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Auditor General
Victoria

Results of 30 June 2005 financial statement and other audits

December 2005

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AUDITOR GENERAL
VICTORIA

The Hon. Monica Gould MP
President
Legislative Council
Parliament House
Melbourne

The Hon. Judy Maddigan MP
Speaker
Legislative Assembly
Parliament House
Melbourne

Dear Presiding Officers

I am pleased to forward this report to you for presentation to each House of Parliament, pursuant to section 16AB of the *Audit Act 1994.*

The Audit Act provides me with discretion to report to parliament on any audits conducted under the Act. It also requires me to report to parliament each year on the government's Annual Financial Report. Consistent with these provisions, my Office annually delivers a parliamentary program which includes reports on:

- *The finances of the State of Victoria* – tabled in November of each year to satisfy the above mentioned legislative requirement to report on the government's Annual Financial Report.
- *Results of financial statement and other audits* - generally tabled in November and May of each year to coincide with the end of the 2 major financial reporting cycles for public sector agencies. These reports present the results of our attest audits, and any other special reviews and investigations completed at the time of their publication.
- *Performance audits* – tabled throughout the year as performance audits are completed.
- *Results of special reviews and other investigations* (including omnibus and single audit "stand alone" reports) - tabled throughout the year as necessary, setting out the results of special reviews, investigations and controls/compliance reviews completed.

This report presents the results of financial statement audits conducted on public sector agencies with a 30 June 2005 balance date, which were completed up to 31 October 2005. The report also presents the results of 3 recently completed special reviews.

Given the significance of matters covered in the report, pursuant to section 16AB of the *Audit Act 1994,* I wish to transmit the report to parliament at the earliest possible opportunity (while parliament is in recess) to ensure that members are informed on these matters on a timely basis. A full copy of the report will be made available on our internet website <www.audit.vic.gov.au> as required by section 16AB(4)(c) of the *Audit Act 1994.*

Yours faithfully

JW CAMERON
Auditor-General

15 December 2005

Foreword

This report summarises the results of the financial audits undertaken by my Office, of agencies with a 30 June 2005 balance date. There are some 476 of these agencies, including all government departments, most public bodies and all local government bodies.

The report notes an improvement in 2005 in the standard and timeliness of financial reporting. It also identifies those areas where further improvement in financial and annual reporting, and in some aspects of financial management, is needed. It further identifies a number of major challenges facing public sector agencies in the next few years, including the implementation of new accounting standards, improved reporting of non-financial performance information by agencies and the development of effective responses to the increasing incidence of fraud.

The report further contains the results of 3 recently completed special audits, examining:

- progress of the EastLink project
- management of the Commonwealth Games Athletes' Village project
- adequacy of consultation associated with certain recent harness racing industry reforms.

In each of these cases, we identify a need for the audited agencies to strengthen their practices, and we make several recommendations to assist them.

Finally, the report provides a status update on the audit of the Regional Fast Rail project, the results of which will be reported in 2006.

JW CAMERON
Auditor-General

15 December 2005

Contents

1. Executive summary

1.1 Introduction

This report draws together the results of our financial audits for public sector agencies with a 30 June 2005 balance date. It also presents the results of 3 special audits which examined issues of public interest.

The report is organised as follows:

- *Part 2 - Summary of audit results and cross-sector issues* – summarises the overall results of the 30 June 2005 audits. This includes comments on the significant factors that have affected financial reporting during the year, or are likely to affect future financial reporting
- *Parts 3 to 14 - Results of financial audits, by sector* – outlines the results of the financial audits of agencies by each major sector of government activity (and of parliament)
- *Parts 15 to 18 – Results of other audits* - sets out the results of 3 special audits (Progress of the EastLink project; Management of the Commonwealth Games Athletes' Village development; and Harness racing industry reforms – Adequacy of consultation). It also includes an update on the status of an audit of the Regional Fast Rail project.

1.2 Overall results of financial audits

1.2.1 Audit opinions issued

There were 476 state and local government agencies that were required to prepare financial and other accountability statements at 30 June 2005 and submit them for audit.

At the date of preparing this report, we had issued 456 clear audit opinions and 11 qualified audit opinions on the financial statements of these agencies. The audit opinions on the financial statements of local governments and regional library corporations also referred to "standard" statements prepared by these entities, with 3 audit opinions on "standard" statements subject to qualification.

The main reasons for qualified audit opinions were:

- failure to consolidate organisations that were regarded as "controlled entities" in financial statements
- assets not reported at fair value, or regular asset revaluations not conducted to ensure that reported asset values do not materially differ from their fair values

- inappropriate accounting for certain grants, expenses, assets, liabilities and contributed capital within financial statements
- for "standard" statements, failure to conduct regular asset revaluations to ensure that reported asset values are fairly stated - consistent with the financial statement qualifications for the respective agencies; and failure to comply with certain requirements of the *Local Government Act 1989* relating to the preparation of these statements.

We also issued 92 clear audit opinions and 2 qualified audit opinions on performance statements prepared by local government agencies and regional water authorities. There were no outstanding performance statements. The qualified audit opinions were issued for the respective entities' failure to comply with certain requirements of the *Local Government Act 1989* relating to the preparation of these statements.

The number of qualified audit opinions slightly increased in 2004-05. This was mainly due to difficulties experienced by some local government entities in complying with the legislative requirements associated with the introduction of more comprehensive "standard" statement reporting in the year.

At the date of preparing this report, we had not issued audit opinions on 9 agencies with 30 June 2005 balance dates because we had not received completed financial statements or had not completed the audits.

1.2.2 Timeliness of financial reporting

There was some improvement in the time taken by agencies to complete their audited financial and other accountability statements:

- 79 per cent of state agencies met the 12-week statutory reporting target (71 per cent in 2004) – with improvement evident across most sectors of government and the state's major agencies
- 95 per cent of local government agencies met the 3-month statutory reporting target for that sector (95 per cent in 2004) – consolidating the significant improvement made in previous years.

This outcome was particularly pleasing, given the additional disclosures required for 2004-05 financial reports associated with the transition to Australian equivalents of International Financial Reporting Standards from 2005-06.

Recommendations

That agencies and their audit committees review the outcomes of the 2004-05 reporting cycle to identify opportunities to further improve the financial statement preparation process, with the outcomes of these reviews used to inform agency planning for the next reporting cycle.

That agencies work closely with their auditors to have their opening balances for 2005-06 (based on the new accounting standards) finalised and audited early, to ensure that any contentious issues are able to be resolved on a timely basis and do not hold up the finalisation of their financial statements.

1.2.3 Timeliness of tabling annual reports

While the timeliness of financial reporting by agencies has continued to improve, the annual reports of most government agencies are still not tabled until the latest possible date allowed by legislation.

Accountability to parliament is not achieved until annual reports (containing the audited statements) are tabled and made publicly available. Accordingly, we support the recent recommendations of parliament's Public Accounts and Estimates Committee for the government to consider amending the reporting provisions of the *Financial Management Act 1994* to facilitate more timely tabling of annual reports.

1.2.4 Quality of financial reporting

We observed continuing improvement in the quality of financial reporting by public sector agencies. However, some agencies can do better. The key success factors for agencies to achieve further improvement in the timeliness and quality of financial reporting are:

- good planning for the financial statement preparation process
- ensuring that appropriate staff and adequate quality control procedures are in place
- ensuring that contentious issues can be identified, discussed with audit and resolved on a timely basis
- assigning high organisational priority to financial statement preparation and closely monitoring progress against key milestones.

Recommendation

That agencies (particularly those that take longer than average (53 days, 2004-05) to provide complete draft financial statements for audit) review their close-off and reporting processes to ensure statements are completed and provided before that time, and that they plan and allocate sufficient resources to do so.

1.2.5 Adequacy of control environments

Our audits confirmed that agencies' systems of internal controls that affect the preparation of their financial reports were generally adequate. However, we identified various opportunities to strengthen the governance and management arrangements of some agencies, particularly in relation to the implementation of effective risk management (including fraud prevention) frameworks and information technology (IT) controls.

Recommendation

That agencies:

- **ensure their audit (or similar governance) committees play a direct leadership role in organisation-wide risk management, including the oversight and regular review of risk management frameworks, strategies and treatment plans**
- **regularly review and, where necessary, revise their risk management (including fraud prevention and detection) approaches and strategies to ensure they remain appropriate to the agencies' level of risk**
- **ensure that all instances of fraud, theft or loss are reported to our Office on a timely basis, consistent with the requirements of the *Financial Management Act 1994***
- **regularly review the effectiveness of IT security management practices and controls across their IT environments and systems**
- **review and test their business continuity and disaster recovery plans regularly, to ensure they are adequate and effective.**

1.2.6 Emerging issues for 2005-06

A number of influences will have major impacts on the future financial management, reporting and accountability of public sector agencies. These include:

- The implementation of new Australian accounting standards issued, following the harmonisation with international accounting standards, for reporting periods beginning from 1 January 2005. Universities and TAFE institutes will be among the first required to prepare their financial reports (including the comparative information) on the basis of the new standards.
- The proposed withdrawal of key public sector accounting standards which deal with whole-of-government reporting, and accounting by departments and by local governments. Other changes may also follow, should the outcome of work currently underway by the Australian Accounting Standards Board to harmonise the Government Finance Statistics (GFS)[1] and the Australian Generally Accepted Accounting Principles (GAAP) reporting frameworks be reflected in a new accounting standard. A draft standard is currently out on exposure for consideration by the community.
- The continuing demand from parliament for improved performance reporting by agencies, through the publication of audited performance statements in agency annual reports.
- The increasing incidence of reported fraud across the public sector, requiring ongoing agency attention to ensure effective prevention strategies are in place.

Agencies (including central government agencies) will need to manage the impacts of these issues carefully to maintain the high quality and timeliness of their financial and other accountability statements.

Recommendations

That the Department of Treasury and Finance, in consultation with other departments, develop an implementation strategy to progressively extend the application of performance reporting requirements to all public sector agencies.

[1] GFS is the reporting framework established by the International Monetary Fund to allow economic analysis of the public sector. To date, it is mainly used by central government agencies to report at a whole-of-government or general government sector levels.

That agencies, in consultation with their portfolio departments, work towards the development and publication in their annual reports of performance statements, consistent with the reporting framework established by the Minister for Finance.

1.3 Other major findings and recommendations of financial audits, by sector

1.3.1 Parliament

Parlynet information technology upgrade

Our September 2003 *Report of the Auditor-General on Parliament's information technology upgrade* raised major concerns about the management and oversight of the project, and about parliament's administrative structure.

Over the past 2 years, parliament has made substantial progress in addressing our major recommendations and management has demonstrated a commitment to addressing the outstanding issues. We will continue to monitor parliament's progress in implementing further improvements in the coming year.

1.3.2 Education and Training

Reporting and audit arrangements for government school councils

Our December 2004 report on the *Results of 30 June 2004 financial statement and other audits* referred to legal advice received by the Department of Education and Training in 2003, which questioned the accountability arrangements for school councils that oversee the state's 1 617 government schools. The advice was that government school councils are public statutory authorities and should, accordingly, be subject to the same financial reporting and auditing arrangements as all other public bodies.

Because school councils do not yet have appropriate systems and processes in place to meet these requirements, our Office and the department have agreed to certain interim arrangements until a long-term solution is developed.

1.3.3 Human Services

Financial performance and position of public hospitals

Our previous reports have commented on the financial condition of the public hospital sector, and the financial difficulties faced by some hospitals, over recent years. Our analysis for 2004-05 showed that the financial standing of the public hospital sector had improved slightly on past years, with a reduction in the total operating deficit and a slight increase in the working capital position. This improvement was due to extra funding provided by the Department of Human Services and initiatives by health services.

The number of health services showing signs of financial difficulty reduced from 10 in 2003-04 to 5 in 2004-05. A further 27 health services registered unfavourable results in at least 2 of our indicators of financial difficulty (37 in 2003-04).

In 2005-06, we plan to undertake a detailed review of the key factors that affect public hospital financial sustainability, and the department's management and monitoring of public hospital performance.

1.3.4 Infrastructure

Application of parliamentary appropriations

The Victorian output appropriation framework is based on a purchaser/provider model. Under the model, the Treasurer (on behalf of the government) only makes appropriation revenue available to departments after they deliver the agreed outputs. However, in 2004-05 the Department of Infrastructure (DoI) received $263 million in output appropriation funding ($169 million in 2003-04) before delivering the services for which the appropriation was made. It then transferred this amount into 2 accounts within the Trust Fund (the Better Roads Victoria Trust Account and the Public Transport Fund), and had not spent it by 30 June 2005.

The drawing-down of output appropriation funding from the Consolidated Fund before it is required to meet the department's cash flow needs, is not consistent with the Department of Treasury and Finance's (DTF's) business rules. Further, some of DoI's related 2004-05 output performance measures may not have fully complied with DTF's business rules. The business rules require the creation of performance measures which can be used to assess whether departmental outputs have been delivered in terms of quantity, quality and timeliness.

DoI has revised some of its output performance measures for 2005-06. We intend to review the output performance measures that are used to certify the outputs of selected departments (including DoI).

1.3.5 Innovation, Industry and Regional Development

Underspent parliamentary appropriations

In recent years, the Department of Innovation, Industry and Regional Development has not fully utilised the parliamentary appropriations available to it. The department continues to underspend its budget – in 2004-05 by $70 million (15 per cent of the available appropriation), compared with $80 million (or 18 per cent) in 2004.

The department has taken steps to examine its processes with a view to improving the management of its budget.

1.3.6 Sustainability and Environment

Completeness and accuracy of crown land records

For many years, we have been concerned about the inability of the Department of Sustainability and Environment to confirm the completeness and accuracy of its records of crown land holdings managed by external agencies. Little progress was again made on this matter in 2004-05.

Recommendation

That the Department of Sustainability and Environment, in 2005-06, allocate the resources required to review and confirm the accuracy of its crown land records.

1.3.7 Treasury and Finance

Victorian Funds Management Corporation role change

During 2004-05, the Department of Treasury and Finance commissioned a strategic review of the Victorian Funds Management Corporation's (VFMC) performance and of its role in public sector investment funds management. The review recommended that this function be centralised, by clients setting their investment objectives; VFMC deciding on investment strategies to achieve those objectives; and VFMC managing implementation of the investment strategies. Under the current model, VFMC's clients set both the investment objectives and strategies.

In July 2005, the Treasurer announced the government's decision to accept the recommendation and implement it by June 2006. This will require significant changes to VFMC's current operations, and to the department's governance and monitoring role.

Recommendation

That the Department of Treasury and Finance ensure that the centralised funds management approach is implemented within an adequate governance and accountability framework, which includes the establishment of:

- **clear roles, responsibilities and accountabilities for all relevant parties, as part of service-level agreements**
- **a post-implementation review to ensure a smooth transition to VFMC's new role**
- **appropriate qualitative and quantitative performance measures and reporting (including assurance arrangements) to enable the department and clients to monitor VFMC's performance.**

1.3.8 Local Government

Financial viability of councils

As a whole, the financial performance and financial position of the local government sector improved in 2004-05 compared with last year. However, some councils continue to face financial viability issues in the medium to longer-term.

Of particular interest is that 36 councils reported an underlying operating deficit[2] for 2004-05, compared with 33 in the previous year. However, the combined underlying deficit of these councils was less than last year, showing a positive trend towards more sustainable operations.

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[2] The underlying result is determined by eliminating the impact of one-off items (such as revenue and expenses relating to asset write-offs and contributed or "found" assets) from the reported result.

Recommendation

That each of Victoria's local governments:

- **review their performance over the past 3 years using indicators of viability and sustainability, such as those used in our report (underlying result, liquidity, indebtedness, self-financing and investment gap)**
- **use the results of their review to set targets for each indicator for each of the next 4 years.**

Adequacy of local governments' internal control systems

Our audits of local governments' internal control systems each year generally find that they operate effectively, given each local government's resource constraints. However, the assignment of incompatible duties to staff is an area of ongoing concern[3].

Recommendation

Where separation of duties is inadequate, that local governments either change their policies and procedures to achieve separation, or ensure adequate management oversight of incompatible duties.

1.4 Results of other audits

1.4.1 Progress of the EastLink project

In October 2004, the government entered into a contractual arrangement (in the form of a concession deed) with a private sector consortium (ConnectEast) for the construction, operation, maintenance, financing and tolling of the proposed EastLink Freeway. This new freeway will provide 45 kilometres of new road connecting the Eastern Freeway to the Frankston Freeway through the Scoresby corridor, and is expected to be completed by late 2008.

A private-public partnerships model was used for this project, similar to that used for the Melbourne CityLink project. Under the model, ConnectEast will construct and operate the tolled freeway for a period of about 39 years, after which time it will hand back ownership of the freeway to the state (in a fully maintained condition) at no cost.

[3] Incompatible duties are duties involving the authorisation and processing of transactions which, if conducted by one person without oversight raise significant risks of error and fraud.

We examined the analysis conducted to support the government's decision to proceed with the project, the project tendering arrangements, the allocation of project risks between the state and other parties, and the project's ongoing governance and management arrangements.

We found that, while a comprehensive business case was prepared to guide the government's decision on whether (and how) to proceed with the freeway, the business case should have included the results of a "public interest test"[4], based on the finally proposed project (that is, a single project incorporating the former Scoresby Freeway and Eastern Freeway Extension projects) using a toll funding model. It didn't. The Southern and Eastern Integrated Transport Authority (the agency established to facilitate the project) believes that the agreed concession arrangements address public interest considerations under the government's guidelines, including matters related to privacy, security, consumer rights, public access and equity.

Deployment of the *Partnerships Victoria* policy is generally pursued by the government where it is considered likely to deliver better value-for-money than traditional delivery methods. Under the policy, a public sector comparator, which estimates the cost of the most efficient form of public sector delivery, is used as a key means to test for value-for-money[5].

In the case of EastLink, the request for proposals from private sector bidders had 2 overall requirements. First, that the proposals must meet the requirements set out in the request for proposals and, second, that they must offer value-for-money by bettering the public sector comparator. The authority concluded that the 2 proposals were conforming proposals (i.e. they met the minimum requirements) and that they satisfied the value-for-money test against the comparator.

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[4] The "public interest test" examines the potential impacts of project proposals (inter alia) on privacy, security, consumer rights, public access and equity.

[5] The public sector comparator estimates what a project would cost if it was delivered by the state rather than by the private sector. It is used as a quantitative indicator to help determine whether proposals for private investment in the provision of public infrastructure offer better value-for-money than would delivery by the state (on a risk adjusted basis).

A key factor underpinning the authority's recommendation to the minister, to accept the ConnectEast project proposal, was the results of its value-for-money assessment using the public sector comparator. We observed that some of the key assumptions used to determine the comparator (about forecast traffic levels, total toll revenue and construction costs) were significantly different from those used in the project proposals received from the 2 private sector proponents. As allowed by the *Partnerships Victoria* policy, in view of these significant differences and the government's decision to change the project scope after the comparator was determined (by including the Dandenong Southern Bypass and revising the minimum traffic lane requirements for the project), the comparator should, in our view, have been recalculated.

The use of the comparator, without revision, to support the authority's assessment that the successful proponent's proposal offered better value-for-money than an alternative public sector delivery model, in our opinion, diminished the reliability of the comparator as an assessment tool. We acknowledge that a number of other indicators were also used by the authority to judge the value-for-money offered by the proponents' proposals. Consideration of these indicators supported the decision to give preference to the successful proponent (from a value-for-money perspective). However, we remain of the view that the public sector comparator was so fundamental to bid evaluation and negotiation that it should have been revised to take account of any required changes in key assumptions and the scope of the project since it was previously calculated.

The authority's recommendation to the minister considered the value-for-money offered by the 2 private sector proposals by comparing the total toll revenue users would pay during the concession period under each proposal. It did not compare these 2 amounts with what users would have paid under a public sector provision model (as estimated in the public sector comparator). This comparison would have enabled a more complete consideration of the impacts of the alternative delivery models on users (the community).

The project's probity and tender evaluation arrangements were generally sound. Project risks have been allocated under the concession deed in accordance with *Partnerships Victoria* policy – that is, to the party best able to manage those risks.

Recommendations

That, consistent with the requirements of the *Partnerships Victoria* guidelines, public interest tests should, for future projects, be based on the final approved financing approach, in this case as a tolled rather than as an untolled freeway.

That future *Partnerships Victoria* projects should revisit the public interest test near to contractual close to confirm the appropriate inclusion of any identified measures necessary to protect the public interest.

That, consistent with the requirements of the *Partnerships Victoria* guidelines, public sector comparators used to support value-for-money assessments should be recalculated where subsequent information becomes available that is likely to affect the value-for-money assessment (such as significant variations in some of the key assumptions used to determine the comparator compared with those used in project proposals received from private sector proponents).

1.4.2 Management of Commonwealth Games Athletes' Village project

Melbourne will host the 18th Commonwealth Games from 15 to 26 March 2006. The games will involve 71 countries, competing in 16 sports, and will be staged over 12 days of competition at venues in Melbourne and regional Victoria. One of the key requirements of a host city is to provide accommodation for the athletes and officials who will visit and compete in the games.

In December 2003, the government entered into an agreement with a developer to build the 2006 Commonwealth Games Athletes' Village as part of a larger, integrated private and social (public) housing development in Parkville, Melbourne. We examined the adequacy of the controls established by the Office of Commonwealth Games Coordination (OCGC)[6] for the games village project, including aspects of the contracting process.

[6] The OCGC is the agency within the Department for Victorian Communities which is coordinating the Commonwealth Games for the Victorian Government and is responsible for the management of delivery of the games village.

We concluded that all systems of management control were sound. We did note, however, some scope for improvement relating to the broader public sector risk management of sites in long-term public use, particularly around environmental risks.

The contracting process for the village also was rigorous and transparent. There were significant scope changes approved by the government late in 2004 at an additional cost of $52.83 million: $43.38 million of which related to the construction of the village and $9.45 million in operational costs for the games “overlay”. These gross costs were offset by expected increases in revenue of $30.47 million. We concluded that these scope changes were driven by external pressures, especially demands for higher standard and less crowded athlete accommodation than was originally envisaged. They were restricted to the “games mode” aspects of the village and were adequately managed.

On the estimation of the village project costs, we concluded that a business case should have been developed for the Parkville site to benchmark against private sector bids, and a formal cost-benefit analysis conducted for the project. These would have been helpful for the government and other stakeholders to better understand the costs, risks and benefits associated with the project.

On OCGC’s setting and control of the village budget, we concluded that the cash outflows in the village project budget were being managed well by OCGC. However, the village budget would have been more complete if it was based on the value that the project would deliver; included the change between the market value and the impaired value of the contributed land; and included the estimated value of retained assets and public amenity as well as the market value of the land.

The changes in the value of the contributed land, the increases in estimated revenue from profit share of sales from the development and the scope changes enabled the government to announce a net increase in cost of only $4 million from the budgeted 2002 figure of $85.4 million to the 2004 figure of $89.4 million. We concluded that an explanation of these major changes between the 2002 and 2004 budget announcements would have been more explicit than announcing a final net increase figure.

1.4.3 Harness racing industry reforms – Adequacy of consultation

In March 2005, Harness Racing Victoria (HRV) made public its decision to discontinue TAB harness racing meetings at 7 racetracks in country Victoria and to transfer the meetings to alternative venues from 1 July 2005.

We conducted an investigation in response to concerns raised with us that HRV had not consulted the 7 affected race clubs prior to making that decision, as required under the *Racing Act 1958*.

We found that no communication or consultation occurred with any of the harness racing clubs before the decision was announced. We consider that in the event that formal industry consultation procedures had not been finalised, consultation should have occurred directly with the 7 affected clubs. In our view, this lack of consultation was not consistent with the intention of the amendments to the Act.

While acknowledging the right of HRV to determine the future strategy for the industry, we further considered that the specific recent amendments to the Act concerning consultation resulted in a “legitimate expectation” of harness racing industry participants that consultation would occur.

1.4.4 Interim report on the Regional Fast Rail project

The Regional Fast Rail project commenced in 2001 with the aim to reduce passenger journey times between Melbourne and the regional centres of Ballarat, Bendigo, Geelong and the Latrobe Valley. Its delivery is to be achieved by undertaking infrastructure works that will allow trains to run at faster than existing speeds, and by introducing faster rolling stock.

We previously reported to parliament on the project’s establishment, tendering and progress. In July 2005, we commenced a further audit focusing on the adequacy of the Department of Infrastructure’s planning and management of the project. Preliminary work has focused on the progress of the project against expected timelines and budgeted costs across the 4 corridors, including reasons for any delays; management of contractors; and identification and ongoing management of risks to project delivery.

Based on work to date, the estimated project investment has increased from $550 million in 2001-02 to $751 million in 2005-06, with the estimated project investment increasing by 21.7 per cent in 2005-06. The practical completion dates for infrastructure works have also been revised to December 2005 for the Bendigo and Latrobe corridors, and March 2006 for the Geelong and Ballarat corridors. These revised timelines now extend the project delays to between 9 months (Ballarat) to 21 months (Latrobe).

The project has now reached a critical phase with the installation and commissioning of an upgraded signalling system across the 4 corridors. In addition, the department is involved in complex and sensitive negotiations to address project issues. These activities are placing significant demands on the project team and limiting their availability to participate in this audit. I have, therefore, decided to adjust the audit timelines to allow for these circumstances. We will complete the audit report on its outcome in autumn 2006.

1.5 General

The special reviews/investigations included in this report were performed in accordance with Australian auditing standards. The total cost of those audits, including the preparation and printing of this report, was $610 000.

2. Summary of audit results and cross-sector issues

2.1 Introduction

This part of the report summarises the results of financial and other accountability statement audits for agencies whose financial reporting period ended on 30 June 2005[1]. It also comments on a number of emerging developments expected to impact on financial reporting and accountability in the Victorian public sector in future.

We have responsibility for the audit of 476 agencies with 30 June 2005 balance dates. This is 7 more than the previous year, mainly due to the change of balance dates for 14 public cemeteries, from 31 December to 30 June, from 2004-05, and certain agencies amalgamating or ceasing to operate. For each of the state's 93 municipal councils and regional library corporations (which are included above), from 2004-05 we have also been required to audit 2 additional "standard statements" which are prepared and published by them in their annual reports, providing summary information about those entities' capital works and financial position against approved budget estimates.

2.2 Audit conclusions

Audit opinions issued

We issue clear audit opinions when agency financial and other accountability statements are, in all material respects, presented fairly, in accordance with Australian accounting standards and other mandatory professional and legislative requirements. Qualified opinions are issued when, in our opinion, the audited statements do not present a fair view of an agency's performance or financial position, or do not comply with the relevant requirements.

Figure 2A summarises the number and nature of audit opinions issued, at the date of preparing this report, on the financial statements of state and local government agencies with 30 June 2005 balance dates.

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[1] Other accountability statements include "performance statements" prepared by local governments (municipal councils) and regional water authorities, and "standard statements" prepared by local governments and regional library corporations. Performance statements report council/authority performance against certain performance measures and targets. Standard statements summarise information about a council's/corporation's financial performance against budget estimates.

FIGURE 2A: AUDIT OPINIONS ISSUED FOR AGENCIES WITH 30 JUNE 2005 BALANCE DATES

Sector	Clear opinions issued		Qualified opinions issued		Total	
	2003-04	2004-05	2003-04	2004-05	2003-04	2004-05
State agencies -						
Financial statements	357	357	8	8	365	365
Performance statements	15	15	-	-	15	15
Local government agencies -						
Financial statements and standard statements (a)	102	98	2	(b) 4	104	102
Performance statements	77	77	2	2	79	79
Total	**551**	**547**	**12**	**14**	**563**	**561**

(a) For municipal councils and regional library corporations, a combined audit opinion was issued covering both the financial statements and standard statements.

