VICTORIA

Victorian
Auditor-General

Audit summary of Portfolio Departments and Associated Entities: Results of the 2008–09 Audits

Tabled in Parliament
9 December 2009

Audit summary

This report sets out the results of audits of 208 state entities, comprising 10 portfolio departments and 198 associated entities with 30 June 2009 balance dates. It is the fifth of six reports to be presented to Parliament covering the results of our audits of 2008–09 financial reports.

This report informs Parliament about significant issues arising from the financial audits of the portfolio departments and associated entities, augmenting the assurance provided through audit opinions issued on financial statements that are included in their respective annual reports. The report also comments on financial management and reporting of the entities and better practice initiatives. It provides recommendations for improving financial reporting preparation processes and internal control.

Further, it assesses the financial sustainability of 51 entities that are not budget dependent because they primarily generate their own revenue and also provides a summary of key changes to the financial reporting framework.

Results of audits

Reporting framework

The principal legislation governing financial reporting by public sector entities is the *Financial Management Act 1994* (FMA). For companies it is the *Corporations Act 2001*.

One hundred and seventy-seven of the 208 entities prepare their financial reports in accordance with the FMA. Twenty-five entities prepare their financial reports in accordance with the *Corporations Act 2001*. The remaining six prepare their financial reports in accordance with other requirements or legislation such as the *Supreme Court Act 1996*.

The FMA requires entities to submit annual reports to the relevant minister. These should be tabled in Parliament within four months of the end of the financial year, and include financial reports for the entity and any controlled entities which must be prepared and audited within 12 weeks. Entities reporting under the *Corporations Act 2001* are required to report to their members within four months of the end of the financial year. The remaining six entities complete their financial statements under time frames determined by management.

Audit opinions issued

All entities had finalised their financial reports. Melbourne Central City Studios received a qualification in relation to 2007–08 comparative figures. Further, 20 entities, principally cemeteries and professional medical registration boards, while receiving an unqualified audit opinion, warranted an emphasis of matter, relating to proposed legislative changes. The remaining entities received clear audit opinions.

Quality of reporting

The quality of financial reporting can be measured by the timeliness and accuracy of the preparation and finalisation of the financial report.

With respect to timeliness:

- 80 per cent of entities reporting under the *Financial Management Act 1994* were finalised within 12 weeks. This is an improvement from the prior year (140 of 179).
- 96 per cent of entities reporting under the *Corporations Act 2001* were finalised within four months, compared to 95 per cent for 2008.

The preparation process by departments needs improvement as 40 per cent of departments did not have sufficiently rigorous quality control and assurance processes to assure the accuracy and completeness of their financial report

Effectiveness of internal control

Internal control encompasses the systems, policies and behaviours established by governing bodies and management to reliably and cost effectively meet their objectives.

In undertaking financial audits we assess the effectiveness of internal controls, established by management, over the reliability of financial reporting. While it is not our responsibility to form an opinion on internal controls, we nevertheless raise with management any control weaknesses or breakdowns we identify.

To the extent we examined those controls, the strength of internal control systems and processes overall was generally satisfactory though variable between departments and associated entities. Specifically a number of important internal control mechanisms required strengthening:

- unreconciled state Crown land holdings of $150 million
- information system security and change management weaknesses
- adequate agreements for outsourcing arrangements were not in place between CenITex and the six departments being serviced.

These matters, together with other audit findings and recommendations, were reported to the relevant governing bodies and their management teams in audit management letters.

This year, as part of our cyclical approach to reviewing significant aspects of corporate governance and financial management, we carried out a review of fraud risk assessment, management of leave and audit committees for the 10 departments.

Appropriate risk assessment requires management to identify and assess the risks for the entity to achieve its business objectives, including compliance with applicable laws and regulations. We assessed the 10 departments and found that three departments do not currently perform a comprehensive fraud risk assessment.

We reviewed departmental management of recreation, sick leave records and leave requests submitted, but not yet processed against individual leave balances. This disclosed the need for tighter controls over the processing of leave requests, and that while the number of staff with excess recreation leave balances has reduced, marginal increases in the total excess leave balances during 2008–09 has increased the cost of this excess leave by $2.2 million or 22 per cent. Further, while average sick leave taken is at the lower end of experience in other jurisdictions, it was likely the better performing departments' initiatives aimed at reducing sick leave were effective.

Our review of the 10 departmental audit committees against better practice criteria found an overall satisfactory situation.

Financial sustainability

Financial sustainability analysis has been provided in this report for the 51 entities that are not budget dependent because they primarily generate their own revenue.

The 10 departments are not included in this analysis of financial sustainability as they are fully funded by government.

To be financially sustainable, entities should have the capacity to meet current and future expenditure as it falls due. They should also be able to absorb foreseeable changes and financial risks as they materialise.

