliamentary reports 2008–09 to 2010–11

Details of performance audit and other Parliamentary reports tabled in the period 2008–09 to 2010–11 are presented in Figure E1. The 2010–11 program includes audits scheduled for tabling in Parliament by 30 June 2011 that are not yet tabled.

Consistent with the Annual Plans for 2008–09 to 2010–11, the reports are presented under the *Growing Victoria Together* framework of the former government.

Figure E1
Reports tabled 2008–09 to 2010–11

<i>Growing Victoria Together</i> vision	2008–09	2009–10	2010–11
Thriving economy	<ul style="list-style-type: none"> Buy-back of the Regional Intrastate Rail Network Effectiveness of Drought Assistance Measures Enforcement of Planning Permits Management of the Multi-Purpose Taxi Program Melbourne's New Bus Contracts The Channel Deepening Project 	<ul style="list-style-type: none"> Management of Major Rail Projects Management of Safety Risks at Level Crossings Towards a 'smart grid' – the roll-out of Advanced Metering Infrastructure Vehicle Fleet Management 	<ul style="list-style-type: none"> Biotechnology and the Victorian Public Sector[#] Effectiveness of Small Business Victoria's Support Programs Management of Major Road Projects[#] Management of the Freight Network Revitalising Central Dandenong The Victorian Life Sciences Computation Initiative[#]

Figure E1
Reports tabled 2008–09 to 2010–11 – continued

Growing Victoria Together vision	2008–09	2009–10	2010–11
Quality health and education	<ul style="list-style-type: none"> • Access to Public Hospitals: Measuring Performance • CASES21 • Funding of the Home and Community Care Program • International Students: risks and responsibilities of universities • Literacy and Numeracy Achievement • Management of School Funds • Managing Acute Patient Flows • Private Practice Arrangements in Health Services • School Buildings: Planning, Maintenance and Renewal • The New Royal Children’s Hospital — a public private partnership 	<ul style="list-style-type: none"> • Access to Social Housing • Administration of the Victorian Certificate of Education • Management of Concessions by the Department of Human Services • Managing Teacher Performance in Government Schools • Partnering with the Community Sector in Human Services and Health • The Effectiveness of Student Wellbeing Programs and Services 	<ul style="list-style-type: none"> • Access to Ambulance Services • Delivery of NURSE-ON-CALL • Early Childhood Development Services: Access and quality[#] • Indigenous Education Strategies for Government Schools[#] • Managing Drug and Alcohol Prevention and Treatment Services • Managing Student Safety • The Department of Human Services’ Role in Emergency Recovery • Victorian Registration and Qualifications Authority

Figure E1
Reports tabled 2008–09 to 2010–11 – continued

Growing Victoria Together vision	2008–09	2009–10	2010–11
Healthy environment	<ul style="list-style-type: none"> • Administration of the <i>Flora and Fauna Guarantee Act 1988</i> • Biosecurity Incidents: Planning and Risk Management for Livestock Diseases 	<ul style="list-style-type: none"> • Control of Invasive Plants and Animals in Victoria's Parks • Hazardous Waste Management • Irrigation Efficiency Programs • Irrigation Water Stores: Lake Mokoan and Tarago Reservoir 	<ul style="list-style-type: none"> • Environmental Management of Marine Protected Areas • Facilitating Renewable Energy Development • Restricting Environmental Flows during Water Shortages • Soil Health Management • Sustainable Management of Victoria's Groundwater Resources
Caring communities	<ul style="list-style-type: none"> • Connecting Courts – the Integrated Courts Management System • Implementing Victoria Police's Code of Practice for the Investigation of Family Violence • Managing Complaints Against Ticket Inspectors • Preparedness to Respond to Terrorism Incidents: Essential services and critical infrastructure • Working with Children Check 	<ul style="list-style-type: none"> • Making Public Transport More Accessible for People Who Face Mobility Challenges • Management of the Community Support Fund • Managing Offenders on Community Corrections Orders • Personal Safety and Security on the Metropolitan Train System • Responding to Mental Health Crises in the Community • The Community Building Initiative • Use of Development Contributions by Local Government 	<ul style="list-style-type: none"> • Construction of Police Stations and Courthouses • Problem-Solving Approaches to Justice • Effectiveness of Victims of Crime Programs • Local Community Transport Services: the Transport Connections program • Management of Prison Accommodation Using Public Private Partnerships • Motorcycle and Scooter Safety Programs • Security of Infrastructure Control Systems for Water and Transport • Sustainable Farm Families Program • Taking Action on Problem Gambling