(b) This includes one audit qualification of a regional library corporation's standard statements where a clear audit opinion was issued on that agency's financial statements.

Source: Victorian Auditor-General's Office.

As shown in Figure 2A, at the date of preparing this report, we had issued 456 clear audit opinions and 11 qualified audit opinions on the financial statements of state and local government agencies with 30 June 2005 balance dates. The audit opinions on the financial statements of local governments and regional library corporations also referred to the standard statements prepared by these entities, with 3 audit opinions on standard statements subject to qualification.

The qualified audit opinions were issued for:

- failure to consolidate organisations that were regarded as "controlled entities" in financial statements (2 instances)
- assets not reported at fair value, or regular asset revaluations not conducted to ensure that reported asset values do not materially differ from their fair values (3 instances)
- inappropriate accounting for certain grants, expenses, assets, liabilities and contributed capital within financial statements (4 instances)
- inability to verify the completeness of cash donations, which is common for charitable organisations (one instance)
- non-compliance with certain requirements of statements of accounting concepts and applicable accounting standards (one instance)

- for standard statements, failure to conduct regular asset revaluations to ensure that reported asset values do not materially differ from their fair values - consistent with the financial statement qualifications for the respective agencies (2 instances); and failure to comply with the requirement of the *Local Government Act 1989* for the budget submitted to the Minister for Local Government for the year to include standard statements (one instance).

We also issued 92 clear audit opinions and 2 qualified audit opinions on performance statements prepared by local government agencies and regional water authorities. The qualified audit opinions were issued for the respective entities' failure to comply with the requirements of the *Local Government Act 1989* which provide that the budget submitted to the Minister for Local Government for the year must incorporate the key strategic activities and related performance measures and targets for the relevant year.

The number of qualified audit opinions slightly increased in 2004-05, mainly reflecting difficulties experienced by some local government entities in complying with legislative requirements associated with the introduction of more comprehensive standard statements in the year.

At the date of preparing this report, we had not issued audit opinions on 9 agencies with 30 June 2005 balance dates because we had not received completed financial statements or had not completed the audits.

Timeliness of financial reporting

In 2004-05, there was a small overall improvement in the time taken by agencies to complete their audited financial and other accountability statements:

- 79 per cent of state agencies met the 12-week statutory reporting target (71 per cent in 2004). While there was an improvement for the state's major agencies, the results were mixed at a sector[2] level, with some sectors experiencing difficulty in meeting the statutory reporting target
- 95 per cent of local government agencies met the 3-month statutory reporting target for that sector (95 per cent in 2004). This represented a good outcome for the sector, consolidating the significant improvement made in the previous years.

[2] Each sector generally comprises a government department and public sector agencies coming within the department's and responsible minister/s' portfolio responsibilities.

This improvement was particularly pleasing, given the additional effort required by agencies to prepare their 2004-05 financial statements, related to additional disclosures required in association with the transition to Australian equivalents of International Financial Reporting Standards from 2005-06. As in prior years, the key success factors for agencies to achieve further improvement in the timeliness and quality of financial reporting are:

- good planning for the financial statement preparation process
- ensuring that appropriate staff and adequate quality control procedures are in place
- ensuring that contentious issues can be identified, discussed with audit and resolved on a timely basis
- assigning high organisational priority to financial statement preparation and closely monitoring progress against key milestones.

Timeliness of tabling annual reports

There is also scope to improve the timeliness of tabling of agency annual reports in parliament. While it is essential for financial and other accountability statements to be promptly prepared and audited, accountability is not achieved until the agency annual reports (containing the audited statements) are tabled and made publicly available. In this regard, we support the recent recommendations of the parliament's Public Accounts and Estimates Committee for the government to consider amending the reporting provisions of the *Financial Management Act 1994* to facilitate more timely tabling of annual reports.

Adequacy of control environments

Our audits confirmed that agency systems of internal controls impacting on the preparation of their financial reports were generally adequate. However, we identified various opportunities to strengthen the governance and management arrangements at some agencies, particularly in relation to:

- the implementation of effective risk management (including fraud prevention) frameworks
- information technology (IT) controls.

Future impacts – Changes to accounting standards and other emerging issues

A number of influences will have major impacts on the future financial management, reporting and accountability of public sector agencies. These include:

- The implementation of new Australian accounting standards issued following the harmonisation with international accounting standards, for reporting periods beginning from 1 January 2005. Universities and TAFE institutes will be among the first required to prepare their financial reports (including the comparative information) on the basis of the new standards.
- The proposed withdrawal of key public sector accounting standards which deal with whole-of-government reporting (AAS 31), accounting by departments (AAS 29) and accounting by local governments (AAS 27). In addition, other changes may follow should the outcome of work currently underway by the Australian Accounting Standards Board to harmonise the Government Finance Statistics (GFS)[3] and the Australian Generally Accepted Accounting Principles (GAAP) reporting frameworks be reflected in a new accounting standard. A draft standard is currently out on exposure for consideration by the community.
- The continuing demand from parliament for improved performance reporting by agencies, through the publication of audited performance statements in agency annual reports.
- The increasing incidence of reported fraud across the public sector, requiring ongoing agency attention to ensure that effective prevention strategies are in place.

Agencies (including central government agencies) will need to manage the impacts of these issues carefully to maintain the high quality and timeliness of their financial and other accountability statements.

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[3] GFS is the reporting framework established by the International Monetary Fund to allow economic analysis of the public sector. To date, it is mainly used by central government agencies to report at a whole-of-government or general government sector levels.

2.3 Financial statement audits

2.3.1 Reporting framework

The *Financial Management Act 1994* and the *Audit Act 1994* set out the annual reporting and audit requirements for departments and other public sector agencies. Section 45 of the Financial Management Act requires agencies to submit annual financial statements to the Auditor-General within 8 weeks of the end of the financial year. The Auditor-General is required to audit the financial statements within 4 weeks of receiving them.

Within 4 months of the end of the financial year (or on the next sitting day after the end of the fourth month), the relevant minister must table in each House of Parliament the annual report of each agency. This report must include the audited financial statements and, for regional water authorities, the audited performance statements.

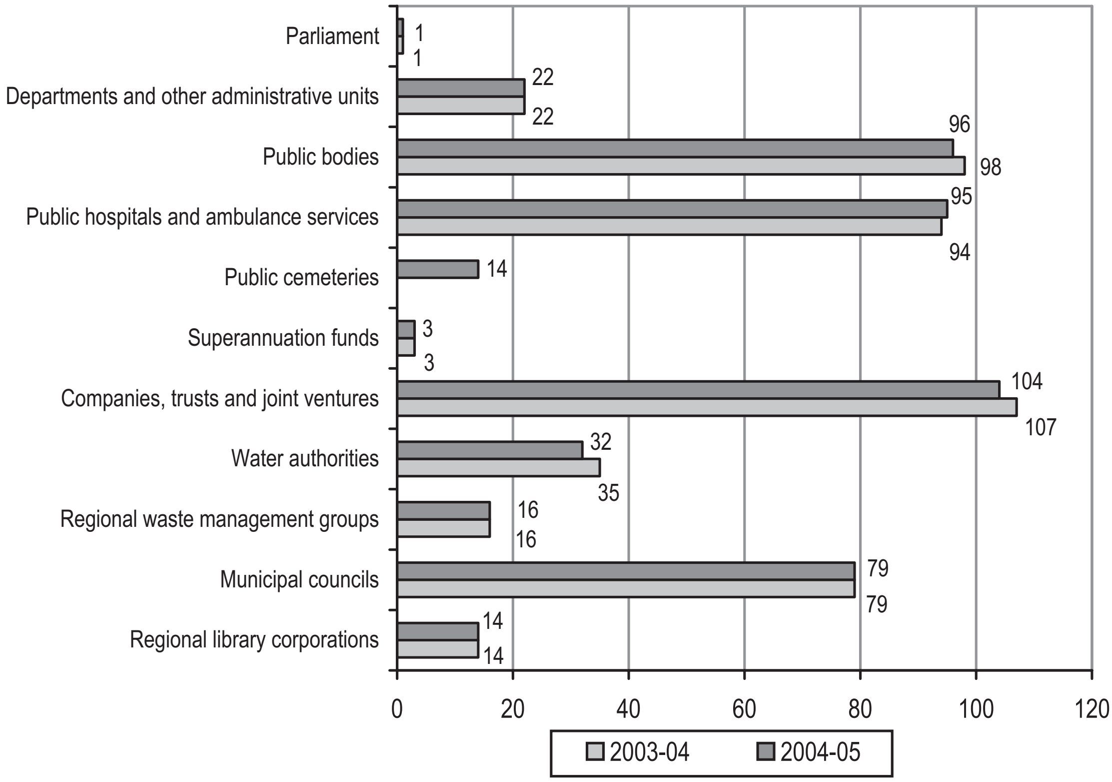
The annual reporting and audit requirements for local government entities are set out in the *Local Government Act 1989* and the *Audit Act 1994*. In 2003-04, the Local Government Act was amended to improve financial management by, and the accountability of, local government entities. Consequently, from that financial year, municipal councils and regional library corporations have been required to include audited "standard statements" in their annual reports to the minister. In 2003-04, these statements provided summary information about financial performance and cash flows against previously approved budget estimates. From 2004-05, they also provided summary information about the entities' financial position and capital works against approved budget estimates. The statements are additional to the annual audited financial statements.

Section 126 of the Local Government Act requires each municipal council and regional library corporation to submit its annual report (including a report of operations and audited financial statements) to the Minister for Local Government within 3 months of the end of the financial year. The annual report must also include an audited performance statement and audited standard statements. Under the Audit Act, the Auditor-General must audit the financial statements and other accountability statements within 4 weeks of receiving them.

2.3.2 Which agencies were audited?

At 30 June 2005, there were 609 public sector agencies that were subject to audit by our Office. Of these, 476 had a 30 June 2005 balance date. Figure 2B shows the types and number of agencies which have a 30 June 2005 balance date.

FIGURE 2B: PUBLIC SECTOR AGENCIES WITH A 30 JUNE BALANCE DATE



Source: Victorian Auditor-General's Office.

2.3.3 Audit purpose

The responsible officer and chief finance officer of each agency is responsible for keeping proper accounts and records, and for maintaining systems to prepare correct financial and other accountability statements. They are also responsible for preventing, detecting and investigating fraud and other irregularities.

Annual financial statements must be prepared in line with Australian accounting standards, with other mandatory professional reporting requirements, with the financial reporting requirements of the *Financial Management Act 1994*, and (where relevant) with the *Local Government Act 1989*.

The purpose of a financial audit is to assess whether the information in an agency's financial statements meets these professional and legislative requirements, so as to fairly present the agency's financial performance, position and cash flows for the financial period.

Local government performance and standard statements must be prepared in line with the specific requirements of the *Local Government Act 1989*. The performance statements of regional water authorities must be prepared in line with the requirements of ministerial directions issued under the *Financial Management Act 1994*. The purpose of our audits of these statements is to express an independent audit opinion on whether the information they contain is presented fairly in line with these legislative requirements.

All audits are conducted in accordance with the Australian auditing standards issued by Australian accounting bodies.

2.4 Major developments impacting on 2004-05 financial reporting

There were only minimal changes to accounting standards and other professional requirements that impacted on agencies' financial reporting requirements for 2004-05. The main change affecting the 2004-05 financial reports was Australian Accounting Standard AASB 1047 *Disclosing the Impacts of Adopting Australian Equivalents to International Financial Reporting Standards*. This standard required agencies to disclose within the accompanying notes to the financial reports:

- any known or reliably estimable information about the impacts on the financial report, had it been prepared using new Australian accounting standards which apply to financial years commencing on or from 1 January 2005 (we make further comment on this subject later in this part of the report)
- if the impacts were not known, or reliably estimable, a statement to that effect.

Financial Reporting Direction FRD 108 *Classification of entities as for-profit*[4] was issued by the Department of Treasury and Finance (DTF), in June 2005, as amplification of the requirements of AASB 1047. This direction designated 17 public sector agencies as "for-profit" entities for reporting periods commencing on or after 1 January 2005. In turn, this meant that certain reporting provisions of the Australian equivalents of International Reporting Standards that provide "relief" for "not-for-profit" entities[5] will not be available to those agencies designated as "for-profit" entities.

The new reporting requirements (AASB 1047 and FRD 108) required agency staff to became familiar with the new accounting standards; identify any new or changed reporting requirements for their financial report; and establish processes/systems to estimate and report on the impact of such changes.

Shorter reporting time frames for major agencies

To prepare for and facilitate the timely audit of the state's whole-of-government annual financial report (AFR)[6], DTF has for many years required major agencies[7] to complete their audited financial statements more promptly than is required by the *Financial Management Act 1994*.

In 2003-04, the reporting timelines for major agencies required them to present their draft financial statements for audit by 30 July. We were then required to audit those accounts within 4 weeks (by 20 August), so that the AFR could be prepared, audited and tabled in parliament by a planned date of 28 September 2004. Delays by several major agencies in completing their accounts meant that the AFR for that year was not tabled until 13 October 2004.

For 2004-05, the reporting timeline for major agencies was further tightened. Agencies were required to present for audit their draft financial statements by 26 July 2005, and our audit of these accounts was to be completed by 17 August 2005. This was expected to allow the 2004-05 AFR to be completed by 20 September 2005. However, delays by several major agencies in completing their audited accounts meant that the AFR was tabled on 6 October 2005.

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[4] Issued under the authority of the *Financial Management Act 1994.*

[5] For example, "not-for-profit" entities can offset asset revaluation increments and decrements against one another within a class of non-current assets, while "for-profit" entities can not.

[6] The AFR provides comprehensive information about the state's finances by consolidating the financial transactions and balances of about 330 agencies. These do not include local government agencies and universities.

[7] These agencies are known as "material entities". They control and account for the majority of the state's revenues, expenditures, assets and liabilities. In 2004-05, 48 agencies were designated as material entities.

To meet the shorter time line for 2004-05, agencies had to allocate staff resources to do so, and finalise the supporting information to their financial statements earlier than the previous year. Our audit teams worked closely with each major agency to help them achieve this shortened time frame. As in the previous year, audit strategies included bringing forward our interim audit work, so that it could be completed before year-end and so that post-balance date work could better focus on year-end financial balances and the verification of financial statements. Audit strategies included the identification and resolution of contentious issues as early as possible.

The collective efforts of the major agencies and audit staff during the 2004-05 reporting cycle contributed to an improvement in the timeliness of reporting by these agencies, and resulted in a one week improvement in the tabling of the government's AFR, compared with the previous year.

Although the shortened time frame for this year was not met, the overall performance of agencies and DTF in finalising the AFR is commendable. Some further capacity to complete audited financial statements earlier still remains, however, there will always be a need to preserve time to step back and reflect on the statements as a whole before finalisation and issue. The risks of not doing so outweigh any excessive effort to meet deadlines.

Additional local government reporting and audit requirements

As previously noted, the *Local Government Act 1989* was amended in 2003-04 to improve financial management by, and the accountability of, local government. Under these amendments, from the 2003-04 financial year, municipal councils and regional library corporations were required to prepare and include within their annual reports audited "standard statements". These statements provided summary information about financial performance and cash flows against previously approved budget estimates, and are subject to audit. From 2004-05, they were also required to provide summary information about the entities' capital works and financial position against approved budget estimates.

In working towards shorter financial reporting time frames, the preparation and audit of these new accountability statements represented an additional challenge for municipal councils and regional library corporations and the auditors, which was successfully met.

2.5 Results of audits

2.5.1 Audit opinions issued

Financial statements, all agencies

There were 476 agencies with 30 June 2005 balance dates requiring audit. At the date of preparing this report, we had completed the audit of, and issued audit opinions on, the financial statements of 467 of these agencies. The financial statements for the remaining 9 agencies were at various stages of completion. We are working with the respective agencies to facilitate their completion as soon as possible[8].

Of the 467 audit opinions issued, 456 were clear and a further 11 qualified. The incidence of qualified audit opinions increased from the 10 qualified opinions issued in the previous year. This reflects the removal of 2 prior year qualified opinions (Wodonga Regional Health Service and Swan Hill Rural City Council); the issue of 2 new audit qualifications (Gannawarra Shire Council and Moira Shire Council); and the inclusion of an audit qualification of the financial statements of the Trustees of the Fawkner Crematorium and Memorial Park which previously had a 31 December balance date and was, therefore, not included in the 30 June statistics. Accordingly, 9 of the qualified audit opinions refer to matters also subject to dispute in the previous year, which we will continue to work towards resolving with the relevant agencies in the coming year.

Appendix A of this report provides information for each agency about the timing of the finalisation of financial reports and audit opinions, and the nature of the audit opinions issued.

The reasons for the issue of qualified audit opinions in 2004-05 were:

- failure to consolidate “controlled entities” in accordance with Australian Accounting Standard AAS 24 *Consolidated Financial Reports* (Mercy Public Hospitals Inc. and Queen Elizabeth Centre)
- land assets not reported at fair value, or asset revaluations not undertaken with sufficient regularity to ensure the reported asset values do not materially differ from their fair values (Trustees of the Fawkner Crematorium and Memorial Park, Gannawarra Shire Council and Moira Shire Council)

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[8] The audited financial statements of 3 agencies with balance dates other than 30 June 2005 were also incomplete at the date of preparing this report. We are also working with these agencies to facilitate the completion of their financial statements as soon as possible.

- inappropriate disclosure of grants within financial statements. These non-exchange revenue grants received were not disclosed in accordance with Australian Accounting Standard AAS 15 *Revenue,* which requires that they be treated as income in the accounts of the recipient in the year of receipt (Wimmera Development Association)
- inability to verify the completeness of cash donations (Royal Women's Hospital Foundation Trust Funds)
- incorrect recognition of contributed net assets from a predecessor entity and inability to attest to the value of certain assets and liabilities (Calvary Health Care Bethleham Limited)
- incorrect recognition of certain debtors (St Vincent's Hospital (Melbourne) Limited)
- non-compliance of financial report with certain requirements of statements of accounting concepts and applicable accounting standards (Bass Coast Regional Health Benefit Trust Fund)
- incorrect recognition of an expense and an associated liability (Melbourne and Olympic Parks Trust).

Local government performance and standard statements

At the date of preparing this report, 77 clear audit opinions had been issued on the performance statements prepared by municipal councils, with a further 2 performance statements qualified. There were no outstanding performance statements.

The qualified audit opinions were issued because the budgets submitted to the Minister for Local Government by 2 local governments (Gannawarra Shire Council and Melton Shire Council) did not incorporate the key strategic activities and related performance measures and/or targets for 2004-05, as required under the *Local Government Act 1989.* These measures were developed subsequent to the submission of the budget to the minister. Accordingly, the performance statements did not fully comply with the requirements of the Act.

In addition to the opinions issued on local government financial statements and performance statements, we issued 90 clear audit opinions on standard statements prepared by municipal councils and regional library corporations, with 3 further standard statements subject to qualification. There were no outstanding statements. The reasons for the audit qualifications were:

- asset revaluations were not undertaken with sufficient regularity to ensure that the reported asset values did not materially differ from their fair values (consistent with the audit qualifications of the financial statements of Gannawarra Shire Council and Moira Shire Council)
- contrary to the requirements of the *Local Government Act 1989*, the budget submitted to the Minister for Local Government for 2004-05 financial year did not include standard statements. Although standard statements were subsequently developed, the requirements of the Act were not met (North Central Goldfields Library Corporation).

Water authority performance statements

At the date of preparing this report, 15 audit opinions on performance statements prepared by regional water authorities had been issued, all of which were clear. There were no outstanding statements.

2.5.2 Timeliness of audited financial statement completion

State government agencies (excluding local government)

Agency financial statements must be completed within 12 weeks of the end of the financial year. Figure 2C shows how well agencies (excluding local government) with 30 June 2005 balance dates met this requirement.

FIGURE 2C: TIMELINESS OF FINANCIAL STATEMENT COMPLETION, STATE GOVERNMENT AGENCIES WITH 30 JUNE BALANCE DATES

Finalisation of audited financial statements (weeks after year-end)	2003-04		2004-05	
	Number of entities	Per cent (cumulative)	Number of entities	Per cent (cumulative)
Less than 8 weeks	34	9	53	14
8 to 10 weeks	58	25	93	39
10 to 12 weeks	168	71	150	79
12 to 14 weeks	72	91	45	91
14 to 16 weeks	13	94	20	97
More than 16 weeks (a)	20	100	13	100
Total	**365**	**-**	**374**	**-**

(a) Includes 9 entities whose financial statements had not been finalised at the date of preparation of this report.

Source: Victorian Auditor-General's Office.

Figure 2C shows that there has been a small improvement from 2003-04 (71 per cent) to 2004-05 (79 per cent) in the number of agencies meeting the 12-week reporting time frame. This improvement, in part, reflects the impact of the substantially unchanged reporting framework for the year and the achievement of shorter reporting time frames by the state's major agencies to meet the tighter reporting time frame set for completing the government's AFR.

This improvement is particularly pleasing, given the additional effort required by agencies to prepare their 2004-05 financial statements, related to additional disclosures required in association with the transition to Australian equivalents of International Financial Reporting Standards from 2005-06. However, as we have commented in previous years, agencies can further improve the timeliness of completion of their audited financial statements. Three per cent of agencies still take more than 16 weeks to complete their audited financial statements after year-end (6 per cent in 2004-05).

Figure 2D illustrates the performance of agencies within each of the major sectors of government in meeting the 12-week time frame, for the 2003-04 and 2004-05 reporting years.

FIGURE 2D: TIMELINESS OF FINANCIAL STATEMENT COMPLETION BY SECTOR (EXCLUDING LOCAL GOVERNMENT)

Sector	2003-04		2004-05	
	Number of statements finalised within 12 weeks	Per cent	Number of statements finalised within 12 weeks	Per cent
Parliament (a)	1	100	1	100
Education and Training	3	43	7	88
Human Services (including Health)	99	79	108	74
Infrastructure	5	22	20	91
Innovation, Industry and Regional Development	7	78	8	89
Justice	28	90	24	80
Premier and Cabinet	8	73	8	73
Primary Industries	8	62	9	82
Sustainability and Environment	36	50	46	68
Treasury and Finance	58	92	56	95
Victorian Communities (b)	6	67	9	90
Total	**259**	**71**	**296**	**79**

(a) Excludes the Victorian Auditor-General's Office, which is audited by a private sector auditor.
(b) Excludes local government entities, which are separately discussed below.

Source: Victorian Auditor-General's Office.

Figure 2D shows substantial improvement in some sectors (Infrastructure, Education and Training, Sustainability and Environment, and Victorian Communities) and deterioration in some others (mainly the Justice sector). The overall outcomes were influenced by:

- some agencies taking longer than the previous year to provide complete draft financial statements to audit
- some agencies not scheduling board meetings to approve the financial statements until some time after the audit was completed
- some staff shortages during the critical year-end reporting period, due to the prevailing market conditions, which affected our collective capacity to achieve a more timely completion of the audited financial statements of smaller agencies.

A detailed analysis of the specific issues impacting on each of the sectors is provided later in this report. We will continue to work closely with agencies to further reduce the time they take to report.

Recommendations

2.1 That agencies and their audit committees review the outcomes of the 2004-05 reporting cycle to identify opportunities to further improve the financial statement preparation process, with the outcomes of these reviews used to inform agency planning for the next reporting cycle.

2.2 That agencies work closely with their auditors to have their opening balances for 2005-06 (based on the new accounting standards) finalised and audited early, to ensure that any contentious issues are able to be resolved on a timely basis and do not hold up the finalisation of their financial statements.

Local government

Figure 2E shows the performance of local government in completing audited financial statements (and, where applicable, performance and standard statements) within the statutory 3-month period in 2003-04 and 2004-05.

FIGURE 2E: TIMELINESS OF COMPLETION OF AUDITED FINANCIAL STATEMENTS AND, WHERE APPLICABLE, PERFORMANCE AND STANDARD STATEMENTS WITHIN THE LOCAL GOVERNMENT SECTOR

Finalisation of audited statements (months after year-end)	2003-04		2004-05	
	Number of entities	Per cent (cumulative)	Number of entities	Per cent (cumulative)
Less than and up to 3 months	99	95	97	95
3 to 4 months	4	99	5	100
More than 4 months	1	100	-	100
Total	**104**	**-**	**102**	**-**

Source: Victorian Auditor-General's Office.

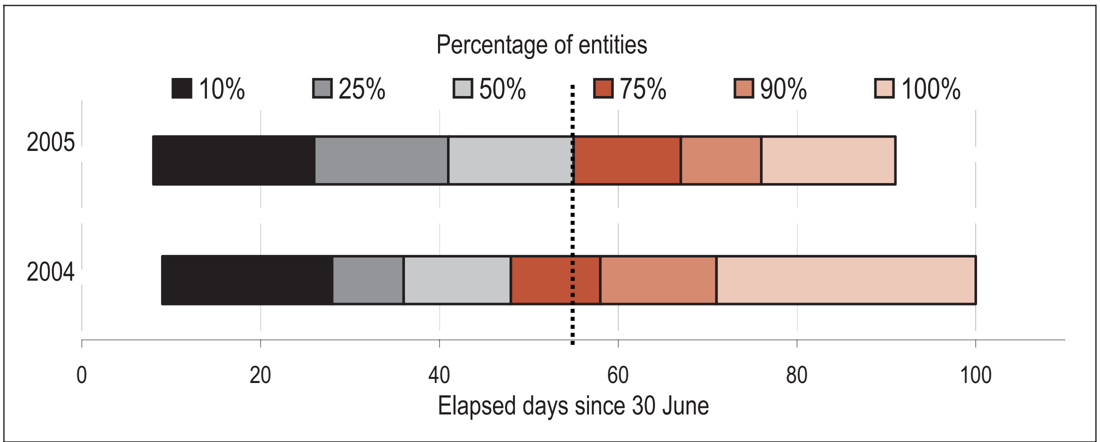
As Figure 2E shows, local government entities maintained the timeliness of completion of their audited financial statements in 2004-05, with 95 per cent of entities completing their statements within the statutory 3-month period, compared with 95 per cent in 2003-04. This represents a good outcome for the sector (particularly having regard for the additional reporting requirements for the year), consolidating the significant improvement made by local government agencies in previous years.

2.5.3 Quality of financial statements

The timely completion of audits is materially effected by how quickly agencies furnish draft financial statements to audit, and the completeness and quality of those drafts.

Figure 2F shows the time from the end of the financial year to when the audited agencies provided complete draft financial statements to our Office, by percentile bands.

FIGURE 2F: PERIOD TAKEN TO PROVIDE DRAFT FINANCIAL STATEMENTS TO AUDIT



Note: Statutory requirement of 56 days for completion of draft financial statements by state agencies.

Source: Victorian Auditor-General's Office.

The average time between the end of the financial year and our Office receiving complete draft financial statements was 53 days for agencies with 30 June 2005 balance dates (47 days, 30 June 2004 balance dates). Best practice (that is, what the quickest 10 per cent of agencies are achieving) is 26 days.

The quality of financial statements submitted for audit has continued to improve in recent years. A major reason for this improvement has been that departments and many industry sectors (such as water, health and local government) now use model financial reports to draw guidance. These model reports have helped to increase awareness among agencies of their disclosure and reporting requirements, and have made reporting within the sectors more consistent.

In 2004-05, the quality of financial statements received was again of a generally high standard. The stable reporting environment in the year (with only minor changes in accounting standards and other reporting requirements) significantly contributed to this positive outcome.