Insight into financial sustainability is obtained from analysis of interrelated financial sustainability indicators over a four year trend period. These indicators reflect each entity's revenue raising performance and expenditure control, and indicate whether current revenue and expenditure trends and policies are sustainable.

There are four core indictors: underlying result; liquidity; self-financing; and capital replacement. These indicators have been applied to the published financial information of the reported entities for the financial periods from 2005–06 to 2008–09. No one indicator is sufficient to determine long-term sustainability; however, the underlying result is the most significant.

The key observations from the analysis are:

- the financial sustainability analysis showed 27.5 per cent (14 of 51) of entities had a high financial sustainability risk. This was a result of the entity obtaining a high risk average rating for the underlying result or liquidity indicator or both indicators.
- Premier and Cabinet and the Innovation, Industry and Regional Development portfolio entities are assessed as having an overall high financial sustainability risk.

The financial sustainability indicators used in this report highlight trends that need to be monitored arising from the adoption of accrual accounting principles. Notwithstanding, the application of sector neutral Australian Accounting Standards and accrual accounting by entities, it should be noted that the current funding model does not provide depreciation funding until capital requirements are determined.

Where the departmental funding model applies, capital grant funding is allocated strategically across the portfolio rather than progressively to each entity. However, where entities are governed by boards that are accountable for financial management and performance, this situation blurs accountability for the financial and operational performance of the individual entities. Successfully resolving this will be a significant step towards realising the benefits of implementing accrual accounting.

Financial reporting framework

The financial reporting framework essentially comprises the *Financial Management Act 1994* and Australian Accounting Standards.

There have been a number of changes to the framework for the 2008–09 year, which has impacted on how financial statements are prepared. Further changes have been foreshadowed to respond to the global financial crisis and the Australian Accounting Standards Board's review of public sector specific standards.

Our review of the financial reporting framework that was operating for the 2008–09 year found that:

- different accounting policies have resulted in a variance of $8 billion between the valuations of rail infrastructure assets in the state's 2008–09 annual financial report and the 2008–09 financial reports of rail sector entities
- land under roads, valued at $18.6 billion, has been included in the Annual Financial Report of the State of Victoria (AFR), which is not recognised in VicRoads' financial report for 2008–09
- fifty-eight entities adopted the new financial report presentation format, consistent with the principles of AASB 1049 *Whole of Government and General Government Sector Financial Reporting*. This was a pleasing outcome, however, as not all general government entities took this approach, financial statements are being presented differently across the general government sector, which limits comparability.

The Department of Treasury and Finance (DTF) is conducting a review of the current public finance legislation and practices. This is expected to be completed in early 2010.

DTF sought public comment during October 2008 on what constitutes best practice public finance legislative frameworks. Key matters raised in our response to that request included the need for:

- a specific public sector principle-based definition of 'control' should be developed in legislation in order to provide clear and unequivocal guidance as to what constitutes a public sector entity
- coverage of audit legislation to include all matters relating to public money and public property to be strengthened
- legislative financial reporting obligations to apply differentially according to the level at which each entity operates while maintaining public accountability and transparency of public sector entities
- consideration to be given to determining whether the current accounting standards remain sufficient and appropriate in meeting the needs of users of public sector financial reports
- strengthening the requirements for timely public sector reporting, having regard to developments in other jurisdictions and the private sector
- greater use of reliable and relevant performance measures for public sector performance reporting
- a greater focus on outcome and sustainability reporting, with audit attestation.

Recommendations

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1.	The Department of Treasury and Finance should work with portfolio departments to improve financial reporting processes.	16
2.	DSE should establish a target date for the finalisation of the reconciliation of the records for the state's Crown land holdings.	21
3.	Entities should regularly review IT system user access levels to confirm they continue to be appropriate and also enforce password complexity.	22
4.	Arrangements for the management of outsourced service providers should be in place, with timely monitoring of performance against these arrangements.	24
5.	Departments should undertake comprehensive fraud risk assessments and review their fraud framework within acceptable intervals aligned with risk.	26

Recommendations – *continued*

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6.	Departments should strengthen leave management processes to assure timely processing of leave requests, undertake more rigorous management of recreation leave balances and take preventative action when experiencing higher than average sick leave absences.	34
7.	Portfolio entities should adopt a core suite of financial sustainability indicators.	72
8.	The Department of Treasury and Finance should lead the adoption of consistent asset recognition and valuation and financial reporting policies for whole-of-government reporting and entity level reporting for 2009–10 to improve the consistency and comparability of financial reports within the Victorian public sector.	79
9.	The Department of Treasury and Finance and sector entities should coordinate their monitoring and responses to proposed accounting standards.	81

General

The total cost of preparing and printing this report was $290 000.