Figure E1
Reports tabled 2008–09 to 2010–11 – continued

<i>Growing Victoria</i> <i>Together vision</i>	2008–09	2009–10	2010–11
Vibrant democracy	<ul style="list-style-type: none"> • Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2007–08 • Claims Management by the Victorian WorkCover Authority • Governance and Fraud Control within Selected Adult Education Agencies • Local Government: Results of the 2007–08 Audits • Results of Audits for Entities with 30 June 2008 Balance Dates • Results of Audits for Entities with other than 30 June 2008 Balance Dates • Withdrawal of Infringement Notices 	<ul style="list-style-type: none"> • Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2008–09 • Fees and Charges—cost recovery by local government • Local Government: Results of the 2008–09 Audits • Maintaining the Integrity and Confidentiality of Personal Information • Managing the Requirements for Disclosing Private Sector Contracts • Performance Reporting by Departments • Portfolio Departments and Associated Entities: Results of the 2008–09 Audits • Public Hospitals: Results of the 2008–09 Audits • Tendering and Contracting in Local Government • Tertiary Education and Other Entities: Results of the 2009 Audits • Water Entities: Results of the 2008–09 Audits 	<ul style="list-style-type: none"> • Acquittal Report: Results of the 2009–10 Audits • Allocation of Electronic Gaming Machine Entitlements[#] • Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2009–10 • Business Continuity Management in Local Government • Local Government: Interim Results of the 2009–10 Audits • Portfolio Departments: Interim Results of the 2009–10 Audits • Public Hospitals: Interim Results of the 2009–10 Audits • State Trustees Ltd: Represented Persons[#] • Tertiary Education and other entities: Results of the 2010 Audits[#] • Water Entities: Interim Results of the 2009–10 Audits

Note: [#] Report yet to be tabled at 24 May 2011.

Source: Victorian Auditor-General's Office.

Appendix F.

Audit Act 1994 section 7A— comments

COMMENTS provided by the Public Accounts Estimates Committee (PAEC)

PARLIAMENT OF VICTORIA
Public Accounts & Estimates Committee



11 May 2011

Mr Des Pearson
Auditor-General
Victorian Auditor-General's Office
Level 24, 35 Collins Street
MELBOURNE VIC 3000

Dear Mr Pearson, *Des*

Final comments on the Victorian Auditor-General's Office Annual Plan 2011-12

On behalf of the Committee, thank you for the detailed information you have provided in answering the extensive list of questions and comments made by this Committee on 4 April 2011.

At this time, the Committee is providing its final comments for inclusion in the 2011-12 Annual Plan, as required under s.7A(5) of the *Audit Act 1994*.

The extra information you have provided has allowed the Committee to further consider your annual plan and the audit topics raised in your plan. The Committee has considered the extra information you have provided, and has made comments on a number of audits in the following attachment.

The Committee noted in your feedback that a number of its suggestions will be considered by your Office in the development of the 2012-13 Annual Plan. The Committee looks forward to your consideration of these items. The Committee is also looking forward to having input into your future annual plans.

When tabling your annual plan in Parliament, you may wish to provide further comments on the matters raised in this attachment. Should you have any queries, please do not hesitate to contact me.

Yours sincerely

Philip R. Davis
Philip R. Davis, MP
Chairman

COMMENTS provided by PAEC – continued

Attachment A

Comments on the 2011-12 Draft Annual Plan from the Public Accounts and Estimates Committee

1. Procurement practices in the health sector

The Auditor-General has listed in the financial audit plan an examination of procurement controls in selected health services. The performance audit annual plan has listed an audit of *Procurement practices in the health sector*. One of the objectives of the performance audit is to examine how well controls are working in a select number of health services, focusing on the probity and transparency of procurement activities undertaken.