Conclusion

The availability of model financial reports has improved agencies' awareness of disclosure and reporting requirements, and have made reporting more consistent within and across sectors. However, some agencies still need to improve their processes for preparing and signing-off their financial statements. Improvements can be made by agencies:

- better planning and managing the financial statement completion process, through the greater use of completion milestones for key elements and stages of the process, and through the use of "hard-close" procedures[9]
- ensuring that appropriate staff are available and adequate quality control procedures are in place to enable complete and accurate draft financial statements to be prepared within the required time frames
- ensuring that contentious issues can be resolved on a more timely basis, through their timely consideration by management, and timely and open communications with audit
- more closely monitoring progress against key financial statement preparation milestones and assigning high priority to achieving them.

[9] "Hard-close" procedures refer to work undertaken by agencies at a date prior to (but close to) year-end (including obtaining necessary actuarial and other valuation reports etc.) to determine with reasonable confidence the value of account balances at that date, with the objective of then updating those balances for additional transactions between the "hard-close" date and the year-end. These procedures enable certain work to be brought forward, thus taking less time after year-end to complete the preparation of the financial statements.

Recommendation

2.3 That agencies, particularly those that take longer than average (53 days) to provide complete draft financial statements for audit, review their close-off and reporting processes to ensure statements are completed and provided before that time, and that they plan and allocate sufficient resources to do so.

2.5.4 Timeliness of tabling of agency annual reports

As commented in my previous report on the results of 30 June 2004 financial statement audits[10], while it is essential for financial and other accountability statements to be promptly prepared and audited, accountability is not achieved until an entity's annual report (which contains the audited financial statements) is tabled in parliament and is then publicly available. My 2004 report identified that the annual reports of most major agencies for 2003-04 were not tabled until the latest possible date allowed by legislation, notwithstanding that the audited financial statements for some of these agencies had been completed for up to 11 weeks.

Under current legislative requirements, annual reports must be tabled within 4 months of the end of the financial year, or on the next sitting day after the end of the fourth month.

To assess the timeliness of annual reporting to parliament, we again assessed the time that elapsed between the dates we issued our audit opinions on the financial and other accountability statements of major agencies (the material entities) and the dates the respective agencies' annual reports were tabled in parliament. Figure 2G shows the results of this assessment.

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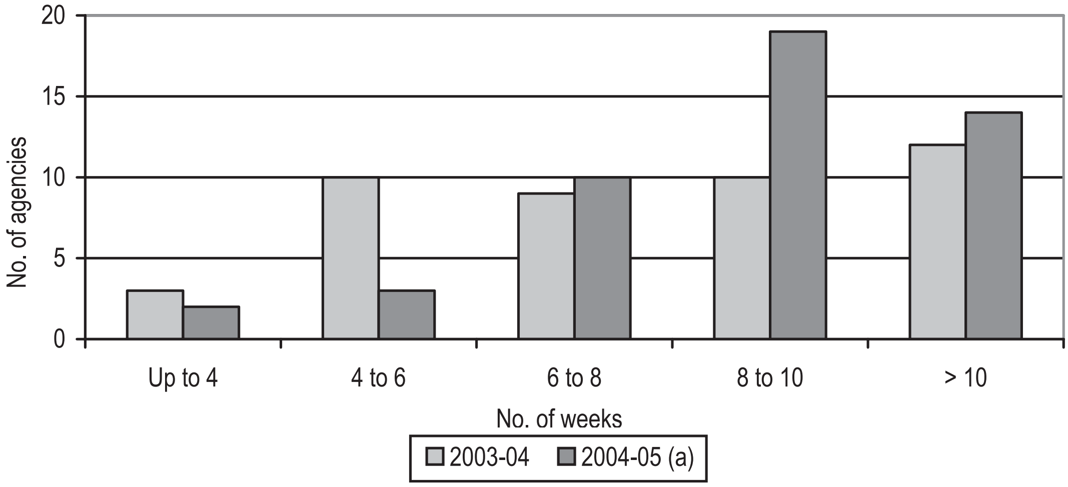
[10] Victorian Auditor-General's Office (2004), *Auditor-General's Report - Results of 30 June 2004 financial statement and other audits*, Victorian Government Printer, Melbourne.

FIGURE 2G: ELAPSED TIME BETWEEN ISSUE OF AUDIT OPINIONS AND TABLING OF ANNUAL REPORTS FOR MAJOR AGENCIES



(a) To 7 November 2005. At that date, the annual reports of 28 "material entities" had not been tabled.

Source: Victorian Auditor-General's Office.

Figure 2G shows that the annual reports of most major agencies were again not tabled until late October 2005 or later, notwithstanding that their audited financial statements were completed for periods up to 11 weeks.

In its May 2005 *Report on Corporate Governance in the Victorian Public Sector*, parliament's Public Accounts and Estimates Committee also identified the substantial time taken by agencies to table their annual reports in parliament as a key factor adversely impacting on their accountability to parliament and the public. The committee recommended that the *Financial Management Act 1994* be amended to require agencies to table their annual reports within 3 months of year-end, and to provide for out-of-session tabling of annual reports if parliament is not sitting during this period. We support these recommendations.

2.5.5 Agency control environments

While the main purpose of financial statement audits is to add credibility to those statements by providing independent assurance on their fair presentation (through the provision of audit opinions), audits also assess the adequacy of the governance and financial control processes of agencies.

Weaknesses in agency control environments identified during the audit process generally do not result in a qualified audit opinion, unless they are so fundamental as to cast doubt on the information presented in the financial reports. However, they are brought to the attention of the agency, for remediation.

Many of the issues identified during the recent audit round have been (or are being) addressed by the relevant agencies, but the following issues require ongoing attention.

Risk management practices

Risk management is a key element of agency governance. It establishes a process to systematically identify, analyse, treat, monitor and communicate risks. These risks could either prevent an organisation from achieving its objectives or provide opportunities for extra benefits to be realised.

Risk management has always been an implicit aspect of organisational endeavors in both the private and public sectors. However, the increasing operating complexities and demands on agencies in recent times have driven its development as an explicit tool for managers and governing bodies to help better manage agency performance.

In Victoria, the key drivers for implementing risk management strategies include the *Financial Management Act 1994*, the *Victorian Managed Insurance Authority Act 1996*, the government's Management Reform Program, and policies associated with the private-public programs such as Partnerships Victoria.

Section 44B of the Financial Management Act requires all public sector agencies within its ambit (more than 300 agencies) to develop and implement a risk management strategy and keep it under review. This requirement is complimented by Standing Direction 2.3 issued by the Minister for Finance which directs each agency to establish and maintain, as part of its overall risk management framework, an effective approach for the identification, assessment, monitoring and management of financial management risks. The Victorian Managed Insurance Authority Act also requires organisations insured with the Victorian Managed Insurance Authority to develop, implement and maintain a risk management strategy.

In the local government sector, section 136 of the *Local Government Act 1989* requires councils to manage financial risks prudently, having regard to economic circumstances. Although there is no legislative requirement for councils to have an overall risk management strategy in place, it is prudent management practice to effectively manage risk.

In March 2003, we completed a performance audit of risk management practices across the Victorian public sector[11]. That audit assessed whether appropriate risk management frameworks had been developed and were operating as an integral part of agency corporate governance arrangements. It concluded that most of the 61 agencies subject to audit were addressing risk management in some way, but that risk management had not yet been established as a mature business discipline. It also found that around one-third of the organisations reviewed did not explicitly identify and assess their key risks, and that organisations did not always report risk information to their key internal and external stakeholders.

As part of the current financial audit round, we examined risk management practices across all agencies to assess the application of risk management across the Victorian public sector. We assessed whether:

- agencies had established appropriate risk management strategies
- the strategies were effectively implemented
- reporting against the strategies was adequate
- risk management was adequately integrated into the agency governance structures and strategic management practices
- sufficient attention was given to identifying and managing state-sector risks.

We found that, overall, agencies had made progress since our 2003 performance audit in further developing/refining their risk management frameworks, and better integrating risk management into their core business and governance processes. However, there remained areas for further improvement. While agencies were at various stages of development/maturity, there was a general awareness of the strategic importance of this discipline to effective agency governance, and a positive momentum to drive ongoing improvement.

Comments follow on the key aspects of risk management we examined.

Appropriate risk management strategies

The risk management strategies of most agencies addressed risks across the entire business operations of the relevant agencies. However, some needed further development and refinement to ensure all agency-wide business risks were identified.

Responsibility for risk management was generally assigned to specific positions or business groups within agencies.

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[11] Victorian Auditor-General's Office (2003), *Managing risk across the public sector,* Victorian Government Printer, Melbourne.

Most agencies had identified risks relating to goals, objectives and planned outcomes. This was managed through the implementation of risk registers which, in most cases, were reviewed and updated annually. However, treatment plans to address the identified risks (and monitoring against them) were not so widely implemented by agencies and, in cases, needed further development.

Implementation of risk management strategies

The audit and risk management committees of most agencies played a key role in coordinating, oversighting and (generally annually) reviewing risk management strategies. In our experience, this involvement contributed to improved risk management and agency governance. However, some agencies do not involve their audit (or similar) committees in risk management and had not annually reviewed their strategies, increasing their vulnerability to changing risk factors.

Agencies, in most cases, had not included in their risk management strategies evaluations of alternative risk treatment options, based on their cost-benefit and compliance requirements, nor a regular review and testing of risk controls and contingency plans.

Most agencies examined had communicated their risk management strategies throughout their organisations, including to management and other personnel, and training was generally provided on an annual basis to employees responsible for risk management.

Reporting against risk management strategies

Increasingly, risk management was included as a standing agenda item for audit and risk committees. These committees generally received and considered regular (quarterly) risk management reports from management which informed them of any new identified risks. However, little mention was made in risk management reports of incidences, losses and claims against identified risks.

There was also little evidence of monitoring/review of business process improvements implemented at the time of initial identification of risks to ensure they remained effective.

Integration into governance structures and strategic management practices

As previously mentioned, the audit and risk committees of most agencies now oversee risk management. Senior management also generally plays a direct role in leading and managing the risk management process, including its integration into the agencies' business planning and management processes.

Agencies are still in the early stages of incorporating key performance indicators into their risk management strategies, however, we observed improvement since our 2003 review.

Agencies are increasingly using the services of internal audit to review risk management strategies and ensure the benefits available to them from their effective implementation have been captured.

Identification and management of state-sector risks

While a number of agencies (water authorities, public hospitals, and municipal councils and libraries) had identified sector issues, others limited risk identification to their own agencies. Accordingly, there is a possibility that agencies do not have a clear understanding of their risk exposures which may impact on the state or, particularly, on other agencies.

Recommendation

2.4 That agencies:

- **regularly review and, where necessary, revise their risk management approaches and strategies to ensure they remain appropriate to the agencies' level of risk**
- **at least annually, rigorously evaluate entity-specific and state-sector risks and risk treatments across the whole of the agencies' business operations, and ensure they are appropriately identified, reported and managed**
- **ensure their audit (or similar governance) committees play a direct leadership role in organization-wide risk management, including the oversight and regular review of risk management frameworks, strategies and treatment plans.**

RESPONSE provided by the Secretary, Department of Treasury and Finance

The Balance Sheet Management Committee (BSMC) within the Department of Treasury and Finance is currently engaged in a series of inter-related projects on the government's approach to state-wide risk management. The comments and recommendations on the "Risk Management Practices" section of this report and the March 2003 report "Managing risk across the public sector" are consistent with the findings to date of these BSMC projects.

The BSMC projects and the reports mentioned above support the government's overall approach to risk management, but have identified specific areas for improvement. The BSMC projects are expected to result in some changes to current risk management practice throughout the Victorian public sector that will address the issues identified in this report.

Incidence and prevention of fraud

Fraud is one of many risks faced by agencies that needs to be carefully managed to minimise potential loss. The establishment of sound fraud control policies should form part of an entity's risk management strategies and is likely to provide an effective tool for minimising opportunities to engage in fraud.

Australian Auditing Standard AUS 210 *The Auditor's Responsibility to Consider Fraud and Error in an Audit of a Financial Report* requires auditors, as part of the financial audit process, to assess the risk of material misstatement resulting from fraud and error. Accordingly, we plan and conduct our audits to obtain reasonable assurance that agency financial reports are free from material fraud and error. However, ultimate responsibility for the prevention and detection of fraud and error remains with agency governing bodies and with agency management.

Standing Direction 4.5 of the Minister for Finance (issued under the authority of the *Financial Management Act 1994*) requires the details of frauds, thefts and losses to be reported by public sector agencies to the Minister for Finance and the Auditor-General. This requirement is not mandatory for local government entities.

Recent research into fraud within the private and public sectors in Australia has identified an increasing incidence of crimes of dishonesty over recent years. The increasing use of electronic technology has been a major factor contributing to this trend[12]. Functions more susceptible to the risk of fraud in the public sector include grant programs, credit card usage, travel allowances, employee claims and payroll activities.

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[12] Parliament of Victoria, Drugs and Crime Prevention Committee (2004), *Inquiry into Fraud and Electronic Commerce*, Final Report, Victorian Government Printer, Melbourne.

We too have observed an increasing incidence of reported fraud across Victorian public sector agencies. During 2004-05, 16 instances of actual or suspected fraud and 190 instances of theft and loss were reported to my Office. While these instances mostly involved small sums of money or theft of assets (such as computers and other equipment), 4 involved more substantial sums (in excess of $100 000). One case, in particular, involved financial statement fraud[13].

The common contributing factors to these frauds and losses were inadequate agency internal controls and poor physical security of premises and vehicles. In all cases, corrective action was taken by the respective agencies to improve any identified control deficiencies and, where appropriate, the matters were reported to the Victoria Police.

While agencies were generally proactive in notifying my Office of these instances of actual and suspected fraud, theft and losses, in a number of cases we were not notified until some time after the events had occurred.

International research into the incidence of fraud indicates that most fraud is either not detected (40 per cent) or, if detected, not made public (40 per cent). In addition, the research shows that fraud is generally detected thus[14]:

- tips from staff, customers, suppliers and others (40 per cent)
- internal audit (24 per cent)
- by accident (21 per cent)
- internal controls (19 per cent)
- external audit (11 per cent)
- notified by police (one per cent).

The current experience in the Victorian public sector points to the need for ongoing attention/diligence by agency management to ensure that appropriate fraud prevention policies and procedures are developed and implemented, focusing on the business activities most susceptible to fraud.

When assessing the potential for fraud and error, and establishing appropriate management arrangements, each agency should consider, as part of its risk management process:

- conduct of an environmental scan to determine the internal and external influences impacting on the occurrence of fraud and error

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[13] Financial statement fraud is the falsification of an organisation's accounts in order to give a false impression of the financial performance or position of the organisation.

[14] *Sources: 2004 Report to the nation on occupational fraud and abuse*, Association of Certified Fraud Examiners, Austin, Texas. Howard R Davia, *Fraud 101*, John Willey and Sons, New York, 2000. The sum of the stated percentages exceeds 100 per cent because in some cases more than one detection method was involved.

- development, implementation and regular review of an agency-wide fraud prevention and detection strategy
- assignment of responsibilities for co-ordination and monitoring compliance with the agency strategy
- supporting the agency strategy with appropriate communication policies, response procedures and training programs
- assessing the potential for fraud and error arising from the introduction of new technologies.

To be effective, these processes need to be reinforced by organisational cultures which support the investigation and resolution of incidents of alleged or actual fraud in a decisive and timely manner.

Recommendation

2.5 That agencies:

- **regularly review the adequacy of their fraud prevention and detection strategies, including the related treatment plans, to ensure the risk of fraudulent activity is minimised**
- **ensure that all instances of fraud, theft or loss are reported to my Office on a timely basis, consistent with the requirements of the *Financial Management Act 1994.***

Adequacy of information technology controls

Agencies place substantial reliance on computerised systems to produce information included in their financial reports. An assessment of these systems and the management of information technology (IT) within agencies is, therefore, an important part of the financial audit process.

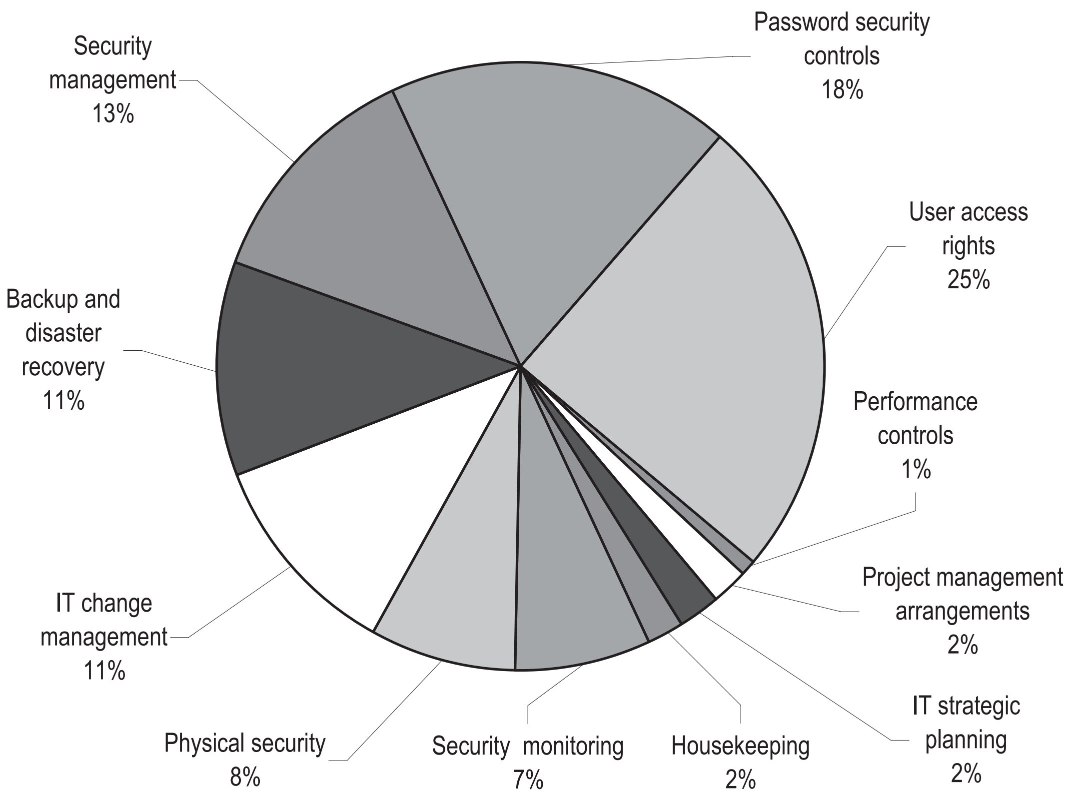
Our recent reports to parliament on the results of financial statement audits have outlined the outcomes of IT reviews undertaken as part of the annual audit process. They have highlighted the continuing need for agencies to develop and maintain comprehensive policies and procedures for the management of their computer environments. They have also identified scope for improvement to various aspects of agencies' IT security management and change management practises.

As part of our 30 June 2005 and 31 December 2004 financial statement audits, we again conducted IT reviews across 47 agencies that use significant IT systems. The scope of each review took into account the results of previous audits, the size of the audited agency and the risks inherent in its computer environment. Our IT reviews typically assessed the appropriateness of technology controls implemented by the agencies, and whether they were functioning as intended. The areas of control examined included:

- the adequacy and effectiveness of operational and technical controls within computer environments that protect financial information
- IT management practices, such as security, change management and organisation-wide IT governance
- the planning of agencies to recover from a major system interruption, IT disaster or virus outbreak.

While agencies had addressed most of the key control weaknesses identified in the prior year, there were areas that required further improvement. Figure 2H summarises the main issues we identified in 2004-05.

FIGURE 2H: IT ISSUES IDENTIFIED BY AUDIT, 2004-05
(PERCENTAGE OF ALL IT ISSUES IDENTIFIED)



Source: Victorian Auditor-General's Office.

As shown in Figure 2H, the management of IT security remains a key area requiring improvement. The key aspects requiring agency attention include:

- controls over the creation, maintenance, removal and periodic review of user access rights to key applications and systems
- development of comprehensive IT security policies and procedures, established by management and based on recognised standards
- the quality and management of passwords
- monitoring of security-related activity to help detect and respond to unauthorised activity within key information systems and applications.

Other major areas identified by our IT audits for further improvement included the testing, documentation and authorisation of information technology changes to financial applications and systems, and agency IT disaster recovery planning and testing practices.

In addition to the IT reviews conducted as part of the annual financial audit process, in 2004-05 we conducted a special audit of the adequacy of internet security practices across 5 local governments. This work recognised the increasing use by public sector agencies of the internet to manage their operations and deliver services to the public, and the substantial security risks that attach to the use of the internet.

The results of that audit, including areas identified for future improvement, were presented in our May 2005 report on the *Results of financial statement audits for agencies with other than 30 June 2004 balance dates, and other audits*. That audit concluded that the local governments reviewed had taken positive steps to establish effective internet security, however, also found scope for improvement in some aspects of this IT activity (for example, monitoring of security-related activity, disaster recover planning, etc.).

Conclusion

The majority of agencies we examined in 2004-05 had taken action to resolve the major issues identified in our prior audits. The agencies had implemented minimum levels of control within their IT environments, which allowed us to place reliance on computer systems and financial applications that support the preparation of financial statements. However, there remains a continuing need for agencies to improve security management practices and to regularly review information technology controls across key IT systems.

As highlighted in our December 2004 report to parliament[15], the establishment of the Office of the Chief Information Officer (OCIO) in 2003[16], and its development and progressive implementation of various improvement initiatives, represent a positive development which will help improve information technology management by agencies over future years. Some of the key initiatives pursued by the OCIO in 2004-05 included:

- in partnership with departments, developing a whole-of-government information security management policy that supports the implementation of effective security management practices and the adoption of relevant Australian standards and guidelines[17]. At the time of preparing this report, were advised by the OCIO that all departments had committed to the policy approach proposed by the OCIO; the Minister for Information and Communication Technology had endorsed the policy; and the OCIO was developing a strategy to formulate compliance by public sector agencies
- continuing to sponsor a "community of practice" for information security, to help identify current issues across government and provide a forum to share ideas and good practice
- renewing a whole-of-government agreement with AusCERT[18] for the provision of security alert services to be available for all departments and other agencies
- establishing a best practice guide for server "patch management" (including patches for security vulnerabilities) across the whole of government.

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[15] Victorian Auditor-General's Office (2004), *Results of 30 June 2004 financial statement and other audits,* Victorian Government Printer, Melbourne.

[16] The Office of the Chief Information Officer forms part of the Department of Premier and Cabinet and was established to provide leadership in egovernment, and information, communication and technology strategy across the Victorian public sector.

[17] Standards Australia, AS/NZS 7799.2:2003 *Information security management – Part 2: Specification for information security management systems*, 2003; AS/NZS ISO/IEC 17799:2001 *Information technology - Code of practice for information security management*, 2001; and HB 231:2004 *Information security risk management guidelines.*

[18] AusCERT is a computer emergency response organisation.

Recommendation

2.6 That agencies:

- **regularly review the effectiveness of IT security management practices and controls across their IT environments and systems**
- **until such time that the whole-of-government information security management policy is implemented, adopt recognised Australian standards in security management such as AS/NZ 7799.2:2003[19], to establish, monitor and review their IT security controls and risks**
- **regularly review and test their business continuity and disaster recovery plans to ensure they are adequate and effective.**

RESPONSE provided by the Secretary, Department of Premier and Cabinet

The Office of the Chief Information Officer acknowledges the audit recommendation.

2.6 Other emerging issues for 2005-06

2.6.1 Implementation of the new accounting standards

Australian equivalents of International Financial Reporting Standards (A-IFRS)

As explained in my previous reports to parliament[20], new Australian accounting standards are to be implemented for reporting periods beginning on or after 1 January 2005 to harmonise the Australian reporting framework with international financial reporting standards. All reporting entities will be required to comply with the new standards, which include new and revised requirements for financial accounting and reporting. This represents the largest change to accounting in Australia for many years.

[19] Standards Australia, AS/NZS 7799.2:2003 *Information security management – Part 2: Specification for information security management systems*, 2003.

[20] Victorian Auditor-General's Office, *Auditor-General's Report - Results of 30 June 2004 financial statement and other audits*, Victorian Government Printer, Melbourne; and Victorian Auditor-General's Office (2005), *Auditor-General's Report - Results of financial statement audits for agencies with other than 30 June 2004 balance dates, and other audits*, Victorian Government Printer, Melbourne.

While the impact of the new accounting standards (the Australian Equivalents of International Financial Reporting Standards – known as A-IFRS) will vary depending on individual agencies' business and scope of financial operations, the major changes for the public sector mainly relate to:

- valuation and impairment of non-current assets
- accounting for financial instruments
- valuation of insurance liabilities, outstanding superannuation and other employee benefit liabilities
- accounting for foreign exchange movements.

Public sector agencies with 30 June balance dates will be required to fully apply the new standards for the first time in their financial statements for 2005-06. The application date for agencies with 31 December balance dates (mainly educational bodies such as universities and TAFE institutes) is 2005.

An important aspect of the new standards is the retrospective manner in which they must be applied. Specifically, Australian Accounting Standard AASB 1 *First-time Adoption of Australian Equivalents to International Financial Reporting Standards* requires the first financial report to be prepared in accordance with the new standards to also include full year comparatives based on the new standards[21]. As mentioned earlier in this part of the report, in their financial statements for the year leading up to the introduction of A-IFRS, agencies are also required to disclose in the accompanying notes:

- any known or reliably estimable information about the impacts on the financial report, had it been prepared using new Australian accounting standards which are due to come into operation on 1 January 2005
- if the impacts were not known, or reliably estimable, a statement to that effect.

Agencies with 30 June balance dates provided this additional disclosure in their 2004-05 financial reports.

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[21] Relief was granted to entities from the application of certain accounting standards (primarily those relating to financial instruments) until 1 July 2005.

Central agency leadership

The Department of Treasury and Finance (DTF) has played, and continues to play, an important leadership role in assisting Victorian public sector agencies with the smooth transition to the new accounting standards. Through the establishment of its Financial Management Knowledge Centre website <www.fmkc.dtf.vic.gov.au>, DTF provides up-to-date information on the implementation of the new standards, provides a forum for the sharing of information between agencies, and provides an issues management system along with various tools and templates for agencies' use. DTF has also:

- provided agencies, in conjunction with a major accounting firm, training workshops to cover technical aspects of the new standards and to assist agencies prepare for their implementation
- prepared and disseminated, through the above website, summaries of the more significant new standards, including a broad overview of the differences between the existing Australian accounting standards and the new standards
- developed and issued 13 new Financial Reporting Directions (FRDs) with the aim of achieving consistency in the accounting policies adopted by entities across the whole-of-government where options are available under A-IFRS
- identified and designated those public sector agencies (17 entities) that are to report on a "for-profit" basis (further comment on this issue is provided earlier in this part of the report)
- issued a model financial report for government departments, incorporating guidance disclosure on the impacts of the new standards on 30 June 2005 financial reports
- issued a 2005-06 A-IFRS guide, which provides an illustrative example of annual financial statements, and notes thereto, presented in accordance with the requirements of A-IFRS. While the guide is generic and not specific to the public sector, it addresses the minimum reporting and disclosure requirements that entities would need to consider in order to comply with A-IFRS.

These initiatives have established a constructive and supportive environment for Victorian public sector agencies for a smooth transition to the new accounting standards.

Response by agencies to these changes

The response of individual agencies to these changes has varied, from taking a proactive approach to identifying the implementation needs of the new standards, to waiting for a central agency response to assist a perceived lack of resources to proceed to implementation.

Agencies had completed sufficient work to determine and disclose the estimated impact of the new accounting standards in their 2004-05 financial reports, as required by Australian Accounting Standard AASB 1047 *Disclosing the Impacts of Adopting Australian Equivalents to International Accounting Standards*. Our Office has supported them in working through and resolving any specific accounting and financial reporting issues as they were identified.

The way forward

While implementation and disclosure issues related to the transition to the new standards will, without doubt, continue to be identified by agencies and auditors into 2005-06, given the work done to date and the disclosures provided by agencies in their 2004-05 financial reports (which we have reviewed), I am confident that agencies are well placed to fully comply with the new standards by the target dates.

There are some significant challenges that remain, particularly for agencies with substantial financial instruments and insurance products, given that the new accounting standards dealing with these issues are not required to be retrospectively implemented for reporting periods prior to 1 January 2005. However, these agencies are well advanced in planning and implementing the requirements of these specific standards.

Other developments in public sector reporting

With the basic set of A-IFRS delivered, the Australian Accounting Standards Board (AASB) has shifted its attention to developing financial reporting standards to meet the specific needs of the public sector, with a focus on reporting at a whole-of government level, and by departments and local government. A key part of this work involves the harmonisation of the Government Finance Statistics (GFS)[22] and the Australian Generally Accepted Accounting Principles (A-GAAP) reporting frameworks.

[22] GFS is the reporting framework established by the International Monetary Fund to allow economic analysis of the public sector. To date, it is mainly used by central government agencies to report at a whole-of-government or General Government Sector levels.

The AASB's approach to the harmonisation project has been to progress it in 3 phases. The first phase focuses on general purpose financial reporting by state, territory and Commonwealth governments, including sector reporting. In the second phase, the AASB will address the general purpose financial reporting needs of individual entities in the General Government Sector (GGS)[23] and the third phase will deal with general purpose financial reporting by other public sector entities, including local governments, universities and government business enterprises.

Within phase 1, the AASB has decided to develop a separate accounting standard setting out the requirements for GGS reporting by governments. To this end, in July 2005, it issued ED 142 *Financial Reporting of General Government Sectors by Governments*, for public comment. ED 142 includes the following key proposals:

- the GGS is to be defined as a reporting entity and required to prepare a general purpose financial report
- the GAAP-based recognition and measurement requirements, as reflected in Australian accounting standards, are to be applied in the preparation of the GGS financial report. However, where GAAP allows optional accounting treatments, only those treatments aligned with the GFS are to be applied
- selected GFS information is to be presented on the face of the financial statements and in the notes, and any convergence differences between GAAP and GFS are also to be disclosed in the financial report.

The AASB has deferred decisions on the extent to which its proposals on GGS financial reporting should be applied to the remaining aspects of phase 1, comprising financial reporting at a whole-of-government level, and by the other sectors of government, as well as phases 2 and 3, comprising financial reporting by government departments, statutory bodies, local governments, universities, government business enterprises and other public sector entities.

Public comment on this exposure draft will provide the basis for the AASB's future deliberations on the remainder of phase 1 and, subsequently, phases 2 and 3, of the harmonisation project.

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[23] The GGS consists of all government departments and other bodies engaged in providing services free of charge or at prices significantly below their cost of production.

The AASB is also proposing to withdraw Australian Accounting Standards AAS 31 *Financial Reporting by Governments,* AAS 29 *Financial Reporting by Government Departments* and AAS 27 *Financial Reporting by Local Governments.* In view of the implications that such action would have on particular financial reporting issues faced by not-for-profit public sector agencies, which are not specifically addressed by other accounting standards (such as accounting for restructures and administered versus controlled transactions and balances), it is also considering a number of proposals to address those issues.

We will closely monitor and, where appropriate, provide (and encourage others to provide) input to these developments, and advise agencies and parliament on their implications and eventual implementation. It is pleasing that a number of committees of parliament across Australian jurisdictions are taking a keen interest in these changes, which are of real importance and provide the opportunity to influence public sector reporting into the future.

2.6.2 Progress in non-financial performance reporting

Over many years, my Office has strongly advocated the need for better reporting of non-financial performance information by public sector agencies so that parliament and the community can be better informed about the outcomes that agencies achieve against their objectives.

My more recent reports[24] have recognised the positive action taken by government to begin addressing this issue, through the issue in May 2004 by the Minister for Finance of Financial Reporting Direction FRD 27 *Presentation of Reporting and Performance Information*. This FRD requires certain agencies to prepare statements of performance, and include them in their annual reports. This includes:

- performance targets and indicators determined by the responsible minister
- reporting actual results for the financial year against the targets and indicators
- an explanation of any significant variances between the actual results and the performance targets and indicators.

While this FRD establishes the framework to implement improved reporting across the entire Victorian public sector, to date its application has been limited to the state's 15 regional water authorities.

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[24] Victorian Auditor-General's Office (2004), *Auditor-General's Report - Results of 30 June 2004 financial statement and other audits*, Victorian Government Printer, Melbourne; and Victorian Auditor-General's Office (2005), *Auditor-General's Report - Results of financial statement audits for agencies with other than 30 June 2004 balance dates, and other audits*, Victorian Government Printer, Melbourne.

I previously expressed an expectation that the application of the FRD will be progressively extended to other agencies over future years to assist improve the quality of publicly reported performance information and, therefore, the accountability of agencies for outcomes achieved. Parliament's Public Accounts and Estimates Committee expressed a similar expectation in its May 2005 *Report on Corporate Governance in the Victorian Public Sector.* The committee recommended that the Department of Treasury and Finance amend the FRD to require all public sector agencies to provide performance information and indicators in their annual reports commencing from the 2006-07 financial year.

Recommendation

2.7 I reiterate the recommendations made in my previous reports to parliament, that:

- **the Department of Treasury and Finance, in consultation with other departments, develop an implementation strategy to progressively extend the application of FRD 27 to all public sector agencies.**
- **agencies, in consultation with their portfolio departments, work towards the development and publication in their annual reports of performance statements, consistent with the requirements of FRD 27.**

RESPONSE provided by the Secretary, Department of Treasury and Finance

The Department of Treasury and Finance (DTF) has considered the issue and has no immediate plans to extend the application of FRD 27 beyond the existing water authorities. More extensive requirements for performance reporting (output measures) are mandatory for departments. These latter departmental performance measures were first developed in 1997-98 and refined over a number of years before being introduced into the "Model Financial Report for Victorian Government Departments" in 2001.

For government agencies, including those in the health and education sector, as well as public financial and other non-financial corporations, the department believes that a more productive approach is to foster the development of meaningful internal performance indicators and measures, and imbed such measures into management decision-making.

RESPONSE provided by the Secretary, Department of Treasury and Finance - continued

The Standing Directions of the Minister for Finance, includes requirement 4.4 which states "Public sector agencies must develop appropriate financial management performance indicators and monitor performance against these to identify key statistics and trends for use in management decision-making".

DTF will continue to work with departments and agencies to improve performance information and reporting.

2.6.3 Future of the capital assets charge

Our December 2004 report on the *Results of 30 June financial statement and other audits* commented on the operation of the capital assets charge and the work underway at the Department of Treasury and Finance (DTF), at that time, to re-assess its future application.

The capital assets charge (CAC) is a fee levied annually by DTF on all departments[25]. It forms part of the government's Asset Management Framework and aims to achieve 2 main objectives:

- enable departmental outputs to be fully costed by attributing to them the opportunity cost of capital used in service delivery
- provide departments with incentives to identify and dispose underutilised or surplus assets in a timely manner.

Since 1998-99, the CAC has been levied at a rate of 8 per cent of the actual written–down value of the non-current physical assets controlled by departments. Some types of assets (such as roads, national parks and cultural assets) have been exempted from the charge.

Departments are required to fund the CAC from their output appropriations. These annual appropriations provide for the charge, based on the budgeted value of departmental assets for the year. Any increase in the value of a department's assets during a year, above budget, will increase the CAC levied, without necessarily increasing the department's output appropriations (its revenues). In these cases, departments need to find savings in other costs to offset the increased CAC payable, or seek additional funding (or an exemption) from the Department of Treasury and Finance for the full application of the CAC.

[25] Some departments in turn on-pass and recover the capital charge from sector agencies with asset holdings.

Our November 2004 report commented on several anomalies and inconsistencies related to the application of the CAC[26] and the practice of granting exemptions to certain departments from the full application of the CAC policy. In our view, these practices brought into question whether the intended objectives of the CAC were being achieved.

In 2004-05, CAC charges levied on departments totalled $2 114 million (2003-04, $1 916 million). Exemptions from the full application of the CAC policy were provided to 3 departments (Departments of Education and Training, Human Services, and Victorian Communities), with a total value of $120 million (2003-04, 2 exemptions granted, amounting to $95 million).

At the time of our previous report, DTF was examining the ongoing operation of the CAC as part of a wider review of asset management policies. During this review, some departments expressed a preference to abolish the CAC, as they believed that the policy did not affect asset management decisions and had an adverse impact on service delivery, resulting from increased CAC expense contributed to asset revaluations. DTF did not support this option as it considered that the abolition of the charge would result in the loss of capacity to measure the proxy cost of capital and, consequently, to measure the full cost of output delivery.

Future direction of the CAC

In February 2005, the government endorsed the progressive implementation of a revised Asset Management Framework (the new framework), with the full operation of most elements of the framework to commence from July 2006. Under the new framework, departments will be required to prepare enhanced asset strategies prior to each annual budget cycle which better link funding needs to government priorities, service delivery requirements, demand drivers and whole-of-life asset plans. The strategies are intended to support improved government decision-making on asset investment and whole-of-life asset funding.

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[26] These included the negative impact of asset revaluations on the CAC payable and, therefore, departmental financial management, and inconsistencies in the types of assets exempted from the CAC.

Under the framework implementation arrangements, from 1 July 2005 to 30 June 2007 the CAC will operate as a "round robin", with departments receiving revenue equal to their budgeted CAC expense. This means that departments will not need to pay the CAC based on their actual asset valuation and, therefore, will not need to take into account asset revaluations when calculating the CAC charge. This is a short-term measure designed not to put at risk the delivery of departmental outputs due to unexpected cost increases resulting from revaluations above the departmental funding model cost escalation index. The previous exemptions to the application of the CAC (such as roads, national parks and cultural assets) will continue to apply over the transitional period.

This transitional period will also allow DTF to assess the future operation of the CAC, including to:

- examine the impact of the introduction of Australian equivalents of International Financial Reporting Standards (A-IFRS) on asset valuations
- develop and trial a mechanism to smooth cost volatility associated with asset revaluations
- clarify a policy on exemptions.

The ultimate aim of the work to be undertaken over this period is to ascertain the future direction of the CAC. The DTF review is due to be completed before the commencement of the 2007-08 budget cycle.

2.6.4 Establishment of the State Services Authority

The State Services Authority was established in April 2005 as part of a suite of major public sector reforms introduced under the provisions of the *Public Administration Act 2004*. Its key role is to advise and support the government and departmental secretaries in continually improving public sector services, standards, governance and work force development. The Act sets out the following key roles for the authority:

- identify opportunities to improve the delivery and integration of government services and report on service delivery outcomes and standards
- promote high standards of integrity and conduct in the public sector
- strengthen the professionalism and adaptability of the public sector
- promote high standards of governance, accountability and performance for public entities.

In discharging these roles, the authority is expected to play a major leadership role in facilitating sector-wide actions that deliver public sector improvement over future years. In an environment of increasing and more complex demands on the Victorian public sector, this is a welcomed development.

The work of the authority will complement that of my Office in seeking to improve the administration, performance and accountability of the Victorian public sector. We look forward to working with the authority in this endeavour.

2.6.5 Other developments

In addition to the abovementioned developments, there are several other issues that need ongoing attention by agencies. These include:

- *Establishment of effective governance arrangements over newly established alliances and similar joint venture arrangements.* As these arrangements can involve complex transactions, relationships and responsibilities, it will be important that agencies establish effective governance structures and accountabilities for them, and ensure that their interests are protected.
- *Ensuring that public statements of agency performance focus on the reported GAAP results.* In recent times, in public statements (such as media releases etc.) some agencies have sought to amplify components of their financial result (for example result prior to capital grants or market effected investment returns) as the key indicator of their performance, rather than the audited GAAP result. This practice can contribute to unnecessary public confusion about the "correct result" and agency performance, and is therefore not encouraged by my Office.

Finally, we are continuing to implement the June 2003 amendments to the *Audit Act 1994*, whereby the Auditor-General's audit mandate was extended to encompass entities controlled by the state and public agencies. This has resulted in several controlled entities becoming subject to our audits over the past 2 years, with further entities also expected to fall within our mandate over future years.

3. Parliament

3.1 Audit conclusions

Clear audit opinions were issued on the financial statements of parliament and my Office for the year ended 30 June 2005. Both entities met the 12-week statutory reporting requirement for 2004-05.

It is also pleasing to report that parliament has addressed many of the recommendations in our 2003 report on the Parlynet information technology upgrade project[1]. We will continue to monitor parliament's progress in this area as part of our 2005-06 financial audit.

RESPONSE provided by the Speaker of the Legislative Assembly and the President of the Legislative Council

We accept the conclusions of the report as they reflect the significant progress made by parliament in addressing issues identified in the 2003 and 2004 Parlynet audit reports.

3.2 Overview

The Parliament of Victoria comprises the Crown (represented by the Governor) and the 2 houses of parliament (the Legislative Council and the Legislative Assembly), which collectively form the legislature.

Its operations are funded from appropriations provided to each of the parliamentary departments which service the 2 houses of parliament and the associated committees, and provide administrative support to members and electorate offices. The parliamentary appropriations also provide funds for the Victorian Auditor-General's Office, the Auditor-General being an officer of parliament.

Parliament is not required by legislation to report on its administrative activities. However, under a standing arrangement with the presiding officers of both houses, my Office audits the financial statements of parliament (which comprises the financial statements of parliamentary departments) annually. These financial statements are prepared in line with the requirements of the *Financial Management Act 1994*.

The financial statements of the Victorian Auditor-General's Office are audited by auditors appointed by parliament on the recommendation of its Public Accounts and Estimates Committee.

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[1] Victorian Auditor-General's Office (2003), *Report of the Auditor-General on Parliament's information technology upgrade*, Victorian Government Printer, Melbourne.

3.3 Results of financial audits

Clear audit opinions were issued on the financial statements of parliament and the Victorian Auditor-General's Office for the year ended 30 June 2005. Figure 3A shows that both entities met the 12-week statutory reporting requirement for 2004-05.

FIGURE 3A: TIMELINESS OF AUDITED FINANCIAL STATEMENT COMPLETION, PARLIAMENT AND VICTORIAN AUDITOR-GENERAL'S OFFICE

Number of weeks after end of financial year audited financial statements were finalised	2003-04		2004-05	
	Number	Per cent (cumulative)	Number	Per cent (cumulative)
Less than 8 weeks	1	50	1	50
8 to 10 weeks	-	-	1	100
10 to 12 weeks	1	100	-	100
Total	**2**	**-**	**2**	**-**

Source: Victorian Auditor-General's Office.

As it did last year, parliament completed its audited financial statements within 8 weeks. Our Office completed its audited financial statements more promptly than the previous year, missing the 8-week mark by one day.

3.3.1 Adequacy of control environment

Each entity is required to establish and maintain an adequate system of internal controls to ensure that:

- its financial records and other information completely and accurately reflect its entire activities
- it adequately safeguards its assets
- it prevents or detects errors and other irregularities.

Our 2004-05 financial audit process for parliament confirmed that the control environment and the internal control systems that we examined, were generally satisfactory.

3.3.2 Parlynet information technology upgrade

In September 2003, we tabled a report on parliament's Parlynet information technology upgrade project[2]. The report resulted from a review requested by the Speaker of the Legislative Assembly and made recommendations about the management and oversight of the project, and about parliament's administrative structure.

In December 2004, we further reported to parliament on progress made in addressing the recommendations in our 2003 report[3]. We reported that while many of our recommendations had been addressed, some had not.

Our 2004 report noted that an Information Technology Sub-committee had been formed, a new information technology strategy drafted and a new position (Secretary, Department of Parliamentary Services) established and filled. We also noted that action had commenced to improve parliament's administrative framework and processes, including:

- the review of roles, responsibilities, policies and procedures to improve decision-making processes
- the development of a risk management framework which, at the time of preparing that report, had not been completed.

As part of this year's audit, we reviewed parliament's progress in implementing our outstanding recommendations. It was pleasing to see that numerous significant improvements had been made, building on the progress made in the previous year and providing the basis for further continuous improvement. We note particularly:

- clarification of the roles and responsibilities of information technology managers and staff, covering decision-making and the provision of advice
- implementation of the risk management framework
- approval of an information technology strategy
- adoption of information technology systems management policies and practices (based on IT Infrastructure Library[4] standards)
- appointment of a new information technology director, operations manager and security administrator

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[2] Victorian Auditor-General's Office (2003), *Report of the Auditor-General on Parliament's information technology upgrade*, Victorian Government Printer, Melbourne.

[3] Victorian Auditor-General's Office (2004), *Auditor-General's Report: Results of 30 June 2004 financial statement and other audits*, Victorian Government Printer, Melbourne.

[4] British Standards institution standard, *IT Infrastructure Library (ITIL)*, available at: <http://www.itil-itsm-world.com/>.

- development of a training program to improve technical skills
- increased customer satisfaction about the delivery of information technology services.

However, our audit noted that further improvement was needed in:

- security management practices
- regular performance monitoring to ensure optimal use of the wide-area network
- recording of software licenses in the information technology asset register
- policy development in areas such as information technology disaster recovery and business continuity planning.

Conclusion

Parliament has responded positively to the findings of our 2003 report on the Parlynet information technology upgrade, and management has demonstrated its commitment to addressing outstanding issues. We will continue to monitor parliament's progress in implementing further improvements, as part of our 2005-06 financial audit.

4. Education and Training

4.1 Audit conclusions

The Education and Training sector includes 8 agencies that had a 30 June 2005 balance date and were subject to audit by our Office[1]. We issued 8 audit opinions on the financial statements of sector agencies, all of which were clear.

We also issued 4 clear audit opinions on the financial statements of agencies within the sector with 31 December 2004 balance dates, which were recorded as outstanding in our May 2005 report *Results of financial statement audits for agencies with other than 30 June 2004 balance dates, and other audits*[2].

The timeliness of financial reporting was greatly improved on last year, with 7 of the 8 agencies with 30 June 2005 balance dates meeting the statutory reporting deadline, compared with 3 out of 7 agencies in 2003-04. Agencies were better prepared for their year-end close-off and external reporting processes and, as a result, met the reporting deadline.

Our audits found the control environments of sector agencies to be generally sound.

In 2003, the Department of Education and Training received legal advice that the state's 1 617 school councils are public statutory authorities and subject to the same reporting and auditing requirements as all other public sector agencies. The department and our Office are continuing to work towards establishing an appropriate reporting and accountability model for school councils.

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[1] The majority of agencies within this sector (including universities and TAFE institutes) have 31 December balance dates and are not covered in this report. We will report to parliament on the audit of the 2005 financial statements of these agencies in autumn 2006.

[2] Audit opinions on the financial statements of 2 other agencies with 31 December 2004 balance dates (Learningfast Inc. and International Training Australia Ltd) remained outstanding at the date of finalising this report because we had not received completed financial statements or had not completed auditing the statements.

4.2 Sector overview

The Education and Training sector comprises the Department of Education and Training and other agencies that provide, purchase and regulate education and training services for Victorians of all ages. These education and training services are delivered through schools, TAFE institutes, adult education institutions, adult and community education providers, other registered training organisations and higher education institutions. The Minister for Education and Training and the Minister for Education Services are responsible for the department. The Minister for Education and Training is responsible for the other agencies in the sector.

The majority of sector agencies (including universities and TAFE institutes) have 31 December balance dates and are not covered in this report. We will report to parliament on the audit of the 2005 financial statements of these agencies in autumn 2006.

Figure 4A shows the nature of sector agencies with a 30 June 2005 balance date.

FIGURE 4A: EDUCATION AND TRAINING SECTOR AGENCIES WITH A 30 JUNE 2005 BALANCE DATE

Reporting entity	Number
Department	1
Public bodies (a)	6
Companies (b)	1
Total	**8**

(a) Public bodies include statutory authorities such as the Adult Community and Further Education Board and the Victorian Learning and Employment Skills Commission.

(b) NMIT International Ltd (a shelf company).

Source: Victorian Auditor-General's Office.

The department provides primary and secondary education in government schools, and regulates and funds non-government schools in Victoria.

Victoria currently has 1 617 government schools providing primary and junior secondary education in the compulsory years (Prep to Year 10) and senior secondary education in the post-compulsory years (Years 11 and 12). At February 2005, there were 1 222 primary schools with 18 835 full-time equivalent (FTE) teaching staff and 261 secondary schools with 17 022 FTE teaching staff. There were also 80 special schools, 4 English language schools and 50 combined primary/secondary schools with a further 3 506 FTE teaching staff. In all, around 540 000 FTE students were enrolled in Victoria's government schools.

The other sector agencies with a 30 June 2005 balance date develop curriculum and assess schools across all year levels, provide post-compulsory education and training, accreditation of training qualifications and courses, and regulate the teaching profession.

In 2004-05, the department expended $6.5 billion on the provision of education and training in Victoria. This was around 23 per cent of the state's general government sector spending. The department managed school buildings valued at $4.4 billion and land valued at $4 billion.

Consolidation of schools' financial affairs

The department's consolidated financial statements incorporate the financial transactions and balances of the government schools operating in 2004. Schools' cash and investment balances are consolidated at 31 December, enabling audited balances to be included in the department's financial statements at 30 June of each year. All other balances of schools are determined at 30 June 2005 and are consolidated in the department's financial statements at that date.

In 2004-05, the department's financial statements included $408.5 million in school cash assets (88 per cent of the department's total cash assets) and $11.3 million of non-current school investments (100 per cent of the department's total non-current investments). At 30 June 2005, schools recorded $408.9 million in local revenue, being mostly locally raised funds.

At 30 June 2005, 120 of the 1 617 schools had transferred from cash-based to part-accrual-based accounting after implementing the new CASES21 Finance school administration computer system. This resulted in the recognition of schools' accruals in the department's financial statements for the first time. Accrued balances will increase over the next few years as all schools gradually implement the new system.

4.3 Results of financial audits

4.3.1 Audit opinions issued

The sector comprises 8 agencies that were required to prepare financial statements at 30 June 2005 and submit them for audit. We issued 8 audit opinions, all of which were clear.

We also finalised the audits of the financial statement of 4 agencies with 31 December 2004 balance dates. These statements had been incomplete at the date of finalising our May 2005 report *Results of financial statement audits for agencies with other than 30 June 2004 balance dates, and other audits.* We issued clear opinions on these financial statements.

Audit opinions on the financial statements of 2 further agencies with 31 December 2004 balance dates (Learningfast Inc. and International Training Australia Ltd) remained outstanding at the date of finalising this report because we had not received their completed statements or had not completed auditing them.

4.3.2 Timeliness of reporting

Figure 4B shows how well sector agencies with a 30 June 2005 balance date met the 12-week statutory reporting requirement for 2004-05.

FIGURE 4B: TIMELINESS OF AUDITED FINANCIAL STATEMENT COMPLETION, EDUCATION AND TRAINING SECTOR

Number of weeks after end of financial year audited financial statements were finalised	2003-04		2004-05	
	Number of agencies	Per cent (cumulative)	Number of agencies	Per cent (cumulative)
Less than 8 weeks	-	-	-	-
8 to 10 weeks	-	-	1	13
10 to 12 weeks	3	43	6	88
12 to 14 weeks	2	71	-	88
14 to 16 weeks	1	86	1	100
More than 16 weeks	1	100	-	100
Total	**7**	**-**	**8**	**-**

Source: Victorian Auditor-General's Office.

Figure 4B shows that the timeliness of agencies' reporting has greatly improved over the previous year, with 7 agencies meeting the 12-week statutory reporting deadline.

4.3.3 Quality of financial reporting

Our 2004-05 audits found that the quality of financial reporting by sector agencies continued to improve. There were fewer errors in, and omissions from, the draft statements presented to us for audit. This was mainly due to better quality assurance processes for the preparation of financial statements.

In 2004-05, agencies were required to determine whether adopting Australian equivalents of International Financial Reporting Standards would have a material impact on their financial statements. Most agencies identified no material impact. The main impacts identified by the department related to the valuation of non-current assets (due to impairment), intangible assets and employee benefit provisions.

Overall, the quality of financial statements presented for audit by sector agencies was satisfactory.

4.3.4 Adequacy of control environments

Each sector agency is required to establish and maintain an adequate system of internal controls to ensure that:

- its financial records and other information completely and accurately reflect its entire activities
- it adequately safeguards its assets
- it prevents or detects errors and other irregularities.

Our financial audit process confirmed that the control environments of sector agencies, and the internal control systems that we examined, were generally satisfactory. The department's internal auditors raised several issues around asset management controls which need attention, mainly relating to the accuracy of asset recording in its asset register and general ledger. The department is currently addressing these issues.

4.3.5 Other issues

Reporting and audit arrangements for government school councils

Each of Victoria's 1 617 government schools has a school council. School councils are set up under the *Education Act 1958*. The Act requires school councils to prepare accounts on a cash basis each calendar year and to have them audited by an approved auditor within 3 months of the end of the calendar year. The Act also requires a school council to publish an annual report of its activities and to present a statement of receipts and expenditure at a public meeting.

For some years, the Department of Education and Training has contracted private sector auditors to audit school councils. These auditors have followed a standard audit program developed by the department. The program has aimed to provide assurance about the contents of councils' cash-based accounts and internal controls, and to ensure schools complied with tax obligations and departmental requirements.

As previously commented in my December 2004 report on the *Results of 30 June 2004 financial statement and other audits*, in 2003 the Victorian Government Solicitor advised the department that school councils are public statutory authorities. This means that they are subject to the accountability and auditing provisions of the *Financial Management Act 1994* and the *Audit Act 1994*. To comply with these Acts, school councils would have to:

- prepare accounts on an accrual basis, rather than a cash basis
- have their accounts audited by the Auditor-General
- present a report of operations (including an audited financial report) to parliament.

The department considers that school councils will not be able to meet these requirements for some considerable time.

At present, schools derive most of their funding from the department. The department consolidates schools' accounts into its statutory accounts and presents these to parliament in line with the reporting requirements of the *Financial Management Act 1994*.

The department recognises the need to address government schools' reporting requirements under the *Financial Management Act 1994.* Since 2003, it has taken several steps to improve the financial accountability of schools and councils, including development of the CASES21 school administration and financial management computer system. Installation of the system's finance component (which will help schools manage their financial, payroll and asset transactions) started in July 2004, and at the date of preparing this report had been installed in some 600 schools. The department plans to fully roll-out the system by October 2006.

In light of this initiative, and given the *Education Act 1958* requirement for councils to appoint approved auditors to provide assurance about their financial affairs, I have continued to exercise the authority available to me under section 8 of the *Audit Act 1994* and dispense with audits of school councils until a longer-term solution is developed.

My Office and the department have agreed that, as interim arrangements and until a long-term solution is developed:

- school councils' financial statements will continue to be consolidated with those of the Department of Education and Training in accordance with section 53 of the *Financial Management Act 1994*
- private sector auditors will continue to audit school councils' statements of receipts and expenditure, and provide independent audit reports about those statements, in line with the requirements of the *Education Act 1958*

- the department's internal auditors will audit selected schools and focus on internal controls and resource management issues.