The Committee is of the view that there may be efficiencies and a fuller coverage of the issues if the financial and performance audits were combined into one comprehensive audit of procurement in the health sector.

2. Effectiveness of Justice strategies in preventing and reducing alcohol-related harm

From the extra information provided by the Auditor-General in relation to this audit, the Committee considers that the title of the audit could be amended to more appropriately reflect the focus on the regulatory aspects of the Victorian Alcohol Action Program as stated in the audit objective.

3. Agricultural food safety

The audit on agricultural food safety will not examine food security. The Auditor-General has stated that food security is a separate issue and that research undertaken in 2009 indicates that this is not an issue for Victoria or Australia.

The Committee supports the Auditor-General's commitment to environmental scanning of issues and understands this underpins the Office's multi-year audit program. The Committee considers therefore, it would be beneficial if the Auditor-General's Office updated its research with relevant information on food security from 2010 and 2011 prior to scoping this audit to consider more recent research on issues surrounding food security.

4. Freedom of Information

From the extra information provided by the Auditor-General in relation to this audit, the Committee considers that the title of this audit could be amended to more appropriately reflect the topic and the focus on data collection and reporting on Freedom of Information.

5. Population growth in Victoria

The Committee notes the Auditor-General's comments and looks forward to the consideration of population growth issues in the Auditor-Generals 2012-13 Annual Plan.

VAGO response to the PAEC's comments

Figure F1 sets out the matters raised by PAEC in the above correspondence and VAGO's comments.

Figure F1
Matters raised by PAEC, May 2011

PAEC suggestions for the 2011–12 Annual Plan		VAGO comment
Area of audit focus	PAEC comment	May 2011
Procurement practices in the health sector	The committee is of the view that there may be efficiencies and a fuller coverage of the issues if the financial and performance audits were combined into one comprehensive audit of procurement in the health sector.	<p>The two audits utilise different methodologies and have a different focus, reflecting their delivery as two separate products:</p> <ul style="list-style-type: none"> • a financial audit with a high level examination of the procurement controls in all public hospitals and published as part of the broader Public hospital results of the 2010–11 audits • a performance audit with an in-depth examination of a selection of health services, the Department of Health and Health Purchasing Victoria. <p>The two audits complement, rather than duplicate each other, preventing inefficiencies and allowing full coverage of the issues.</p>
Effectiveness of justice strategies in preventing and reducing alcohol-related harm	The committee considers that the title of the audit could be amended to more appropriately reflect the focus on the regulatory aspects of the Victorian Alcohol Action Program as stated in the audit objective.	<p>While regulation will be the primary focus, it will not be the only focus. For example, the audit will examine the effectiveness of coordination between Victoria Police, the City of Melbourne and the Department of Justice. It will also examine education and information.</p> <p>Amendment of the title as suggested narrows the scope of the audit.</p>

Figure F1
Matters raised by PAEC, May 2011 – *continued*

PAEC suggestions for the 2011–12 Annual Plan		VAGO comment
Area of audit focus	PAEC comment	May 2011
Agricultural food safety	<p>The audit on agricultural food safety will not examine food security. The Auditor-General has stated that food security is a separate issue and that research undertaken in 2009 indicates that this is not an issue for Victoria or Australia.</p> <p>The committee supports the Auditor-General's commitment to environmental scanning of issues and understands this underpins the office's multi-year audit program. The committee considers therefore, it would be beneficial if the Auditor-General's office updated its research with relevant information on food security from 2010 and 2011 prior to scoping this audit to consider more recent research on issues surrounding food security.</p>	The committee's comments are noted. Food security will be considered in the audit research and scoping.
Freedom of Information	The committee considers that the title of this audit could be amended to more appropriately reflect the topic and the focus on data collection and reporting on Freedom of Information.	Title refined to 'Quality of Freedom of Information reporting'.
Population growth in Victoria	The committee notes the Auditor-General's comments and looks forward to the consideration of population growth issues in the Auditor-General's 2012–13 Annual Plan.	As advised in the conduct of its annual planning function, VAGO will continue to, consider issues such as population growth and its impact on current and future service delivery and public sector activity.

Source: Victorian Auditor-General's Office.