My Office, the Department of Education and Training and the Department of Treasury and Finance are currently considering options for a long-term solution.

Results of school council audits for 2004-05

As mentioned above, the department currently engages auditors to audit the calendar year financial statements of Victoria's 1 617 government school councils.

In 2004, the auditors issued qualified audit opinions on the 2004 financial statements of 871 school councils. Of these qualifications, 867 reflected the auditors' inability to audit cash receipts, due to the inherent risks in cash handling practices at fundraising events. Two qualified opinions arose from an inability to confirm cash receipts because some bank deposit slips were missing. The final 2 qualified opinions were due to 2 instances of unquantifiable fraud, both of which were previously known to the department. These instances related to the misappropriation of cash, and the expenditure of funds for non-school-related purposes. These resulted in the dismissal of 2 senior school staff.

The department advised us that its regional directors will follow-up issues arising from 2004 school council audits at meetings with school principals.

Recording of school operating leases

Schools are responsible for recording information about their operating leases into the School Asset Management System. The department uses this information to calculate and disclose operating lease commitments in its financial statements.

When investigating a significant increase in the value of recorded school lease commitments in 2003-04, the department discovered numerous incorrect balances. As a result, it manually reviewed lease data in 2004-05 so as to improve the accuracy of the note disclosure. This resulted in an $85.6 million reduction in initially recorded school operating lease commitments.

We have recommended to the department that it systematically review all school operating lease information during 2005-06. In addition, we recommended that it remind all schools that they are responsible for accurately inputting data into the system and reiterate the correct procedures for recording such information.

5. Human Services

5.1 Audit conclusions

The Human Services sector comprises 145 entities required to prepare financial statements at 30 June 2005 and submit them for audit. We issued 134 clear audit opinions and 7 qualified opinions. The financial statements of 4 entities had not been finalised at the date of finalising this report.

The timeliness of the sector's audited financial statements slipped a little compared with last year. Only 74 per cent of entities met the statutory 12-week completion deadline, compared with 79 per cent in 2003-04.

The financial position of health services has improved, although some still face financial difficulties. At 30 June 2005, 32 of Victoria's health services had unfavourable results for at least 2 of our indicators of financial difficulty (compared with 47 in 2003-04). The number of health services with unfavourable results for all 4 indicators fell from 10 in 2003-04 to 5 in 2004-05. The improvement resulted from extra funding provided by the Department of Human Services (DHS) and initiatives by health services.

In 2004-05, DHS provided $196 million to health services to better meet their service delivery requirements. Of this amount, $64 million was to meet increasing running costs, while $112 million was allocated for the Hospital Demand Management Strategy (HDMS) for the treatment of more patients. A further one-off funding of $20 million was provided to improve the financial position of health services.

It was announced in the *2004-05 Budget Papers* that $333 million of additional funding would be provided to public hospitals. This included the $196 million referred above and $137 million that had been provided prior to 2004-05.

Our audits of 2004-05 financial statements found that entities' control environments and their systems of internal control were generally satisfactory, although there were some major management issues that arose in relation to Melbourne Health and the Cheltenham and Regional Cemetery Trust.

5.2 Sector overview

The Human Services sector comprises the Department of Human Services (DHS) and other entities that deliver, purchase or regulate health and human services in Victoria. These services aim to enhance and protect the health and wellbeing of all people in Victoria, as well as provide particular services for people who are vulnerable and most-in-need.

DHS and other sector entities (such as health services, ambulance services, professional registration boards, public cemeteries and some statutory authorities) directly deliver services. Other services are delivered by a range of non-government organisations with funding provided by DHS. The Minister for Health, the Minister for Community Services, the Minister for Children, the Minister for Aged Care and the Minister for Housing are responsible for DHS, and each is responsible for specific sector entities.

Figure 5A shows the nature of the entities with a 30 June 2005 balance date.

FIGURE 5A: HUMAN SERVICES SECTOR ENTITIES WITH A 30 JUNE 2005 BALANCE DATE

Reporting entity	Number
Department of Human Services	1
Public bodies (a)	16
Public hospitals and ambulance services (b)	95
Companies, trusts and joint ventures (c)	19
Public cemeteries (d)	14
Total	**145**

(a) Public bodies include statutory authorities such as the Victorian Health Promotion Foundation, the Dental Practice Board of Victoria and the Nurses Board of Victoria.

(b) On 1 July 2004, Women's and Children's Health was disaggregated into The Royal Children's Hospital and The Royal Women's Hospital.

(c) Companies, trusts and joint ventures include entities controlled by public bodies or public hospitals such as charitable trusts and foundations.

(d) Public cemeteries audited by the Auditor-General are included for the first time in this report as their reporting date has changed from 31 December to 30 June.

Source: Victorian Auditor-General's Office.

DHS regulates and delivers public health services, public housing, accommodation support services, services for people with disabilities, services for the aged, services for children and other community services.

Responsibilities of other sector entities are:

- health services, which include acute inpatient, non-admitted and emergency, mental health, aged care, community health and public health services to the community
- ambulance services, which provide emergency services through the Metropolitan Ambulance Service, Rural Ambulance Victoria and the Alexandra and District Ambulance Service
- statutory authorities, such as the Victorian Health Promotion Foundation, Health Purchasing Victoria and the Infertility Treatment Authority
- registration boards, which register a range of health professionals such as medical practitioners, nurses, optometrists, pharmacists, physiotherapists, Chinese medicine practitioners, dental practitioners, chiropractors, osteopaths and podiatrists
- public cemeteries, which provide burial and cremation services and manage cemetery trusts and land.

In 2004-05, DHS expended $9.9 billion on the provision of human services in Victoria. This was 36 per cent of the state's general government sector spending. It included $5.8 billion for acute health and mental health services, 9.3 per cent more than the 2003-04 budget.

In 2004-05:

- legislation was passed to make governance and accountability arrangements consistent across all metropolitan and large regional public health services, and to introduce governance and accountability arrangements for ambulance services
- significant additional funding was provided for health services
- a new public-private sector partnerships hospital (Casey Hospital) was opened
- the redevelopment of the Austin Hospital (including the relocation of the Mercy Hospital for Women) was completed
- a new Office for Children was established within DHS.

5.3 Results of financial audits

5.3.1 Audit opinions issued

The Human Services sector comprises 145 entities that were required to prepare financial statements at 30 June 2005 and submit them for audit. We issued 134 clear audit opinions and 7 qualified opinions (which are detailed in Figure 5B). The financial statements of 4 entities had not been finalised at the date of preparing this report.

FIGURE 5B: HUMAN SERVICES SECTOR, QUALIFIED AUDIT OPINIONS

Entity	Reason for qualification
Bass Coast Regional Health Benefit Fund Trust	Non-compliance of financial report with certain requirements of statements of accounting concepts and applicable accounting standards.
Calvary Health Care Bethlehem Limited	Inability to verify the value of assets and liabilities arising from DHS grants receivable.
	Non-compliance with AASB1040: *Statement of Financial Position* for the recognition of net assets received from predecessor entity.
Queen Elizabeth Centre	Failure to consolidate the financial statements of a controlled entity - the Queen Elizabeth Centre Foundation.
Mercy Public Hospital Inc.	Failure to consolidate the financial statements of the controlled entities Werribee District Hospital Charitable Foundations Nos. 1 and 2.
Royal Women's Hospital Foundation Trust Funds	Inability to verify the completeness of cash donations.
St Vincent's Hospital (Melbourne) Limited	Understatement of receivable arising from financing arrangements for the original redevelopment of the hospital.
Trustees of the Fawkner Crematorium Memorial Park	Value assigned to land understated in the Statement of Financial Position.

Source: Victorian Auditor-General's Office.

We removed last year's qualification for Wodonga Regional Health Service (non-compliance with an AAS 15 *Revenue* requirement for the recognition of grant revenues) after resolving the issue giving rise to the qualification.

5.3.2 Timeliness of reporting

Figure 5C shows how well entities with 30 June 2005 balance dates met the 12-week statutory reporting requirement for 2004-05.

FIGURE 5C: TIMELINESS OF AUDITED FINANCIAL STATEMENT COMPLETION, HUMAN SERVICES SECTOR

Number of weeks after end of financial year audited financial statements were finalised	2003-04		2004-05	
	Number of entities	Per cent (cumulative)	Number of entities	Per cent (cumulative)
Less than 8 weeks	8	6	13	9
8 to 10 weeks	16	19	31	30
10 to 12 weeks	75	79	64	74
12 to 14 weeks	19	94	18	87
14 to 16 weeks	3	97	12	95
More than 16 weeks (a)	4	100	7	100
Total	**125**	**-**	**145**	**-**

(a) Includes the financial statements of 4 entities that had not been completed at the date of finalising this report.

Source: Victorian Auditor-General's Office.

Figure 5C shows that, while the audited financial statements of certain entities were finalised earlier, overall, the proportion of entities completing their audited financial statements within the statutory 12-week deadline fell. In 2004-05, 74 per cent of entities met the statutory 12-week completion deadline compared with 79 per cent in 2003-04.

Some entities did not meet the statutory deadline because:

- approximately 10 entities had statements ready within the timeframe, but we were unable to complete our audits within the 12-week time frame
- they did not adequately plan and/or resource their financial statement preparation process.

As in past years, the rural health services that outsourced the preparation of their financial statements to accounting firms completed their financial statements in a more timely manner.

RESPONSE provided by the Secretary, Department of Human Services

A more appropriate comparison is 74 per cent of agencies in 2004-05 completing their statements within the 12 week completion deadline and 74 per cent (not 79 per cent) in 2003-04. Audit did not adjust the 2003-04 result for the introduction of additional entities such as cemeteries.

5.3.3 Quality of financial reporting

Our 2004-05 audits found that the quality of financial reporting by sector entities was lower than it was last year. This appeared to be because certain entities took less care preparing their financial statements.

Entities were required to report in their 2004-05 statements the impacts of the new Australian equivalents to International Financial Reporting Standards (A-IFRS) and disclose any material impacts in a separate note which reconciled the Australian accounting standards (AGAAP) and A-IFRS balances.

Our audits noted that the main impacts of the new standards on health services were around changes to the recognition of employee benefits, impairment of assets and reclassification of investment properties.

5.3.4 Financial performance and position of health services

In previous reports to parliament, we have assessed the financial position of Victoria's health services and the steps taken by DHS to address the financial difficulties some of them have faced. We undertook a similar assessment for 2004-05. Figure 5D shows the financial indicators we used to assess the financial position and performance of health services.

FIGURE 5D: INDICATORS USED TO ASSESS THE FINANCIAL POSITION AND PERFORMANCE OF HEALTH SERVICES

Indicator	Notes
1. Operating result for the year	A deficit results if revenues do not cover operating costs. Ongoing deficits may indicate underfunding or an inability to contain costs.
2. Operating result (excluding capital grants, depreciation and amortisation, and other specific items) (a)	Health services are given a grant when an asset needs to be replaced, rather than funds to match the depreciation expense. This causes fluctuations in operating results because grants rise and fall from year-to-year. Other specific items incorporated in the operating result include other capital-purpose income, interest earned on capital fund, proceeds from the sale of assets, assets received free of charge, the written-down value of assets sold, and other specific abnormal revenue or expense items. Excluding capital grants, depreciation and amortisation, and other specific items normalises the operating result.
3. Net cash flows from operating activities (excluding capital grants)	In accordance with accounting standards, capital grants that are not classed as capital contributions (i.e. equity injections), are classified as operating cash inflows, whereas the resultant outflows are classified as investing activities. Excluding these grants normalises the net cash flows from operating activities.
4. Working capital ratio	This is the ratio of current assets to current liabilities. A working capital ratio of less than one may suggest that a health service will not be able to meet its financial obligations as and when they fall due.

(a) In 2003-04, only capital-purpose income grants were excluded from indicator 2.

Source: Victorian Auditor-General's Office.

Aggregate financial standing of health services

Our assessment for 2004-05 indicated that the aggregate financial standing of health services had improved significantly on past years with a reduction in the total operating deficit and a slight increase in the working capital ratio. This improvement was because of extra funding provided by DHS and initiatives by health services.

Our assessment revealed that:

- 5 health services had unfavourable results for all 4 indicators (compared with 10 health services in 2003-04)
- a further 27 health services had unfavourable results for at least 2 indicators.

Figure 5E summarises the aggregate financial standing of all health services at 30 June 2005 compared with a year earlier. See Figure 5D for notes to the indicators.

FIGURE 5E: AGGREGATE FINANCIAL STANDING OF ALL HEALTH SERVICES, AS AT 30 JUNE 2005

Item/indicator		30 June 2004	30 June 2005
Revenue	($m)	6 251	6 796
Expenditure	($m)	(6 291)	(6 742)
Operating surplus/(deficit)	($m)	(40)	54
Operating result/(deficit) excluding capital grants, depreciation and amortisation, and other specific items (a)	($m)	(33)	21
Net cash flows from operating activities, excluding capital income	($m)	(b) 19	63
Working capital -			
Current assets less current liabilities	($m)	(174)	(175)
Ratio	(Current assets/ current liabilities)	0.83	0.84

(a) In December 2004, we reported an operating deficit of $266 million. For comparison purposes, we have adjusted this figure to exclude depreciation and amortisation or other specific items.

(b) In December 2004, we reported net cash flows from operating activities, excluding operating income, of $155 million. This figure was revised to $19 million, following further analysis of health services' financial results.

Source: Victorian Auditor-General's Office.

As Figure 5E shows, total revenue from government and other sources increased by $545 million (or about 9 per cent) in 2004-05. This included once-off funding of $20 million provided to certain health services at the end of the year. The purpose of this funding was to assist the health services reduce their operating deficits.

Financial standing of individual health services

Figure 5F shows the health services that we consider were operating with financial difficulties (with unfavourable results for all 4 indicators) at 30 June 2005.

FIGURE 5F: HEALTH SERVICES OPERATING WITH FINANCIAL DIFFICULTIES AT 30 JUNE 2005 ($'000)

Health service	Operating result – surplus (deficit)		Operating result excluding capital grants, depreciation & amortisation and other specific items		Net cash inflows (outflows) from operating activities (excluding capital grants)		Working capital ratio	
	2003-04	2004-05	2003-04	2004-05	2003-04	2004-05	2003-04	2004-05
Metropolitan hospitals -								
Northern Health	(4 759)	(7 539)	(1 994)	(3 594)	(1 776)	(4 530)	0.61	0.40
Southern Health (a)	(25 806)	(2 822)	(18 555)	(5 480)	(34 576)	(29 470)	0.47	0.64
Regional and rural hospitals -								
Bendigo Health Care Group (a)	(94)	(3 203)	621	(2 943)	1 223	(3 663)	0.89	0.63
Mansfield District Hospital (b)	(1 130)	(341)	(1 268)	(230)	170	(108)	0.62	0.61
Wodonga Regional Health Service	(3 682)	(2 916)	(1 627)	(1 124)	443	(2 488)	0.46	0.35

(a) Consolidated figures for hospital and controlled entities.

(b) The net cash outflow from operating activities for Mansfield District Hospital does not exclude capital grants as these were not separately disclosed.

Source: Audited financial statements of health services.

Five health services faced financial difficulties in 2004-05, which is an improvement on the 10 that faced financial difficulties in 2003-04. The 5 were:

- Northern Health and Bendigo Health Care Group, the financial position of both deteriorated for all 4 indicators in 2004-05
- Mansfield District Hospital and Wodonga Regional Health Service, both of which improved against 2 indicators and deteriorated for 2 indicators
- Southern Health, the financial position of which improved for all 4 indicators in 2004-05.

A further 27 health services had unfavourable results for either 2 or 3 of the indicators. Of these 27 health services, 5 faced financial difficulty (unfavourable results against all 4 indicators) in 2003-04, but their financial position improved in 2004-05.

Initiatives to improve the financial standing of health services

Following a review in 2003 of public hospital governance arrangements, amendments to the *Health Services Act 1988* came into effect on 1 July 2004 to make governance and accountability arrangements consistent across all metropolitan and 5 large regional public health services. These revised arrangements require a health service to prepare an annual statement of priorities outlining its performance expectations and targets for the year. The statement also summarises (and is supported by) the service's main planning, financial, performance reporting and accountability statements.

Health services that report poor operating positions or cash management issues are required to submit detailed financial recovery plans and budgets. These plans must include initiatives to increase revenue and reduce costs (by improving efficiencies and economies of scale) such as:

- improving revenue from patients' private health insurance
- improving revenue from the Commonwealth Government by providing aged care services
- reducing occupational health and safety costs
- reviewing purchasing strategies to reduce costs.

In 2004-05, DHS provided $196 million to health services to better meet their service delivery requirements. Of this amount, $64 million was to meet increasing running costs, while $112 million was allocated for the Hospital Demand Management Strategy (HDMS) for the treatment of more patients[1]. A further one-off funding of $20 million was provided to improve the financial position of health services.

It was announced in the *2004-05 Budget Papers* that $333 million of additional funding would be provided to public hospitals. This included the $196 million referred above and $137 million that had been provided prior to 2004-05.

DHS has advised that the HDMS was implemented to address the increasing demand pressures in the following ways:

- funding targeted growth in the activity performed within hospitals
- substitution through expansion of non-bed-based models of care
- encouraging clinical practice change to achieve best practice
- funding the Hospital Admission Risk Program (HARP) to improve health outcomes and reduce the avoidable use of hospitals
- providing improved working conditions that attract and retain nurses
- expanding opportunities for people to access elective surgery.

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[1] Of the $112 million, $44 million was accessed by Southern Health, including funding for the new Casey Hospital.

In 2004-05, 20 (15 metropolitan and 5 major regional) health services were required to prepare statements of priorities. We analysed the 2004-05 operating results of these 20 services against the targets in their statements of priorities and found that 11 of the 20 had exceeded their targeted operating result. Nine health services achieved an operating surplus for the year, compared with 6 in 2003-04.

Seven of the 20 services had developed financial recovery plans, 5 of whose financial performance exceeded their recovery plan targets.

DHS advised the improved planning and monitoring processes required to develop statements of priorities, and detailed financial plans and financial recovery plans helped to improve the financial positions of health services.

In 2005-06, we plan to undertake a detailed review of the key factors that affect public hospital financial sustainability, and DHS' management and monitoring of public hospital performance. The results of this work are expected to be reported to parliament in autumn 2006.

RESPONSE provided by the Secretary, Department of Human Services

The overall performance of the health sector improved significantly in 2004-05 when compared to 2003-04. This has been due in part to financial support provided by the department, but also due to a range of improved governance arrangements implemented by the department and initiatives by health services. As a consequence, the report confirms the number of health services reporting unfavourable results in accordance with the Auditor-General's indicators has declined.

5.3.5 Adequacy of health services' control environments

Each sector entity is required to establish and maintain an adequate system of internal controls to ensure that:

- its financial records and other information completely and accurately reflect its entire activities
- it adequately safeguards its assets
- it prevents or detects errors and other irregularities.

Our audit process confirmed that the control environments of sector entities, and the internal control systems that we examined, were generally satisfactory.

However, the following initiatives would improve internal controls and accountability:

- formalisation of shared service arrangements to provide clarity on roles, responsibilities and deliverables
- external comfort letters for outsourced IT and payroll services that give assurance over internal controls at the service providers
- due diligence check lists presented by chief financial officers to audit committees that confirm the steps undertaken to ensure that financial statements comply with accounting standards and other legislative reporting requirements.

5.4 Other significant issues

5.4.1 Melbourne Health investigation

In 2005, the management of Melbourne Health discovered errors and other anomalies totalling $17.2 million which originated in, and were limited to, the north-west mental health division of Melbourne Health. As a consequence, Melbourne Health's 2003-04 financial statements overstated revenue and receivables by $6.6 million. Melbourne Health highlighted and corrected this overstatement in its 2004-05 financial statements.

In May 2005, 3 separate and independent investigations into this matter were finalised. They found that the errors and other anomalies:

- commenced in July 2003 and continued until March 2005
- related to over-accrual of revenue and deferral of prior period expenditure
- did not result in a loss to Melbourne Health of any cash or physical assets, nor in any personal financial gain for the individuals involved.

The investigations identified the individual responsible for creating the erroneous accounting entries and found that:

- the individual was acting without authority
- Melbourne Health governance and monitoring functions had failed to identify the anomalies.

The individual responsible for these erroneous accounting entries left Melbourne Health prior to the discovery of the errors. The matter has been referred to Victoria Police.

This investigation has highlighted the need for vigilance by board directors, executive staff, managers, internal auditors and external auditors. Key lessons include the need to ensure appropriate reporting of financial information to boards and that movements in the financial statements are rigorously analysed.

5.4.2 Rural health information and communication technology alliances

In 1997-98, the Department of Human Services (DHS) established 5 information and communication technology (ICT) alliances, to plan and deliver ICT services to public health services in Victoria's rural regions. The alliances were Gippsland Health Alliance (GHA), Grampians Health ICT Alliance (GHICTA), the Hume Alliance (now HumeNET Ltd), Loddon Mallee Health Alliance (now LMHA Network Ltd) and South West Alliance of Rural Health (SWARH).

The alliances are responsible for rolling out *healthSMART*[2] initiatives. This will include replacing obsolete software and hardware, and by providing central ICT services throughout the system.

The 5 rural health ICT alliances operate under different corporate structures. These are:

- joint venture agreements (SWARH and GHA)
- a memorandum of understanding (GHICTA)
- companies limited by guarantee (HumeNET Ltd and LMHA Network Ltd).

As a consequence of the different corporate structures, each rural public health service has accounted for its interest in an alliance in one of the following ways:

- by equity accounting (that is, they have recognised their share of the alliance's assets, liabilities and net result in their financial statements)
- as an investment, in their statement of financial position
- as a debtor, in their statement of financial position
- as a gift (that is, by writing-off the debtor or investment in the joint venture) to the incorporated entity/alliance, with a note in their financial statements stating this.

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[2] *health*SMART is an initiative to standardise information and communication technology within the public health care system.

DHS needs to provide guidance to the health services on the appropriate accounting treatment under each alliance structure.

In addition, while the Auditor-General is responsible for the audit of the alliances, they are not subject to financial reporting provisions of the *Financial Management Act 1994*. Therefore, there is no requirement to provide the annual financial statements to the responsible minister for tabling in parliament.

Recommendation

5.1 That all information and communication technology alliances be made subject to the financial reporting and accountability requirements of the *Financial Management Act 1994.*

RESPONSE provided by the Secretary, Department of Human Services

Recommendation partially accepted. The department notes the recommendation and supports improved and more consistent governance and accountability for rural health ICT alliances. The department is currently reviewing rural health ICT alliance governance arrangements and will implement more appropriate governance and financial accountability arrangements during 2005-06.

5.4.3 Review of Victorian cemetery trusts' governance, financial management and expenditure

In response to a departmental request, we reported in May 2005 on an audit of the Cheltenham and Regional Cemetery Trust. My report - *Results of special reviews and other investigations* - noted:

- inadequacies in governance processes
- improper use of trust funds
- failure to observe expenditure policies and guidelines
- failure to maintain adequate security over fixed assets.

In May 2005, I agreed to a request by the secretary to DHS to review the governance, financial management and expenditure of all other public cemetery trusts, which are required to comply with the *Financial Management Act 1994*.

The review is examining whether these 13 cemetery trusts established and complied with adequate corporate governance, financial management, asset management, and expenditure policies and procedures. It is also examining the extent to which trusts have complied with the requirements of the *Financial Management Act 1994*, the *Cemeteries Act 1958* (replaced by the *Cemeteries and Crematoria Act 2003*, effective from 1 July 2005) and with the Minister for Finance's directions.

The review will cover the 18-month period from 1 January 2004 to 30 June 2005.

At the time of finalising this report, work was well underway on this review. We expect to report to parliament in the 2006 autumn session.

6. Infrastructure

6.1 Audit conclusions

The Infrastructure sector comprises 22 agencies that were required to prepare financial statements at 30 June 2005 and submit them for audit. We issued 21 audit opinions, all of which were clear. The financial statements of one agency (Victorian Urban Development Authority) were incomplete at the date of preparing this report.

Compared with the previous year, agencies in this sector were far more timely in completing their 2004-05 financial statements. Ninety-one per cent of agencies met the 12-week deadline, compared with 22 per cent for 2003-04. This was a substantial improvement in agency compliance with this requirement.

Our audits of 2004-05 financial statements again confirmed that overall agency control environments and their systems of internal control were generally satisfactory.

One company (Victorian Rail Services Pty Ltd) did not finalise its 2003-04 financial statements until September 2005. Consequently, its annual report for that year was not tabled in parliament until October 2005, some 12 months after the legislated tabling deadline. This company also failed to meet its tabling deadline for its 2002-03 annual report.

The Victorian output appropriation framework is based on a purchaser/provider model. Under the model, the Treasurer (on behalf of the government) only makes appropriation revenue available to departments after they deliver the agreed outputs. However, in 2004-05, the Department of Infrastructure (DoI) received $263 million in output appropriation funding ($169 million in 2003-04) before delivering the services for which the appropriation was made. It then transferred this amount into 2 accounts within the Trust Fund, and had not spent it by 30 June 2005.

The drawing-down of output appropriation funding from the Consolidated Fund before it is required to meet the department's cash flow needs is not consistent with the Department of Treasury and Finance's business rules. Further, some of DoI's related 2004-05 output performance measures may not have fully complied with the Department of Treasury and Finance's business rules. The business rules require the creation of performance measures which can be used to assess whether departmental outputs have been delivered in terms of quantity, quality and timeliness.

DoI has revised some of its output performance measures for 2005-06. We intend to review the output performance measures that are used to certify the outputs of selected departments (including DoI).

RESPONSE provided by the Secretary, Department of Infrastructure

Victorian Rail Services Pty Ltd

Victorian Rail Services Pty Ltd (VRS) was a company established as a subsidiary of the Department of Infrastructure after the withdrawal of National Express from the provision of public transport services in Victoria. VRS was created to assist with the administration of public transport services during the receivership period. The financial statements have now been tabled and the company has since been liquidated and will no longer report to parliament. The department recognises that the financial statements of VRS should have been independently tabled, however, the VRS financial results were included as a note in the Department of Infrastructure's financial statements in 2003-04.

Application of parliamentary appropriations

In relation to the comments on the application of parliamentary appropriations, the department has met all the requirements agreed between the department and the Treasurer to receive output funding in accordance with the Financial Management Act 1994. Equally, the Treasurer has certified outputs and provided the funding to the department.

Funding received relates to committed projects, which is held in the Better Roads Victoria Trust Fund and the Public Transport Trust Fund, and cash remains in the Public Account until it is required to meet commitments.

As I understand it, differences of view between your report and my response will be fully explored through your intended review of output performance measures across government.

6.2 Sector overview

The Infrastructure sector comprises the Department of Infrastructure (DoI) and 21 other agencies with 30 June 2005 balance dates. These agencies provide transport, energy and major project (including property development) services. DoI and the agencies support 4 ministerial portfolios: transport, major projects, information and communication technology, and energy industries.

Figure 6A shows the nature of sector agencies with a 30 June 2005 balance date.

FIGURE 6A: INFRASTRUCTURE SECTOR AGENCIES WITH A 30 JUNE 2005 BALANCE DATE

Reporting entity	Number
Department	1
Public bodies (a)	11
Companies, trusts and joint ventures	10
Total	**22**

(a) Excludes the Office of Gas Safety and the Office of the Chief Electrical Inspector, whose balance dates were extended to 9 August 2005 due to their merger to form a new agency, Energy Safe Victoria.

Source: Victorian Auditor-General's Office.

DoI, in its own right, or through the other agencies and private sector providers, is responsible for Victoria's road and rail transport services and infrastructure, for ports and marine facilities and services, for information and communication technology policy, for energy policy, for large-scale development and construction projects, and for the security of essential infrastructure.

In 2004-05, sector agencies:

- managed property, plant and equipment valued at $25.3 billion ($23.4 billion in 2003-04)
- had interest-bearing liabilities of $1 250 million ($1 100 million in 2003-04)
- spent $763 million on the subsidisation of rail services ($973 million in 2003-04)
- spent $725 million on roads ($735 million in 2003-04)
- spent $494 million on the subsidisation of bus services ($462 million in 2003-04).

6.2.1 Changes in sector agencies in 2004-05

Victorian Railway Heritage Operations Pty Limited was registered in July 2004. The company's principal activities in 2004-05 were to provide labour (through V/Line Passenger Pty Ltd) for 3 mainline heritage train operators, and to obtain accreditation to operate a passenger train network under the *Transport Act 1983*.

In November 2004, the directors of Victorian Rail Services Pty Limited (a subsidiary of DoI) placed the company into voluntary liquidation. The liquidators made the final distribution of the company's assets in May 2005 and then wound-up the company. Consequently, the company's 2004-05 financial report was its last.

In December 2001, the government announced it would make special power payments to householders, small business and farmers in outer suburban, regional and rural areas, through the Special Power Payments Trust Fund. Payments were to subsidise their consumption of power up to March 2003. In January 2005, after all claims and creditors were paid, the remaining balance of the Special Power Payments Trust Fund was refunded to DoI and the fund wound-up. Consequently, the trust's 2004-05 financial report was its last report.

In August 2005, the Office of Gas Safety and the Office of the Chief Electrical Inspector merged to form Energy Safe Victoria, pursuant to the *Energy Safe Victoria Act 2005*. These agencies were not required to prepare financial statements as at 30 June 2005 as their balance date was extended to 9 August 2005.

6.3 Results of financial audits

6.3.1 Audit opinions issued

The sector comprises 22 agencies (23 in 2003-04) that were required to prepare financial statements at 30 June 2005 and submit them for audit. We issued 21 audit opinions, all of which were clear. The financial statements of one sector agency (Victorian Urban Development Authority) were incomplete at the date of preparing this report.

Last year, we included "emphasis-of-matter" comments in our 2003-04 audit reports on the financial statements of the Special Power Payments Trust Fund, Victorian Rail Services Pty Limited and the Network Tariff Rebate Trust Fund. These comments were made to draw attention to the fact that the agencies did not prepare their financial reports on a going-concern basis. We removed these comments from our 2004-05 audit reports because:

- the Special Power Payments Trust Fund and Victorian Rail Services Pty Ltd financial statements for 2004-05 were their last, as both agencies were wound-up during the year and this was disclosed in their final accounts

- the Network Tariff Rebate Trust Fund prepared its 2004-05 financial statements on a going concern basis, because the government extended the operation and funding of the scheme for an additional 3 years (to March 2008).

6.3.2 Timeliness of reporting

Figure 6B shows how well sector agencies, with a 30 June 2005 reporting balance date, met the 12-week reporting requirement for 2004-05.

FIGURE 6B: TIMELINESS OF AUDITED FINANCIAL STATEMENT COMPLETION, INFRASTRUCTURE SECTOR

Number of weeks after end of financial year audited financial statements were finalised	2003-04		2004-05	
	Number of agencies	Per cent (cumulative)	Number of agencies	Per cent (cumulative)
Less than 8 weeks	-	-	14	64
8 to 10 weeks	1	4	5	86
10 to 12 weeks	4	22	1	91
12 to 14 weeks	7	52	1	95
14 to 16 weeks	2	61	-	95
More than 16 weeks (a)	9	100	1	100
Total	**23**	**-**	**22**	**-**

(a) Includes one agency (Victorian Urban Development Authority) that had not finalised its 2004-05 financial statements at the date of preparing this report.

Source: Victorian Auditor General's Office.

Figure 6B shows a substantial turnaround in the timeliness of sector agencies' 2004-05 audited financial reports. Ninety-one per cent of agencies met the 12-week deadline, compared with only 22 per cent in the previous year. This was a very significant achievement by sector agencies and by my Office in better managing the process of finalising these financial statements.

The improvement was led by DoI. The department managed to finalise its financial statements almost 2 months earlier than the previous year, and well before the statutory financial reporting deadline.

The Victorian Urban Development Authority's financial report was delayed beyond the 12-week deadline, and beyond the target date for completion set by the Department of Treasury and Finance (DTF) for "material entities". This was mainly due to the need to resolve certain reporting issues arising from the authority's designation[1] as a "for-profit entity" under Australian equivalents to International Financial Reporting Standards.

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[1] Under Financial Reporting Direction 108 (FRD 108 *Classification of entities as for profit*), issued by the Department of Treasury and Finance in June 2005.

6.3.3 Quality of financial reporting

The quality of sector agency 2004-05 financial reports was generally satisfactory.

6.3.4 Adequacy of control environments

Each agency is required to establish and maintain an adequate system of internal controls to ensure that:

- its financial records and other information completely and accurately reflect its entire activities
- it adequately safeguards its assets
- it prevents or detects errors and other irregularities.

The assessment of agency governance and financial control processes is an important aspect of our financial audit process.

Our 2004-05 financial audit process confirmed that the overall control environments of sector agencies, and the systems of internal control that we examined as part of conducting our audits, were generally satisfactory. However, we considered that some information technology controls at DoI and at the Melbourne Port Corporation could be strengthened. These agencies have indicated that they are taking steps to strengthen those information technology controls.

6.3.5 Other significant issues requiring attention

Non-presentation of annual report in parliament

The *Financial Management Act 1994* requires a company incorporated under the *Corporations Act 2001* that has all its shares owned by, or on behalf of, the state to submit an annual report (including its audited financial statements) to the relevant minister as soon as practicable after the end of each financial year.

The Act also requires the relevant minister to table the annual report in parliament on or before 31 October each year. If the minister does not receive the annual report in time to table it by 31 October, the minister must report this to parliament and table the report as soon as practicable after it is received.

Our December 2004 report, *Results of 30 June financial statement and other audits*, noted that the 2002-03 annual reports of 7 companies were not tabled in parliament until November 2004. These annual reports should have been tabled up to 12 months earlier. Our report also noted that the reasons for the delays in tabling the annual reports had not been explained to parliament.

The 2003-04 annual reports of 6 of the 7 companies were tabled in parliament on 3 November 2004, which is consistent with the requirements of the Financial Management Act. However, the 2003-04 annual report of the remaining company (Victorian Rail Services Pty Ltd) was not tabled in parliament until 27 October 2005. This annual report should have been tabled in parliament some 12 months earlier (before 31 October 2004). We also point out that our audit report on the company's 2003-04 financial statements contained an emphasis-of-matter comment to draw attention to the fact that its financial report had not been prepared on a going-concern basis.

In conclusion, the annual reporting obligations of Victorian Rail Services Pty Ltd for 2003-04 under the *Financial Management Act 1994* were again not met. Consequently, its accountability to parliament was again diminished. Nevertheless, the company's annual report for 2004-05 was tabled in parliament on 27 October 2005, which was in accordance with the requirements of the Act.

Application of parliamentary appropriations

The Victorian output appropriation framework is based on a purchaser/provider model. A key principle embodied in this framework is that appropriation revenue is only made available, by the Treasurer on behalf of the government, to departments once outputs are delivered.

In 2004-05, DoI received $263 million in output appropriation funding ($169 million in 2003-04) before delivering the services for which the appropriation was made. It then transferred this amount into 2 accounts within the Trust Fund, and had not spent the funds by 30 June 2005.

The funding comprised $211 million ($92 million in 2003-04) transferred into the Better Roads Victoria Trust Account and $52 million ($77 million in 2003-04) transferred into the Public Transport Fund.

DoI expects to spend the appropriated funds in accordance with the purposes of the trust funds, that is to construct and maintain roads (from the Better Roads Victoria Trust Account) and on public transport (from the Public Transport Fund). At 30 June 2005, DoI had not incurred expenditure equivalent to these balances.

The output appropriation framework is supported by the Minister for Finance's Standing Direction 4.4, issued pursuant to the *Financial Management Act 1994*. The standing direction sets out the required performance management and evaluation arrangements which departments must establish, which are used to make an assessment of a department's performance in the delivery of outputs.

The standing direction requires that departments must set output performance targets and indicators in accordance with the business rules in the budget and financial management guidance documents issued by DTF. The business rules require the creation of performance measures which can be used to assess whether departmental outputs have been delivered in terms of quantity, quality and timeliness.

We considered that some of DoI's 2004-05 output performance measures could have been set with a greater degree of specification. For example, regional road project performance measures for 2004-05 included the numbers of projects commenced, in progress and completed during the year. It is our view that the performance measures could have included the number of lane kilometres completed for such projects. This would have enabled the output and the expenditure incurred for it to be more closely aligned.

In conclusion, the drawing-down of output appropriation funding from the Consolidated Fund before it is required to meet a department's cash flow obligations, is not consistent with DTF's business rules. In our opinion, some of DoI's 2004-05 output performance measures may not have fully complied with the business rules issued by DTF. The business rules require the creation of performance measures which can be used to assess whether departmental outputs have been delivered in terms of quantity, quality and timeliness.

We noted that DoI had revised some of its output performance measures for 2005-06. We intend to undertake a review across selected departments (including DoI) of output performance measures published in the government's budget papers and agency annual reports, and compare them with the measures that are used to certify the outputs.

7. Innovation, Industry and Regional Development

7.1 Audit conclusions

The Innovation, Industry and Regional Development sector comprises 9 agencies that were required to prepare financial statements at 30 June 2005 and submit them for audit. We issued 8 audit opinions, all of which were clear. The financial statements of one sector agency (VCPO Limited[1]) were incomplete at the date of finalising this report.

All sector agencies (except for VCPO Limited) completed their audited financial statements within the 12-week deadline. In 2003-04, 2 agencies did not meet the deadline.

Our 2004-05 audits again confirmed that agencies' overall control environments and their systems of internal control were generally satisfactory. The quality of financial reporting by sector agencies was also generally satisfactory.

In recent years, the Department of Innovation, Industry and Regional Development (DIIRD) has not fully utilised the parliamentary appropriations available to it. DIIRD continues to underspend its budget – in 2004-05 by $70 million (15 per cent of the available appropriation), compared with $80 million (or 18 per cent) in 2004. DIIRD has taken steps to examine its processes with a view to improving the management of its budget.

RESPONSE provided by the Secretary, Department of Innovation, Industry and Regional Development

The department's underspend in parliamentary appropriations is primarily related to grants to organisations. Many of these grants are strategic in nature and have significant milestones related to the payments. Where milestones are not achieved within the financial year, the payments are not made, however the commitment for these grants is included as part of the department's annual report.

The department continues its investment in improving the process to manage its overall budget. Grants expenditure is a very high priority given it is a significant part of the department's budget. Further improvements in this area will be implemented to ensure the underspent parliamentary appropriations continue to decline.

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[1] VCPO Limited was formally known as the Overseas Projects Corporation of Victoria Ltd. The company changed its name in January 2005.

7.2 Sector overview

The Innovation, Industry and Regional Development sector comprises the Department of Innovation, Industry and Regional Development (DIIRD) and 8 other agencies. These agencies support 7 ministerial portfolios, being state and regional development, industrial relations, innovation, manufacturing and export, financial services industry, small business and tourism.

Figure 7A shows the nature of sector agencies with 30 June 2005 balance dates.

FIGURE 7A: INNOVATION, INDUSTRY AND REGIONAL DEVELOPMENT SECTOR AGENCIES WITH A 30 JUNE 2005 BALANCE DATE

Reporting entity	Number
Department	1
Public bodies	5
Companies, trusts and joint ventures	3
Total	**9**

DIIRD is the lead agency for economic and regional development in Victoria. The other sector agencies operate in the tourism industry, stage the Australian Formula 1 and Motorcycle Grand Prix events, and manage Federation Square in the Melbourne central business district.

DIIRD is one of the smaller government departments. In 2004-05, it had annual operating expenditure of $334 million, compared with $311 million in 2003-04.

In 2004-05:

- the department provided grants of about $229 million to private and public sector organisations, compared with $211 million in 2003-04
- Fed Square Pty Ltd[2] managed assets valued at about $470 million
- the Australian Grand Prix Corporation generated about $58 million in ticket sales and sponsorship revenue ($56 million in 2003-04).

[2] Fed Square Pty Ltd was formally known as Federation Square Management Pty Ltd. The company changed its name in May 2005.

7.3 Results of financial audits

7.3.1 Audit opinions issued

The sector comprises 9 agencies that were required to prepare financial statements at 30 June 2005 and submit them for audit. We issued 8 audit opinions, all of which were clear. The financial statements of one sector agency (VCPO Limited) were incomplete at the date of preparing this report.

Our 2003-04 audit report on VCPO Limited (which was then known as the Overseas Projects Corporation of Victoria Ltd) included an "emphasis-of-matter" comment to point out that the company did not prepare its financial report on a going-concern basis but on a liquidation basis. This was because the company was being prepared for voluntary liquidation in 2004-05.

The emphasis-of-matter comment may no longer be required if the company prepares final financial statements for 2004-05, after having been wound-up. We will review our position on this matter after the company presents its 2004-05 financial statements for audit.

7.3.2 Timeliness of reporting

Figure 7B shows how well sector agencies with a 30 June reporting date met the 12-week reporting requirement for 2003-04 and 2004-05.

FIGURE 7B: TIMELINESS OF AUDITED FINANCIAL STATEMENT COMPLETION, INNOVATION, INDUSTRY AND REGIONAL DEVELOPMENT SECTOR

Number of weeks after end of financial year audited financial statements were finalised	2003-04		2004-05	
	Number of agencies	Per cent (cumulative)	Number of agencies	Per cent (cumulative)
Less than 8 weeks	1	11	1	11
8 to 10 weeks	3	44	3	44
10 to 12 weeks	3	78	4	89
12 to 14 weeks	2	100	-	89
14 to 16 weeks	-	100	-	89
More than 16 weeks [(a)]	-	100	1	100
Total	**9**	**..**	**9**	**..**

(a) The 2004-05 results include one agency (VCPO Limited) that had not finalised its financial statements at the date of preparing this report.

Source: Victorian Auditor-General's Office.

As Figure 7B shows, all sector agencies (except for VCPO Limited) completed their audited financial statements within the 12-week deadline. In 2003-04, 2 agencies did not meet the deadline.

It is pleasing to recognise the commendable achievement of the sector's agencies in the timely preparation of their financial reports for 2004-05.

7.3.3 Quality of financial reporting

The quality of sector agencies' 2004-05 financial reports was generally satisfactory.

7.3.4 Adequacy of control environments

Each sector agency is required to establish and maintain an adequate system of internal controls to ensure that:

- its financial records and other information completely and accurately reflect its entire activities
- it adequately safeguards its assets
- it prevents or detects errors and other irregularities.

The assessment of agency governance and financial control processes is an important aspect of our financial audit process.

Our 2004-05 audits confirmed that agencies' overall control environments, and their systems of internal control that we examined as part of conducting our audits, were generally satisfactory.

7.3.5 Other significant issue requiring attention

Underspent parliamentary appropriations

In recent years, DIIRD has not fully used the parliamentary appropriations available to it. In the past 3 years, the value of appropriations used by the department has averaged about 18 per cent less than its available parliamentary funding limit, compared with 21 per cent for the 3 years to 2003-04. This is an average underspend of $84 million annually over the 3 years to 2004-05, compared with $102 million for the 3 years to 2003-04.

In previous reports, we noted that DIIRD's continuing underspending of its parliamentary appropriations raised questions about the quality of its internal budgeting and financial management processes. In 2004-05, DIIRD commissioned an internal audit review of its business processes for spending appropriations. The review identified some deficiencies and made recommendations for improvement, which DIIRD was addressing at the time of preparing this report.

In 2004-05, DIIRD underspent its available parliamentary budget by $70 million (15 per cent of the total) compared with $80 million (or 18 per cent) in 2003-04.

We support the department's continuing focus on improved management of its budget.

8. Justice

8.1 Audit conclusions

The Justice sector comprises 30 agencies that were required to prepare financial statements at 30 June 2005 and submit them for audit. We issued clear audit opinions on the financial statements of all 30 agencies.

The timeliness of completion of agencies' audited financial statements slipped slightly compared with last year, with 4 less agencies than the previous year able to meet the statutory 12-week completion deadline. The main reason for this outcome was a shortage of staff at my Office during the year-end reporting period. This resulted from an economy-wide shortage of available qualified auditors and meant that we were unable to achieve earlier completion dates for some smaller agencies.

Our audits of 2004-05 financial statements confirmed that agencies' overall control environments and their systems of internal control that we examined were generally satisfactory. While some exceptions were identified, such as those highlighted on our recent report on the *Geelong Magistrate's Court – Investigation into alleged misuse of court funds*[1], the relevant agencies have been proactive in addressing them.

RESPONSE provided by the Secretary, Department of Justice

The department considers that the Auditor-General's report on the results of financial statement audits represents a fair and factually accurate assessment of the department's position regarding timeliness of completion of financial statements, quality of financial reporting and adequacy of control environments.

Further improvements are being pursued in all 3 areas, building upon the very sound 2004-05 departmental results.

8.2 Sector overview

The Justice sector comprises the Department of Justice and 29 other agencies. These include 4 major agencies (Victoria Police, Metropolitan Fire and Emergency Services Board, Country Fire Authority and Victorian Commission for Gambling Regulation), and a variety of statutory agencies and offices and judicial and quasi-judicial bodies.

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[1] Victorian Auditor-General's Office (2005), *Auditor-General's Report – Results of special reviews and other investigations,* Victorian Government Printer, Melbourne.

In 2004-05, Justice sector agencies incurred expenditure of $7 billion. They managed assets of $4.9 billion and liabilities of $2.5 billion.

The Attorney-General, Minister for Police and Emergency Services, Minister for Corrections, Minister for Consumer Affairs, Minister for Gaming and Minister for Racing were responsible for the department and had particular responsibility for the other sector agencies.

Figure 8A shows the nature of the agencies with 30 June 2005 balance dates.

FIGURE 8A: JUSTICE SECTOR AGENCIES WITH A 30 JUNE 2005 BALANCE DATE

Reporting entity	Number
Department and other administrative units	9
Public bodies	17
Companies, trusts and joint ventures (a)	4
Total	**30**

(a) These were Tattersall's Sweeps Pty Ltd, Tattersall's Gaming Pty Ltd, Tattersall's Club Keno Pty Ltd and Footy Consortium Pty Ltd.

Source: Victorian Auditor-General's Office.

8.3 Results of financial audits

8.3.1 Audit opinions issued

The Justice sector comprises 30 agencies that were required to prepare financial statements at 30 June 2005 and submit them for audit. We issued clear audit opinions on the financial statements of all 30 agencies.

Figure 8B shows how well agencies with a 30 June balance date met the 12-week statutory reporting requirement in 2003-04 and 2004-05.

FIGURE 8B: TIMELINESS OF AUDITED FINANCIAL STATEMENT COMPLETION, JUSTICE SECTOR

Number of weeks after end of financial year audited financial statements were finalised	2003-04		2004-05	
	Number of agencies	Per cent (cumulative)	Number of agencies	Per cent (cumulative)
Less than 8 weeks	6	19	-	-
8 to 10 weeks	11	55	6	20
10 to 12 weeks	11	90	18	80
12 to 14 weeks	1	94	2	87
14 to 16 weeks	1	97	3	97
More than 16 weeks	1	100	1	100
Total	**31**	**-**	**30**	**-**

Source: Victorian Auditor-General's Office.

The timeliness of completion of agencies' audited financial statements slipped slightly compared with last year, with 4 less agencies able to complete their audited statements within the 12-week deadline. This was mainly due to a shortage of audit staff in my Office during the year-end reporting period, due to prevailing market conditions, which meant that were unable to achieve earlier completion dates for the smaller agencies.

8.3.2 Quality of financial reporting

Our 2004-05 audits found that the quality of reporting by sector agencies was generally of a high standard. This was substantially due to the stable reporting environment during the year, which saw only minor changes in accounting standards and reporting requirements.

8.3.3 Adequacy of control environments

The responsible officer and chief finance officer of each sector agency is required to establish and maintain an adequate system of internal controls within the agency to ensure that:

- its financial records and other information completely and accurately reflect its entire activities
- it adequately safeguards its assets
- it prevents or detects errors and other irregularities.

An assessment of agency governance and financial control processes is an important aspect of our financial audit process.

Our audits of 2004-05 financial statements did not identify any major issues requiring attention by sector agencies, other than the matter explained below. While some exceptions were identified, such as those highlighted on our recent report on the *Geelong Magistrate's Court – Investigation into alleged misuse of court funds*[2], the agencies have been proactive in addressing them.

Improvements by Victoria Police in recording and validating employee leave benefits

At 30 June 2005, the outstanding leave benefits of Victoria Police employees totalled $318 million. This was 75 per cent of Victoria Police's total liabilities.

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[2] op. cit.

Our December 2004 report - *Results of 30 June 2004 financial statement and other audits* identified several deficiencies in Victoria Police's payroll and financial systems. These deficiencies reduced the timeliness and accuracy of management reporting and could lead to employees being overpaid.

In response, Victoria Police told us it planned to improve its processes and systems as an interim solution, and to develop a business case for a replacement payroll system.

In 2004-05, Victoria Police documented and reviewed its payroll policies and procedures and conducted further training for payroll staff. However, Victoria Police had not yet established clear written policies for the validation of employee leave benefits to ensure that annual leave taken and leave balances were accurately recorded.

Recommendation

8.1 That Victoria Police develop validation processes to ensure the accuracy and completeness of employees' leave balances.

RESPONSE provided by the Chief Commissioner, Victoria Police

A significant amount of work has been undertaken by Victoria Police to improve leave management practices over the past 7 years. This includes practitioner training, standardised validation processes and system enhancements. Files audited can be reconciled back to 1998, which reflect the effectiveness of initiatives since that time.

However, there are difficulties validating some records prior to 1998. This is largely due to practices that existed at that time, which included adjustments to entitlements without proper documentation and incorrect adjustment of leave balances.

In order to provide an acceptable level of confidence with regard to leave entitlements, Victoria Police proposes to implement an organisation-wide validation of leave over the next 6 months. The process and time frames will be agreed with the Victorian Auditor-General's Office and this will be the commencing point for all future leave validations. An organisation-wide validation, from the date of appointment to present, represents a significant amount of work and will require detailed planning and organisational commitment.

Given the level of accuracy with validations since 1998, we believe that the current processes are more than satisfactory and, consequently, require little change.

9. Premier and Cabinet

9.1 Audit conclusions

The Premier and Cabinet sector comprises 11 reporting entities which were required to prepare financial statements at 30 June 2005 and submit them for audit. We issued clear audit opinions on the financial statements of all these entities.

The timeliness of financial reporting was similar to 2003-04, with 8 entities meeting the statutory reporting deadline. The audited financial statements of 2 of the remaining 3 entities were completed one day later - an improvement on last year.

The quality of reporting by entities within the sector was satisfactory. Our audits did not identify any major weaknesses in agency control environments.

RESPONSE provided by the Secretary, Department of Premier and Cabinet

The audit conclusion is accepted.

9.2 Sector overview

The Premier and Cabinet sector comprises the Department of Premier and Cabinet (which includes Arts Victoria, the Office of the Governor, the Office of the Chief Parliamentary Counsel and the Office of the Chief Information Officer), the State Services Authority, the Office of the Ombudsman, the Office of Police Integrity (whose financial operations are presented in a composite report with those of the Office of the Ombudsman), and 8 arts agencies. The Premier, the Minister for the Arts and the Minister for Information and Communications Technology are responsible for the department, and have specific responsibility for the other entities in the sector.

Figure 9A profiles sector reporting entities with a 30 June 2005 balance date.

FIGURE 9A: PREMIER AND CABINET SECTOR REPORTING ENTITIES WITH A 30 JUNE 2005 BALANCE DATE

Reporting entity	Number
Department and other administrative units	3
Public bodies	8
Total	**11**

Source: Victorian Auditor-General's Office.

The department advises the Premier and the Cabinet about all aspects of policy. It develops whole-of-government initiatives and manages Victoria's relationships with other governments. It organises programs and hospitality to attract investment to Victoria and to enhance its reputation. It organises special projects and events, delivers government information and communications programs and services, and oversees state-owned cultural agencies through Arts Victoria.

The Victorian Ombudsman mainly investigates complaints about administrative actions taken by departments and local government. The Office of Police Integrity, which was established in November 2004, aims to ensure that the highest ethical and professional standards are maintained in the Victoria Police Force, and that police corruption and serious misconduct is detected, investigated and prevented.

The State Services Authority was established in April 2005, replacing the Office of Public Employment and Office of Workforce Development. The authority advises and supports the government and departmental secretaries on improving public sector services, standards, governance and work force development.

Arts Victoria (which forms part of the department) and arts agencies develop and present cultural projects, programs and services to benefit the Victorian arts industry and community.

In 2004-05, the department received appropriated funding of $404 million, provided grants of $250 million for arts and cultural development, and contributed $6 million to building upgrades and redevelopment works. Arts agencies raised $13 million in public donations and gifts, and managed cultural assets valued at $3.1 billion.

9.3 Results of financial audits

9.3.1 Audit opinions issued

Clear audit opinions were issued on the financial statements of all 11 reporting entities in the sector with a 30 June 2005 balance date[1].

9.3.2 Timeliness of reporting

Figure 9B shows how well sector entities with a 30 June balance date met the 12-week statutory reporting requirement for 2003-04 and 2004-05.

[1] A full list of the sector agencies and the audit opinions issued is provided in Appendix A to this report.

FIGURE 9B: TIMELINESS OF COMPLETION OF AUDITED FINANCIAL STATEMENTS, PREMIER AND CABINET SECTOR

Number of weeks after end of financial year audited financial statements were finalised	2003-04		2004-05	
	Number of entities	Per cent (cumulative)	Number of entities	Per cent (cumulative)
Less than 8 weeks	1	9	1	9
8 to 10 weeks	-	9	-	9
10 to 12 weeks	7	73	7	73
12 to 14 weeks	3	100	2	91
14 to 16 weeks	-	100	1	100
More than 16 weeks	-	100	-	100
Total	**11**	**..**	**11**	**..**

Source: Victorian Auditor-General's Office.

Figure 9B shows that entities' reporting timelines were similar to the previous year, with 8 entities meeting the 12-week statutory reporting timeline. The audited financial statements of 2 of the remaining 3 entities were completed within one day of the deadline - an improvement on last year.

9.3.3 Quality of financial reporting

In 2004-05, the quality of financial reporting by entities in the sector remained satisfactory. We did not identify any significant reporting issues.

9.3.4 Adequacy of control environments

Each entity is responsible for establishing and maintaining a sound control environment and an adequate system of internal controls to ensure that:

- the entity's financial records and other information completely and accurately reflect its activities
- its assets are safeguarded
- errors and other irregularities are prevented or detected.

Our financial audits assess entities' governance and financial control processes.

In 2004-05, we did not identify any major weaknesses in entities' control environments. Our audits confirmed that the control environments of entities in the sector, and the internal control systems that we examined, were generally satisfactory.

10. Primary Industries

10.1 Audit conclusions

The Primary Industries sector comprises 11 agencies that were required to prepare financial statements at 30 June 2005 and submit them for audit. We issued 10 audit opinions, all of which were clear. The audit of the financial statements of one agency (Northern Victorian Fresh Tomato Industry Development Committee) was incomplete at the date of preparing this report, but was expected to be finalised in the near future.

The timeliness of financial reporting by agencies in the sector improved on last year, with 82 per cent of sector agencies having their audited financial statements completed within the 12-week statutory deadline (62 per cent in 2003-04). The quality of financial reporting has also continued to improve.

Our audits of 2004-05 financial statements confirmed that agencies' overall control environments and their systems of internal control that we examined were generally satisfactory.

RESPONSE provided by the Secretary, Department of Primary Industries

The department accepts the conclusion reached in the audit report that the overall control environments and systems of internal control within the department and its agencies were generally satisfactory.

10.2 Sector overview

The Primary Industries sector comprises the Department of Primary Industries and 10 other agencies. Figure 10A shows the nature of sector agencies with a 30 June 2005 balance date.

FIGURE 10A: PRIMARY INDUSTRIES SECTOR AGENCIES WITH A 30 JUNE 2005 BALANCE DATE

Reporting entity	Number
Department	1
Public bodies	8
Companies, trusts and joint ventures	2
Total	**11**

Source: Victorian Auditor-General's Office.

The Department of Primary Industries is one of the smaller state government departments. It delivers 3 outputs at an annual cost of about $394 million. The outputs and related areas of focus are:

- *Agriculture* - to improve the profitability and market competitiveness of agricultural industries, while ensuring that their operations are sustainable and environmentally responsible
- *Fisheries* - to facilitate the sustainable development of Victoria's commercial and recreational fishing industries and aquaculture, and the management of Victoria's marine and freshwater fish resources
- *Minerals and petroleum* - to promote and regulate the exploration and development of Victoria's extractive, mineral and petroleum resources.

The department's responsibilities include funding and oversighting the state's interest in the Royal Melbourne Showgrounds redevelopment. Further comment on this redevelopment and the related financial arrangements is included in our November 2005 *Report of the Auditor-General on the Finances of the State of Victoria, 2004-05.*

Of the other sector agencies, 5 focus on industry development, 3 on research and 2 provide regulation and assurance services for product and service safety.

The number of agencies with a 30 June balance date reduced by 2 in the year. The Australian Food Industry Science Centre (AFISC) ceased operations from 30 June 2004 due to the repeal of its enabling legislation; and the state's interest in Food Science Australia reduced from 50 per cent to 15 per cent from 1 July 2004, resulting in this entity no longer being a controlled entity of the state of Victoria[1].

The Minister for Agriculture and the Minister for Resources are responsible for the department and have specific responsibility for the other agencies in the sector.

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[1] The remaining 85 per cent interest in Food Science Australia is held by a Commonwealth Government controlled entity. Consequently, Food Science Australia is now subject to audit by the Australian National Audit Office.

10.3 Results of financial audits

10.3.1 Audit opinions issued

The Primary Industries sector comprises 11 agencies that were required to prepare financial statements at 30 June 2005 and submit them for audit. We issued 10 audit opinions, all of which were clear. The audit of the financial statements of one agency (Northern Victorian Fresh Tomato Industry Development Committee) was incomplete at the date of preparing this report, but was expected to be finalised in the near future.

10.3.2 Timeliness of reporting

Figure 10B shows how well sector agencies with a 30 June balance date met the 12-week statutory reporting requirement for 2003-04 and 2004-05.

FIGURE 10B: TIMELINESS OF AUDITED FINANCIAL STATEMENT COMPLETION, PRIMARY INDUSTRIES SECTOR

Number of weeks after end of financial year audited financial statements were finalised	2003-04		2004-05	
	Number of agencies	Per cent (cumulative)	Number of agencies	Per cent (cumulative)
Less than 8 weeks	1	8	2	18
8 to 10 weeks	3	31	3	45
10 to 12 weeks	4	62	4	82
12 to 14 weeks	4	92	1	91
14 to 16 weeks	-	92	-	91
More than 16 weeks (a)	1	100	1	100
Total	**13**	..	**11**	..

(a) Includes Northern Victorian Fresh Tomato Industry Development Committee, the financial statements of which had not been finalised at the date of preparing this report.

Source: Victorian Auditor-General's Office.

As Figure 10B shows, the number of agencies having audited financial statements completed within 12 weeks increased from 62 per cent in 2003-04 to 82 per cent in 2004-05.

10.3.3 Quality of financial reporting

The quality of financial reporting by sector agencies has continued to improve in recent years.

Agencies are largely meeting reporting requirements, but there is still scope for them to improve the quality of the financial statements they submit for audit. Some agencies (particularly smaller ones) cannot always allocate the required resources to preparing and reviewing statements. However, they could improve their planning and statement preparation processes.

10.3.4 Adequacy of control environments

Each sector agency is required to establish and maintain an adequate system of internal controls to ensure that:

- its financial records and other information completely and accurately reflect its entire activities
- it adequately safeguards its assets
- it prevents or detects errors and other irregularities.

Our financial audits assess agencies' governance and financial control processes. This year, we again found that sector agencies generally maintained adequate control environments and systems of internal control.

11. Sustainability and Environment

11.1 Audit conclusions

The Sustainability and Environment sector comprises 68 agencies that were required to prepare financial statements at 30 June 2005 and submit them for audit. We issued 67 audit opinions, all of which were clear. The financial statements of one agency were incomplete at the time of finalising this report.

We also issued, for the second year, audit opinions on the performance statements of the state's 15 regional water authorities. All of these opinions were clear.

There was substantial improvement in the timeliness of agencies' completion of their audited 2004-05 financial statements. This resulted from better planning and preparation by agencies for their audits.

We continue to be concerned about the ongoing risks arising from the department's records of Crown land, which are possibly incomplete and inaccurate.

RESPONSE provided by the Secretary, Department of Sustainability and Environment

We note your concern about the inability of the department to confirm that the records of land managed by other agencies are complete and accurate. On this basis, we accept your recommendation to allocate resources to review and confirm the accuracy of the Crown land records. Initial scoping suggests that this project may extend beyond the end of the 2005-06 financial year, however, we expect to be able to demonstrate to you that significant achievement has been made during the course of this financial year.

Overall, I am pleased that you have found that agencies have improved how quickly they complete their audited financial statements and that generally the quality remained at a good standard. We will continue to work with agencies to reduce the submission of low quality draft financial statements which we note resulted in delays and additional work.

11.2 Sector overview

The Sustainability and Environment sector comprises the Department of Sustainability and Environment and 67 other agencies. Of these other agencies, 22 are water agencies, 10 are catchment management authorities and 16 are waste management groups. The Minister for Environment, Minister for Water and Minister for Planning are responsible for the department and have particular responsibility for the other sector agencies.

The water agencies include 3 retailers for which policy responsibility rests mainly in the Sustainability and Environment sector. The shares in these agencies are held by the Treasurer of Victoria on the state's behalf. The Treasury and Finance sector, accordingly, has certain governance and financial management responsibilities in relation to these agencies.

Figure 11A shows the nature of sector agencies with a 30 June 2005 balance date.

FIGURE 11A: SUSTAINABILITY AND ENVIRONMENT SECTOR AGENCIES WITH A 30 JUNE 2005 BALANCE DATE

Reporting entity	Number
Department and another administrative unit	2
Other public bodies	14
Metropolitan water bodies	4
Regional water authorities	15
Rural water authorities	3
Catchment management authorities	10
Waste management groups	16
Companies, trusts and joint ventures	4
Total	**68**

Source: Victorian Auditor-General’s Office.

The department assists in delivering the government's vision to position Victoria as a world leader in sustainability, in terms of both the natural and built environment. The department leads the state's effort to use limited natural resources in a sustainable manner and to improve productivity. The other sector agencies provide water and waste water services, manage the state’s catchments and waterways, regulate the water industry and manage the infrastructure used for these activities.

In 2004-05, the sector's total expenditure was $3.1 billion. This included $1.6 billion spent by water agencies and $100 million in grants to other parties. Water agencies collected $2.2 billion in charges from water users. Sector agencies also managed a substantial asset portfolio, including water infrastructure assets valued at $26 billion and land managed by the department valued at $9.1 billion. This land was mainly Crown land, national parks and reserves.

In 2004-05, water agencies also paid $162 million in dividends to the Consolidated Fund. Most of this was paid by Melbourne's 3 water retailers and by the Melbourne Water Corporation.

11.3 Results of financial audits

11.3.1 Audit opinions issued

The sector comprises 68 agencies that were required to prepare financial statements at 30 June 2005 and submit them for audit. We issued 67 audit opinions, all of which were clear. The financial statements of one agency were incomplete at the time of finalising this report.

11.3.2 Timeliness of reporting

Figure 11B shows how well sector agencies with a 30 June balance date met the 12-week statutory reporting requirement for 2003-04 and 2004-05.

FIGURE 11B: TIMELINESS OF AUDITED FINANCIAL STATEMENT COMPLETION, SUSTAINABILITY AND ENVIRONMENT SECTOR

Number of weeks after end of financial year audited financial statements were finalised	2003-04		2004-05	
	Number of agencies	Per cent (cumulative)	Number of agencies	Per cent (cumulative)
Less than 8 weeks	11	15	10	15
8 to 10 weeks	6	24	11	31
10 to 12 weeks	19	50	25	68
12 to 14 weeks	29	90	18	94
14 to 16 weeks	3	94	3	99
More than 16 weeks (a)	4	100	1	100
Total	**72**	**..**	**68**	**..**

(a) Includes the Commissioner for Environmental Sustainability whose financial statements had not been finalised at the date of finalising this report.

Source: Victorian Auditor-General's Office.

Figure 11B shows, there was a substantial improvement this year in the number of agencies having audited financial statements completed within 12 weeks, from 50 per cent in 2004 to 68 per cent in 2005. The audited financial statements of one agency was still not finalised after 16 weeks, compared with 4 agencies in 2004.

11.3.3 Quality of financial reporting

The overall quality of reporting by sector agencies remained at a generally good standard. However, some agencies submitted low-quality draft financial statements for audit. This resulted in delays and additional work to complete their audits.

The final sign-off of some financial statements was also delayed by the absence of signed allocation statements, which evidence the transfer of assets or assets and liabilities between wholly-owned government entities as contributed capital. Closer attention by the department to ensure allocation statements are signed in a timely manner in future financial years can improve the timeliness of the audited financial statements for the sector.

11.3.4 Adequacy of control environments

Each sector agency is required to establish and maintain an adequate system of internal controls to ensure that:

- its financial records and other information completely and accurately reflect its entire activities
- it adequately safeguards its assets
- it prevents or detects errors and other irregularities.

Our financial audits assess agencies' governance and financial control processes. This year, we again found that sector agencies had generally maintained sound control environments.

11.3.5 Other significant issues

Completeness of Crown land records

The department is responsible for recording the state's holdings of Crown land. It directly manages about 70 per cent of all Crown land, and provides details about these holdings in its financial statements. The other 30 per cent is managed and reported by other agencies.

In the past 2 years, we have expressed concerns about the department's inability to confirm that its records of Crown land managed by other agencies are complete and accurate. Our audits this year found this to still be an issue that requires attention. This deficiency could result in:

- double counting of land holdings, if a holding recognised by the department is also recognised by another agency or agencies
- agencies not fully accounting for, or effectively managing, Crown land.

We continue to be concerned about the ongoing risks arising from the department's records of Crown land, which are possibly incomplete and inaccurate.

Recommendation

11.1 That the Department of Sustainability and Environment, in 2005-06, allocate the resources required to review and confirm the accuracy of its Crown land records.

Water agency operations

The Sustainability and Environment sector includes 22 agencies (25 in previous year) that provide water and waste water services[1]. These water agencies are further grouped as:

- metropolitan water agencies (Melbourne Water and the 3 metropolitan water retailers)
- regional water agencies (15 regional water authorities)
- rural water agencies (3 rural water authorities).

All these agencies are required to operate commercially and (except for the rural water authorities) to pay dividends to the Consolidated Fund. The dividends payable are a percentage of profits after allowing for certain non-assessable transactions. Although rural water authorities are not subject to the same dividend requirements, the government periodically requires them to make payments to the Consolidated Fund.

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[1] The reduction in sector agencies reflects the result of administrative restructures. Last year, the operations of Casey's Weir and Major Creek Rural Water Authority were taken over by Goulburn Murray Rural Water Authority. From 1 July 2004, the operations of 2 regional and 2 rural water authorities (Grampians Region Water Authority, Wimmera Mallee Rural Water Authority, Lower Murray Region Water Authority and Sunraysia Rural Water Authority) were merged into 2 new regional/rural water authorities (the Grampians Wimmera Mallee Water Authority, and Lower Murray Urban and Rural Water Authority).

As well, under national tax equivalency arrangements, public sector agencies are taxed in the same way as private sector companies. However, the tax is paid to the Victorian Department of Treasury and Finance, not to the Australian Taxation Office.

As from 2004-05, the *Environmental Contributions Act 2004* required water authorities to also make annual environmental contributions to the Consolidated Fund. In 2004-05, these contributions totalled $44.6 million.

Figure 11C summarises the key financial statistics of the water agencies.

FIGURE 11C: WATER AGENCY FINANCIAL INFORMATION SUMMARY ($MILLION)

	Metropolitan		Regional		Rural		Total	
	2003-04	2004-05	2003-04	2004-05	2003-04	2004-05	2003-04	2004-05
Financial performance -								
Total revenue	1 496	**1 555**	519	**572**	165	**138**	2 180	**2 265**
Total expenses	1 024	**1 131**	442	**532**	168	**151**	1 634	**1 814**
Profit/loss (pre-tax)	472	**424**	77	**40**	(3)	**(13)**	546	**451**
Dividends paid to government	240	**162**	-	-	-	-	240	**162**
Financial position -								
Cash assets	1	**2**	147	**52**	52	**41**	200	**95**
Infrastructure assets	6 008	**5 957**	3 885	**4 965**	2 644	**2 289**	12 537	**13 211**
Borrowings	2 304	**2 426**	101	**115**	15	**15**	2 420	**2 556**

Source: Victorian Auditor-General's Office.

Figure 11C shows that water agencies' total profits before tax in 2004-05 were $451 million. This reduction of 17 per cent on the previous year's profits follows a reduction in 2003-04 profits of 9 per cent.

The continued fall in profit was due to a higher increase in annual expenditures (11 per cent) than revenue (4 per cent). Water restrictions and the subsequent introduction of permanent water saving measures in recent years has contributed to lower water consumption, and has resulted in smaller revenue growth relative to the growth in expenditures over the same period. Major areas of expenditure growth in 2004-05 included:

- repairs and maintenance - the ongoing dry conditions have contributed to burst pipes and have driven agency programs of routine repairs and maintenance
- depreciation expense – increased infrastructure investment over recent years has increased the value of the asset base, resulting in a higher depreciate expense
- environmental contribution levy - introduced by the government on 1 October 2004

- customer refunds relating to an over-billing by the 3 metropolitan retailers (further comment on this issue is provided later in this part of the report).

In 2004-05, water agencies net borrowings increased by $136 million, compared with a $125 million increase in the previous year. Their infrastructure assets increased by $674 million. This indicates that the agencies have financed a considerable investment in capital works not using borrowings. However, a number of agencies did borrow to ensure they had the cash to make dividend payments.

The financial performance, position and cash flows of the state's 10 catchment management authorities is generally quite strong. In 2004-05, the authorities generated a combined profit of $10.3 million; had an average liquidity ratio of 6.5[2], and generated overall positive cash flows from operating activities of $12.1 million.

Although 2 authorities made a small loss of around $260 000 and $540 000, respectively, their liquidity ratio was strong.

Asset valuation in the water sector

Our December 2004 *Auditor-General's Report: Results of 30 June 2004 financial statement and other audits* noted that the Minister for Finance had, in 2003-04, exempted (as he had done in previous years) water agencies from valuing their assets on a fair-value basis. This meant that metropolitan water agencies continued to record their assets at cost, while all other water agencies recorded assets at valuation. Our report recommended that all water agencies value their assets on the same basis.

In 2004-05, the minister again extended the exemption. This continued the ongoing inconsistency which makes it difficult to compare the performance of metropolitan and other agencies. Under the new A-IFRS accounting regime to apply from 1 July 2005, revaluation of water sector infrastructure assets will not take place. Accordingly, consistency of reporting will be achieved.

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[2] The liquidity ratio identifies an agency's ability to settle current liabilities from current assets.

Over-billing by metropolitan water retailers

During the year, a customer inquiry resulted in the 3 metropolitan water retailers identifying a billing error. The billing error related to the interpretation of a change in legislation that occurred in 1998. The 3 retailers had levied the service charge on the understanding that it applied to each connected property. However, the service charge is in fact applicable according to property title, not the number of connected properties on a title.

Each retailer initiated a detailed review to identify customers over-billed and have implemented a process for managing the disbursement of refunds. The reviews have revealed refunds of around $20.5 million. At 30 June 2005, the retailers had refunded $11.5 million, and intend to refund a further $9 million in 2005-06.

Our audit process concluded that the processes established by the retailers to determine the overpayments were sound and that appropriate steps have been taken to refund such amounts.

Water sector performance statements

In 2003-04, the Minister for Finance directed all regional water authorities to prepare performance statements. The statements are submitted to the Auditor-General for audit, and included in authorities' annual reports. The statements disclose the performance targets and indicators required by the Minister for Water, the actual results achieved for the year against the targets and indicators, and explanations of any significant variances.

For the second year, all 15 regional water authorities prepared statements in accordance with the requirement. We issued clear opinions on all statements.

12. Treasury and Finance

12.1 Audit conclusions

The Treasury and Finance sector comprises 59 agencies that were required to prepare financial statements at 30 June 2005 and submit them for audit. We issued 58 audit opinions, all of which were clear. The audit of the financial statements of one entity (South Eastern Medical Complex Limited) was incomplete at the date of preparing this report.

Ninety-five per cent of agencies completed their audited financial statements within the statutory 12-week deadline (92 per cent in 2003-04).

Our audits found the internal control environments of agencies in the sector to be generally sound. The quality of financial reporting by agencies was also of a high standard.

The major issues requiring attention by sector agencies in the coming year will be the implementation of:

- the revised Australian accounting standards issued following the harmonisation with international accounting standards, particularly those dealing with the accounting treatment and reporting of financial instruments and insurance liabilities, which are particularly relevant to agencies in this sector
- revised governance and assurance arrangements for sector agencies involved in funds and superannuation management, addressing recently announced major changes to the responsibilities of these agencies.

12.2 Sector overview

The Treasury and Finance sector comprises the Department of Treasury and Finance (DTF) and 58 other agencies with a 30 June 2005 balance date. This is 4 less than last year because the State Trustee Limited's Managed Common Fund, the Victoria 2003 Bushfire Recovery Appeal Fund, and the Paragon Warehouse Trust No. 1 and 2 ceased operations during the year.

Sector agencies provide funds management, borrowing, treasury, superannuation, insurance and regulatory services. The Treasurer of Victoria, Minister for Finance and Minister for WorkCover have responsibility for DTF and specific responsibility for individual sector agencies.

Figure 12A shows the nature of Treasury and Finance sector agencies with a 30 June 2005 balance date.

FIGURE 12A: TREASURY AND FINANCE SECTOR AGENCIES WITH A 30 JUNE 2005 BALANCE DATE

Reporting entity	Number
Department and administrative unit	2
Public bodies (a)	7
Superannuation funds	3
Companies, trusts and joint ventures	47
Total	**59**

(a) Public bodies include statutory authorities such as Treasury Corporation of Victoria, Transport Accident Commission and the Victorian WorkCover Authority.

Source: Victorian Auditor-General's Office.

DTF is the Victorian public sector's central agency for economic, financial and resource management. It also provides government financial reporting, budget, liability and risk management services. The State Revenue Office (which is the state's main revenue collection agency) and the Victorian Government Purchasing Board (which is responsible for procurement and contracting policies and guidelines) are part of DTF.

Sector agencies include:

- Treasury Corporation of Victoria, Victorian Funds Management Corporation, Rural Finance Corporation and State Trustees Limited (which provide financial services)
- Transport Accident Commission, Victorian WorkCover Authority and Victorian Managed Insurance Authority (which manage statutory insurance schemes)
- Parliamentary Contributory Superannuation Fund, State Superannuation Fund and Emergency Services Superannuation Scheme (which are superannuation funds for parliamentarians and some public sector employees)
- Essential Services Commission (which mainly regulates the electricity and gas industries)
- State Electricity Commission of Victoria (which manages residual financial and other obligations remaining from the privatisation of public sector utilities).

In 2004-05, sector agencies:

- collected about $10 billion in state taxes
- administered about $26 billion in parliamentary appropriations (that is, payments from the Consolidated Fund)
- managed about $40 billion in state liabilities (mainly unfunded superannuation liabilities, insurance scheme outstanding claims liabilities; the state's debt portfolio; and an onerous contract provision associated with the state's flexible electricity tariff obligations linked to the Portland and Point Henry aluminium smelters)
- managed investments of about $30 billion
- held about $2.2 billion in trust for the clients of state-controlled entities.

In 2004-05, the operating performance and the financial positions of the state's insurance agencies and superannuation funds improved[1]. A major factor contributing to these outcomes was the stronger national and international equity markets, which helped in:

- up to 15 per cent growth in the value of agencies' investments
- the Victorian Managed Insurance Authority's catastrophe reserve and solvency margin returning to target levels
- the Victorian WorkCover Authority's scheme being fully funded
- payment by the Transport Accident Commission of dividends to the Treasurer from its 2004-05 operating profit.

12.2.1 Major portfolio developments

Victorian Funds Management Corporation role change

During 2004-05, DTF commissioned a strategic review of the performance of the Victorian Funds Management Corporation (VFMC) and of its role in public sector investment funds management. At 30 June 2005, VFMC managed $30 billion in public sector investment funds.

The review found that the investment performance of VFMC's fund managers compared favourably with their private sector counterparts, but they had not met "out-performance" targets agreed with VFMC's clients.

The review recommended that public sector funds management be centralised by clients setting their investment objectives, VFMC deciding on investment strategies to achieve those objectives and VFMC managing implementation of the investment strategies. Under the current model, VFMC's clients set both the investment objectives and strategies.

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[1] These agencies were Victorian WorkCover Authority, Transport Accident Commission, Victorian Managed Insurance Authority, State Superannuation Fund, Emergency Services Superannuation Scheme and Parliamentary Contributory Superannuation Fund.

On 28 July 2005, the Treasurer announced that the government accepted the recommendation and would implement it by June 2006. This will change VFMC's strategy development and management role, and will require changes to its service level agreements with clients and the related auditing requirements.

Importantly, the proposed centralised fund management approach will require significant changes to VFMC's current operations, and to DTF's governance and monitoring role. To implement the model, appropriate governance and accountability mechanisms will need to be established to provide clear roles and responsibilities for DTF, VFMC and clients. As part of these mechanisms, DTF and VFMC will need to establish assurance, compliance, monitoring and reporting procedures over VFMC's operations in order to satisfy client agency requirements.

Recommendation

12.1 That the Department of Treasury and Finance ensure that the centralised fund management approach is implemented within an adequate governance and accountability framework, which includes the establishment of:

- **clear roles, responsibilities and accountabilities for all relevant parties, as part of service-level agreements**
- **a post-implementation review to ensure a smooth transition to VFMC's new role**
- **appropriate qualitative and quantitative performance measures and reporting (including assurance arrangements) to enable the department and clients to monitor VFMC's performance.**

Proposed integration of State Superannuation Fund and Emergency Service Superannuation Scheme administration

In July 2005, the Minister for Finance proposed to integrate the State Superannuation Fund into the Emergency Service Superannuation Scheme. The aim of the integration is to reduce the costs of administering government superannuation arrangements. The key features of the minister's proposal are that:

- there will be no change in members' entitlements
- a single board will oversee administration of the scheme, the State Superannuation Fund and the Government Superannuation Office

- the Emergency Service Superannuation Scheme will administer the assets and liabilities of the State Superannuation Fund from 1 December 2005.

To enable smooth integration of the fund into the scheme, a number of governance, regulatory, assurance and accounting matters will need to be considered. Some of these matters include:

- regulatory amendments, to enable an efficient amalgamation of the fund into the scheme
- the level of due diligence and audit assurance work required on the 1 December 2005 closing of the fund
- whether a full rather than an update actuarial valuation of the fund is required at the date of transfer
- the new board and governance structure
- scheme and fund administrative system amalgamation.

Recommendation

12.2 That the Department of Treasury and Finance arrange for an independent due diligence review to be conducted, to ensure that all scheme and fund integration matters and risks are identified and dealt with in a timely manner.

Deconstruction of Victorian Funds Management Corporation trusts

In recent years, the funds management industry has created a broad variety of wholesale trusts in which agencies such as the Victorian Funds Management Corporation (VFMC) can invest and, thereby, reduce its administration costs. In 2004-05, after consulting with unit holders, VFMC deconstructed 6 of its unit trusts and a further 2 in July 2005. Unit holders redeemed their units in these trusts and invested the proceeds through VFMC's fund managers. The VFM Global Small Companies Trusts and the VFM Emerging Market Trust were not deconstructed and are currently planned to be retained.

12.3 Results of financial audits

12.3.1 Audit opinions issued

The Treasury and Finance sector comprises 59 agencies that were required to prepare financial statements at 30 June 2005 and submit them for audit. We issued clear audit opinions on the financial statements of 58 agencies. The audit of the financial statements of one entity (South Eastern Medical Complex Limited) was incomplete at the date of preparing this report.

12.3.2 Timeliness of reporting

Figure 12B shows how well sector agencies with a 30 June balance date met the 12-week statutory reporting requirement for 2003-04 and 2004-05.

FIGURE 12B: TIMELINESS OF AUDITED FINANCIAL STATEMENT COMPLETION, TREASURY AND FINANCE SECTOR

Number of weeks after end of financial year audited financial statements were finalised	2003-04		2004-05	
	Number of agencies	Per cent (cumulative)	Number of agencies	Per cent (cumulative)
Less than 8 weeks	5	8	9	15
8 to 10 weeks	17	35	31	68
10 to 12 weeks	36	92	16	95
12 to 14 weeks	4	98	2	98
14 to 16 weeks	1	100	-	98
More than 16 weeks	-	100	1	100
Total	**63**	..	**59**	..

Source: Victorian Auditor General's Office.

As Figure 12B shows, 95 per cent of agencies completed their audited financial statements by the statutory 12-week deadline, compared with 92 per cent in 2003-04.

12.3.3 Quality of financial reporting

Sector reporting in general

In 2004-05, the quality of sector agencies' financial reporting continued to be of the same high quality as in previous years.

Major superannuation, insurance and financial services agencies continued to disclose key transactions and balances, so as to improve readers' understanding of their financial statements. They disclosed more information than was required by accounting standards.

Managers of some agencies continued to use quality control check lists to certify the completeness, accuracy and validity of information used in their financial statements, and to check compliance with Australian accounting standards, the Financial Management Act and the Financial Management Compliance Framework. This contributed to the high quality of the financial reporting processes across the sector agencies.

Reporting of the impacts of adopting Australian equivalents to International Financial Reporting Standards

Australian Accounting Standard AASB 1047 *Disclosing the Impacts of Adopting Australian Equivalents to International Financial Reporting Standards* (A-IFRS) required agencies to note in their 2004-05 financial statements any known or reliably estimable information about the impacts of A-IFRS on their statements as at 30 June 2005. Every sector agency referred to such A-IFRS impacts in the notes to their 2004-05 financial statements. It was pleasing to note that during the 2004-05 year, sector agencies were proactively managing the A-IFRS implementation transition.

Major A-IFRS impacts reported by sector agencies related to the valuation of the state's insurance agencies' outstanding claims liabilities and the state's unfunded superannuation liability.

Outstanding claims liabilities

Under the A-IFRS version of AASB 1023 *General Insurance Contracts*, and in line with the Department of Treasury and Finance's (DTF's) policy guidance, the state's insurance agencies are now required to adopt a prudential/risk margin (based on a 75 per cent probability of sufficiency) for inclusion in the outstanding claims liability valuation calculation. This means, that as at 30 June 2005, the reported value of the Transport Accident Commission's outstanding claims liability would increase by $193 million and the Victorian WorkCover Authority's liabilities would increase by $615 million.

Unfunded superannuation liability

Under the A-IFRS version of AASB 119 *Employee Benefits*, employers that sponsor defined benefit funds must recognise their superannuation-related obligation in their financial statements. When measuring the liability, they must discount the present value of the obligation using the long-term government bond rate (instead of using the expected long-term earning rate of investments, which is what superannuation funds now do). This changed requirement means that, as at 30 June 2005, the unfunded superannuation liability to be recognised by DTF would increase by $4.819 billion, mainly related to the State Superannuation Fund.

Aggregate financial reporting of multiple trusts and funds

In past years, the Victorian Fund Management Corporation and State Trustees Limited have prepared separate financial statements for each trust and fund they manage. As commented in our December 2004 *Auditor General's Report: Results of 30 June 2004 financial statement and other audits*, in 2003-04 these 2 agencies accepted our recommendation to adopt funds management industry better practice and aggregate the financial statements of their trusts. This would make it easier for the agencies to prepare financial information, and easier for readers to understand and use the information.

For 2004-05, both agencies continued to aggregate their trust financial statements into 2 statements each. Figure 12C shows the trusts and funds included in each of the statements.

FIGURE 12C: VICTORIAN FUND MANAGEMENT CORPORATION AND STATE TRUSTEES LIMITED FINANCIAL STATEMENTS AND ENTITY COVERAGE

Financial statements for -	Entities included
Victorian Fund Management Corporation equity trusts	VFM Australian Equities Trust, VFM International Equities Trust, VFM Hedged International Equities Trust, VFM Global Small Companies Trust, VFM Emerging Markets Trust
Victorian Fund Management Corporation fixed interest trusts	VFM Short Term Money Market Trust, VFM Australian Fixed Interest Trust, VFM Indexed Bonds Trust, VFM Global Bond Trust, VFM Income Trust
State Trustees Limited premium funds	Premium Cash, Fund, Premium Fixed Interest Fund, Premium Property Fund, Premium Equity Fund, Premium Diversified Fund, Premium International Fund, Premium Cash Plus Fund
State Trustees Limited	Cash Common Fund No. 1, Cash Common Fund No. 2, Equity Common Fund, Fixed Interest Common Fund, Property Common Fund, Charitable Common Fund

Source: Victorian Auditor-General's Office.

The trusts and funds in Figure 12C are not subject to the financial reporting provisions of the *Financial Management Act 1994*. Rather, they are subject to the provisions of their governing trust deeds and, in the case of the State Trustees Limited premium funds, to the *Corporations Act 2001*. Therefore, these trusts and funds are not required to provide the annual financial statements to the responsible minister for tabling in parliament.

Recommendation

12.3 I reiterate the recommendation made in my December 2004 report, that the Department of Treasury and Finance include all state-controlled trusts and funds under the financial reporting and accountability requirements of the *Financial Management Act 1994*, to enable the responsible minister to table the trusts' and funds' annual financial statements in parliament.

RESPONSE provided by the Secretary, Department of Treasury and Finance

The Department of Treasury and Finance will consider the requirement for ministers to table the financial statements of trusts and funds as part of a broader review of the financial reporting and accountability requirements of the Financial Management Act 1994 and subordinate legislation.

12.3.4 Adequacy of control environments

Each sector agency is required to establish and maintain an adequate system of internal controls to ensure that:

- its financial records and other information completely and accurately reflect its entire activities
- it adequately safeguards its assets
- it prevents or detects errors and other irregularities.

Our financial audits assess agencies' governance and financial control processes. We found the internal control environments and systems of internal control that we examined to be generally sound. However, we identified the following major issue requiring attention.

Audit certification by external service providers

We noted in our December 2004 *Auditor General's Report: Results of 30 June 2004 financial statement and other audits* that a number of sector agencies that outsource a significant portion of their core business activity to external service providers do not receive independent certification that the service providers have adequate internal control systems. Our audits this year found this still to be the case.

We again saw no evidence that agencies (except for the investment services of the Victorian Funds Management Corporation) received independent audit certification about the adequacy of their main service providers internal control systems.

Audit guidance statements AGS 1042 *Reporting on Control Procedures at Outsourcing Entities* and AGS 1026 *Auditor Reports on Externally Managed Funds* recommend detailed reporting on external service providers' governance and operating control environments. We support this recommendation.

Recommendation

12.4 That sector agencies that outsource core business activities obtain regular certifications from the independent auditors of their major service providers to establish:

- **the financial viability of the service providers**
- **the adequacy of service providers' control procedures to safeguard assets and services.**

12.3.5 Other significant issues

Implications of international financial reporting standards

All agencies will be required to implement the Australian equivalents of International Financial Reporting Standards (A-IFRS) for reporting periods commencing on or after 1 January 2005. In our December 2004 *Auditor General's Report: Results of 30 June 2004 financial statement and other audits* we made several recommendations to help agencies in the sector smoothly transition to A-IFRS.

During 2004-05, DTF and other sector agencies worked closely to address the implications of A-IFRS. However, at the time of preparing this report, several matters relating to the accounting treatment and disclosure of financial instruments needed further attention.

Implications for the state's financial assets and liabilities

AASB 139 *Financial Instruments: Recognition and Measurement* establishes principles for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. AASB 132 *Financial Instruments: Disclosure and Presentation* provides guidance about the disclosures to be provided in financial statements about financial assets and liabilities.

Important issues that need further analysis and resolution are:

- The fair value of Treasury Corporation of Victoria (TCV) traded assets and liabilities is currently determined using mid-market rates - which represent the average of the bid (purchase) and offer (sell) price. TCV may need to apply bid/offer rates rather than the currently used mid-market rates to fair value all of its securities, unless it is able to identify and designate those securities that offset market risk.
- TCV intends to review the valuation of its "quarantined" indexed-based financing portfolio (i.e. the non-market value portfolio). It is still to determine how to calculate the fair value of the portfolio, given that there is no readily traded market for the respective indexed securities. It is also assessing several other accounting treatments, to ensure that they are allowable under A-IFRS rules.
- The State Electricity Commission of Victoria's (SECV) is currently reviewing the measurement and disclosure requirements for assets and liabilities relating to certain domestic currency loans which have been the subject of debt extinguishment arrangements.
- SECV is also assessing whether its accounting for assets and liabilities associated with an onerous contract provision will need to be separately disclosed in its financial statements.

Recommendation

12.5 That the Department of Treasury and Finance and sector agencies:

- **continue to monitor developing financial services industry practice in the above areas**
- **in consultation with audit, agree on accounting treatment and presentation solutions as soon as possible, to enable smooth transitioning to A-IFRS compliant accounting system changes and processing.**

Implications for employer sponsors and defined benefit schemes

As part of preparing for A-IFRS, AASB 119 *Employee Benefits* has been revised. The revised standard requires employer sponsors of defined benefit superannuation schemes to recognise, from 1 July 2005, their share of the scheme's net surplus or deficit in the statement of financial position, and gains and losses on assets and liabilities as revenue or expenses. Under AASB 119, a scheme's surplus or deficit is based on the "risk-free" discount rate, rather than on the earnings rate of the scheme. AAS 25 *Financial Reporting by Superannuation Plans* requires a scheme's surplus or deficit to be based on the earnings rate of the scheme.

Neither the State Superannuation Fund nor the Emergency Services Superannuation Scheme are currently mandated under AASB 119 or AAS 25 to incorporate in their financial statements notes additional disclosure to highlight the difference in the fund/scheme and the employer sponsor defined benefit scheme's unfunded liability (or surplus assets) calculated under the 2 standards.

Recommendation

12.6 That the Department of Treasury and Finance provide guidance to both the State Superannuation Fund and the Emergency Services Superannuation Scheme about disclosing in their financial statements the difference between the funds' AAS 25 defined benefit scheme's unfunded liability (or surplus assets), and that which is to be reported by the employer sponsor (as per AASB 119).

Implications for state insurance agencies

We commented in our December 2004 *Auditor General's Report: Results of 30 June 2004 financial statement and other audits* that, under the revised Australian accounting standard AASB 1023 *General Insurance Contracts*, state insurance agencies must:

- discount their outstanding claims liabilities using a risk-free rate, and must also include a prudential margin to allow for inherent uncertainty in central estimates
- report about their risk management policies and objectives and about the sensitivity of key outstanding claims liability assumptions.

This requirement is also in line with the findings of the recent HIH Royal Commission and current Australian Prudential Regulation Authority (APRA) guidelines.

As mentioned earlier in this report, during 2004-05, DTF provided policy guidance to the 3 state insurers on how to determine a prudential margin and so calculate their outstanding claims liabilities.

DTF also advised us that it had consulted with the 3 state insurers about the implementation of a capital pricing and reserving regime. The aim is to complete consultations and provide guidance to the insurers in 2005-06. This will also involve working with the insurers to review the applicability of their capital adequacy reserves in the 2005-06 financial year.

Recommendation

12.7 That DTF guidance to public sector insurers:

- **take account of the APRA guidelines and the recommendations of the HIH Royal Commission**
- **include appropriate disclosure requirements for agency annual reports.**

13. Victorian Communities[1]

[1] This Part does not include the local government sector, which is in Part 14.

13.1 Audit conclusions

The Victorian Communities sector comprises 10 agencies which were required to prepare financial statements at 30 June 2005 and submit them for audit. We issued clear audit opinions on the financial statements of all agencies except for the Melbourne and Olympic Parks Trust, which were again qualified this year.

Apart from the issues giving rise to the qualification, the quality of the financial statements provided for audit by the sector agencies has improved. No significant accounting or control issues delayed finalisation of the financial statements for the sector.

13.2 Sector overview

The Victorian Communities sector comprises the Department for Victorian Communities and 9 smaller agencies with specific event or service delivery responsibilities.

Local government in Victoria is administered under the *Local Government Act 1989* by Local Government Victoria (a division of the Department for Victorian Communities). Given the size and diversity of the department, and the size and diversity of the local government sector, we have reported the results of our financial audits of local government in Part 14 of this report.

Figure 13A shows Victorian Communities sector agencies (excluding local government) with 30 June 2005 balance dates.

FIGURE 13A: VICTORIAN COMMUNITIES' AGENCIES WITH A 30 JUNE 2005 BALANCE DATE

Reporting entity	Number
Department and other administrative units	1
Statutory authorities	4
Companies, trusts and joint ventures	5
Total	**10**

Source: Victorian Auditor-General's Office.

During 2004-05, the following changes took place in the sector:

- the 2007 World Swimming Championships Corporation was created as a new public body on 16 February 2005 to stage, conduct and manage the 2007 FINA World Swimming Championships to be held in Melbourne
- the Shrine of Remembrance Trustees was transferred into this sector from the Sustainability and Environment portfolio
- the Melbourne 2006 Commonwealth Games Pty Ltd was deregistered, with any residual responsibilities transferred to the Melbourne 2006 Commonwealth Games Corporation in the previous year.

The department continued to provide support for the Victorian communities, employment and youth affairs, multicultural affairs, veterans' affairs, women's affairs, Aboriginal affairs, local government, sport and recreation, and Commonwealth Games ministerial portfolios.

The department includes the Public Records Office and the Registry of Births, Deaths and Marriages. It operates 5 sport and recreation camps as well as the Community Support Fund and the Victorian Grants Commission. The department also includes the Office of Commonwealth Games Co-ordination, which is responsible for funding games' operations and the construction of several infrastructure projects (including the athletes' village at Parkville). The Office of Seniors was transferred into the department from the Department of Human Services on 1 July 2004.

The department's key financial responsibilities are:

- administration and operation of the Community Support Fund ($105 million in payments were made from the fund in 2004-05)
- funding of, and payments from, the Victorian Grants Commission to local government ($379 million)
- coordinating and funding of the Melbourne 2006 Commonwealth Games.

The other sector agencies are:

- Melbourne 2006 Commonwealth Games Corporation, which is responsible for scoping, planning, organising and managing the operational requirements (including negotiating key contracts) for the Melbourne 2006 Commonwealth Games
- 2007 World Swimming Championships Corporation, which is responsible for organising and managing this event in 2007
- Shrine of Remembrance Trustees, which has responsibility for the management and maintenance of the Shrine of Remembrance

- Melbourne and Olympic Parks Trust, and State Sports Centre Trust, which are responsible for the care, improvement, use and promotion of sports facilities (including Melbourne Park, Olympic Park, Melbourne Sports and Aquatic Centre, and the State Netball and Hockey Centre)
- Victorian Institute of Sport and Victorian Institute of Sport Ltd, which give talented athletes the opportunity to achieve at the highest level
- Queen Victoria Women's Centre Trust which, as custodian of the former Queen Victoria Hospital site, manages the redevelopment of the site and resources, informs and encourages women throughout the community
- VITS Languagelink, which provides interpreting and translating services.

13.3 Results of financial audits

13.3.1 Audit opinions issued

Clear audit opinions were issued on the financial statements of 9 sector agencies with 30 June 2005 balance dates. The audit opinion on the Melbourne and Olympic Parks Trust financial statements was qualified[2]. This is a continuing qualification arising from a disagreement with the trust about the appropriate accounting treatment of a past liability, the payments against which gave rise to a material misstatement of expenditure in 2004-05.

The trust reported a payable of $921 019 at 30 June 2004, representing the balance owing at that time on a commitment made in December 2001 to fund the City of Darebin to build a state training velodrome. The full amount of the commitment was incorrectly bought to account in that year as a liability and, as a result, the trust's financial statements were qualified in that year, and each year since 2000-01.

The Trust's treatment of $921 019 as a liability in 2003-04 did not satisfy the liability definition criteria contained in the Statement of Accounting Concepts SAC 4 *Definition and Recognition of the Elements of Financial Statements.*

During 2004-05, the balance of the commitment ($921 019) was paid and no liability existed at 30 June 2005, however, the effect of debiting the payment against the liability rather than recording it as an expense was material. Accordingly, we qualified our opinion on the trust's 2004-05 financial statements.

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[2] Appendix A to this report contains information about the timing of the finalisation of the financial report and audit opinion for each agency, and the nature of the opinion issued.

As all commitments have now been met and the liability no longer exists, it is likely that this qualification will cease in 2005-06.

RESPONSE provided by the Chief Executive Officer, Melbourne and Olympic Park Trust

The trust is firmly of the view that in connection with the funding arrangements for the construction of Vodafone Arena 5 years ago, the government required the trust to make a contribution towards the cost of a new Training Velodrome. As there was a clear obligation for the trust to contribute funding towards the cost of this facility, the trust considered it proper to create a provision for the future funding obligation.

As the trust would not have any ownership of the Training Velodrome it was not considered prudent to include the funding obligation in the capitalised cost of Vodafone Arena, so it was expensed at the time of creating the provision. The Auditor-General is of the view that the contributions should have been expensed in the year when they were actually paid and not when the trust became aware of the funding obligation. Accordingly, it would seem that the issue has been one of timing and not of substance.

13.3.2 Timeliness of reporting

No issues were experienced in 2004-05 that delayed the clearance and signing of financial statements. There was a significant improvement in timeliness of financial statement preparation and in the conduct of the audits.

Figure 13B shows how well sector agencies met the 12-week statutory reporting requirement for 2003-04 and 2004-05.

FIGURE 13B: TIMELINESS OF COMPLETION OF AUDITED FINANCIAL STATEMENTS, VICTORIAN COMMUNITIES SECTOR

Number of weeks after end of financial year audited financial statements were finalised	2003-04		2004-05	
	Number of entities	Per cent (cumulative)	Number of entities	Per cent (cumulative)
Less than 8 weeks	-	-	2	20
8 to 10 weeks	1	11	2	40
10 to 12 weeks	5	67	5	90
12 to 14 weeks	1	78	1	100
14 to 16 weeks	-	78	-	100
More than 16 weeks	2	100	-	100
Total	**9**	**..**	**10**	**..**

Source: Victorian Auditor-General's Office.

13.3.3 Quality of financial reporting

Apart from the issue resulting in the qualification of the financial statements of the Melbourne and Olympic Parks Trust, the quality of financial statements produced by sector agencies was satisfactory. Audit did not identify any significant reporting issues in 2004-05.

13.3.4 Adequacy of control environments

The responsible officer and chief finance officer of every agency are principally responsible for establishing and maintaining a sound control environment and an adequate system of internal controls to ensure that:

- the agency's financial records and other information completely and accurately reflect its entire activities
- its assets are safeguarded
- errors and other irregularities are prevented or detected.

Our financial audits assess agencies' governance and financial control processes. No significant control issues were identified during our audits.

14. Local government

14.1 Audit conclusions

The Local Government sector comprises 102 entities that were required to prepare financial statements at 30 June 2005 and submit them for audit. Local governments (municipal councils) and regional library corporations were also required to prepare 4 "standard" financial statements at 30 June 2005 and submit them for audit. Local governments were further required to prepare (non-financial) performance statements and have them audited.

We issued clear audit opinions on the financial and "standard" statements of all 79 local governments and 14 regional library corporations, except for Gannawarra Shire Council and Moira Shire Council and the North Central Goldfields Regional Library Corporation. We also issued clear audit opinions on the financial statements of all other sector entities that were completed at 31 October 2005, except for those of the Wimmera Development Association.

We issued clear audit opinions on the performance statements of all local governments, other than the Gannawarra Shire Council and Melton Shire Council.

The timeliness of financial reporting in this sector was again good. Ninety-five per cent of sector entities had their statements finalised within the 3-month statutory deadline.

The financial performance and financial position of the sector improved in 2004-05.

Some local governments continued to have problems valuing their assets and measuring their liabilities. Some needed to improve the reliability of their asset records.

Inadequate separation of duties and the effectiveness of internal audit functions remained areas of weakness impacting on the internal control environment of a number of local governments.

RESPONSE provided by the Secretary, Department for Victorian Communities

I agree with your report's recommendations, which my department will continue to encourage and support local governments to implement.

14.2 Sector overview

14.2.1 Introduction

The state has constitutional responsibility for local governments and provides the legal framework in which local governments operate. Local government in Victoria is administered under the *Local Government Act 1989*.

Local Government Victoria (a division of the Department for Victorian Communities) administers the Act. Given the size and diversity of the department, and the size and diversity of the local government sector, we have detailed the results of audits of sector entities in this part of the report and not in the part in which the department is reported.

Figure 14A shows the nature of the local government entities with a 30 June balance date.

FIGURE 14A: LOCAL GOVERNMENT SECTOR ENTITIES WITH A 30 JUNE BALANCE DATE

Reporting entity	2004	2005
Local governments	79	79
Regional library corporations	14	14
Companies, trusts and joint ventures (a)	11	9
Total	**104**	**102**

(a) GMT (Holdings) Pty Ltd and GMT Infrastructure Limited were deregistered during the year.

Source: Victorian Auditor-General's Office.

As well as auditing the financial statements of entities in the sector, we also audited the standard statements that local governments and regional library corporations are required to prepare under the *Local Government Act 1989*. We also audited the performance statements prepared by local governments.

14.2.2 Financial performance and position

In 2004-05, local governments collected $5.4 billion in revenue ($4.9 billion in 2003-04) and spent $4.6 billion ($4.3 billion in 2003-04) on services.

In 2004-05, total local government revenue grew by $511 million, or 10.5 per cent. The main area of growth was in rate revenue (up $186.6 million, or 8.6 per cent), user fees and charges (up $116.4 million, or 15.6 per cent) and contributions by developers (up $94.1 million, or 28.2 per cent).

In 2004-05, total local government expenditure grew by $285.8 million, or 6.6 per cent. The main area of growth was in wages (up $115 million, or 7.8 per cent), materials and contract costs (up $91.8 million, or 5.7 per cent) and landfill remediation costs (up $21.6 million, or 126.6 per cent).

Local governments' net assets grew in value by $2.2 billion (or 5.8 per cent), to $40.1 billion at 30 June 2005. This growth was almost entirely due to increases in the value of infrastructure and other non-current assets, which were valued at $39.9 billion at the end of the year. About 43 per cent of the increase in the value of non-current assets was due to asset additions, which totalled $951 million. The remainder of the increase was due to adjustments to valuations.

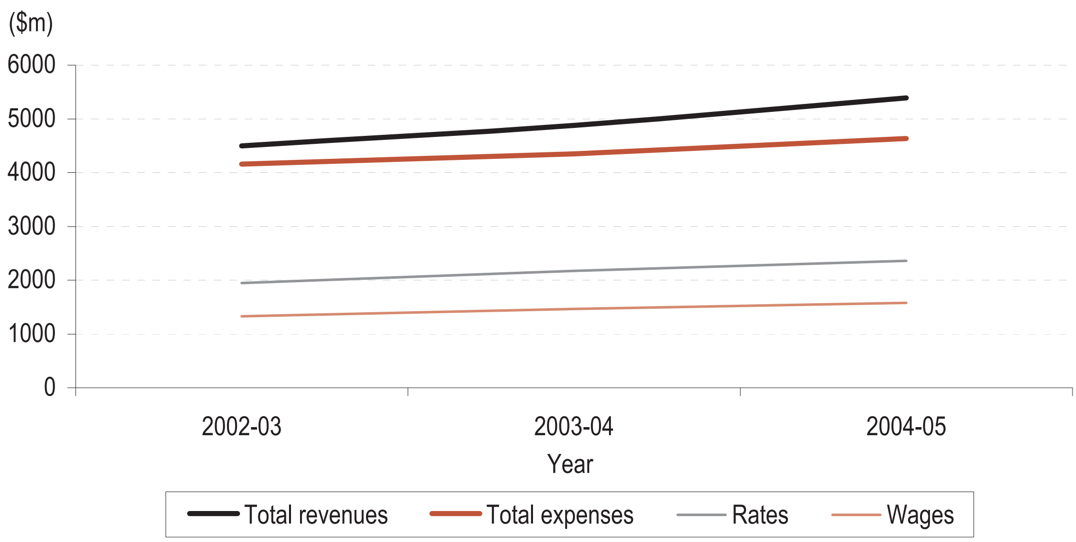
While current assets (mainly cash) grew by $78.3 million (or 4.7 per cent), current liabilities fell by $3.7 million. This fall was largely due to the reclassification of some employee leave balances from current to non-current liabilities.

Local governments' total liabilities grew by $50 million (3.3 per cent) to $1.6 billion. Although their new borrowings totalled $45.8 million, they repaid $62.1 million of borrowings. Against this trend, outer metropolitan local governments borrowed $30.1 million and repaid $20 million.

14.2.3 Financial viability

In 2004-05, local governments' total operating revenue grew more than did their costs. Their cash reserves also grew. Figure 14B shows trends over the last 3 years in total local government revenue, expenditure, rates revenue and wages expenditure.

FIGURE 14B: LOCAL GOVERNMENT REVENUE AND EXPENDITURE TRENDS



The 3-year trend suggests that the sector's financial performance is improving, as the gap between expenditure and revenue seems to be widening. However, as in previous years, local governments' reported operating results in 2004-05 were distorted by the accounting standard requirement to recognise as revenue non-current assets that were either "contributed" to them as part of development activity, or recognised for the first time ("found" assets). The significant upward trend in total revenue this year can be largely attributed to these factors.

Contributed assets recognised as revenue in 2004-05 totalled $359.5 million. The majority of these were roads and public open space in outer metropolitan areas. Found assets recognised as revenue totalled $370.2 million, an increase of $144.5 million over last year. Offsetting these revenue increases were non-current asset write-offs of $80.2 million, treated as expenses.

To assess local governments' ongoing viability, it is better to adjust their reported results for these large and generally one-off distortions. The adjusted operating result for the sector in 2004-05 was $95.2 million ($76.2 million in 2003-04), compared with the reported result of $744.7 million ($448.7 million in 2003-04).

This year we again considered local governments' performance against a number of measures, rather than focus solely on the bottom-line operating result. We also considered the extent of change from prior periods: it is better to examine trends over time, rather than focus on results for only one period.

Figure 14C shows the average performance of the 79 local governments for the past 3 years against 5 indicators of short-term viability and longer-term sustainability[1].

FIGURE 14C: FINANCIAL PERFORMANCE INDICATORS

Indicator	Formula	2002-03	2003-04	2004-05	Trend
Underlying result	Adjusted net surplus/total underlying revenue	-1.9%	1.7%	2.1%	+
Liquidity	Current assets:current liabilities	2.06:1	2.20:1	2.32:1	+
Indebtedness	Non-current liabilities/own-sourced revenue	25.3%	23.7%	23.8%	-
Self-financing	Net operating cash flows/underlying revenue	19.6%	19.0%	19.8%	+
Investment gap	Capital spend:depreciation	1.16:1	1.17:1	1.23:1	+

Source: Victorian Auditor-General's Office.

[1] Local governments might find these indicators useful as benchmarks against which to compare their financial performance.

Underlying result

This is a measure of local governments' surpluses (or deficits) as a percentage of their revenues. For surpluses, the higher the percentage the stronger the result. A negative result indicates a deficit, which is not desirable in the longer term.

As a whole, the sector's performance against this measure again improved significantly this year. In 2004-05, the total local government surplus was $95.2 million, compared with a surplus of $76.2 million in 2003-04.

Thirty-six local governments reported an underlying operating deficit for 2004-05, compared with 33 last year. However, the combined underlying deficits of these local governments in 2004-05 was $73.5 million, compared with $114.4 million last year. Fifty local governments reported underlying operating deficits totalling $152.9 million for 2002-03.

Operating deficits cannot be sustained in the longer term, and deficits by their nature shift the burden of today's costs to future ratepayers. It is therefore encouraging to see that the total deficit is diminishing steadily over time.

Liquidity

This is a measure of local governments' ability to pay their existing liabilities in the next 12 months. For example, a 2:1 ratio means that local governments in total have twice the value of current assets as current liabilities.

In 2004-05, this ratio improved again, from already good levels. Only 3 local governments had ratios that were close to 1:1. Forty-eight local governments had ratios above 2:1.

Indebtedness

This is a longer term measure that compares non-current liabilities (which mainly comprises borrowings and employee benefit provisions) to own-sourced revenue. It complements the liquidity ratio which is a shorter-term measure. The higher the percentage, the less local governments are able to cover their non-current liabilities from the revenues they generate themselves. We used own-sourced revenue (rather than total revenue) because it does not include capital grants, which are generally tied to specific projects and cannot be used to retire debt.

While local governments' total non-current liabilities increased substantially, they increased only slightly as a proportion of total own-sourced revenue. Accordingly, local governments in total had a similar ability to repay debt as they did last year. Of course, the position of individual local governments varied from the average: 20 had ratios for this measure above 40 per cent; twice as many as last year.

Self-financing

This is a measure of local governments' ability to fund the replacement of assets from cash generated by their operations: the higher the percentage, the more able they are to do so.

Although this measure remained about the same for all local governments in 2004-05, 2 generated net operating cash flows that were less than 10 per cent of underlying revenue (compared with 5 last year). Such a situation, if sustained, would limit the ability of these local governments to source funds for infrastructure from their own operations. This would increase the likelihood of local governments having to borrow to replace or add to assets.

Investment gap

This is a measure of whether local governments are spending on infrastructure at a greater rate than the infrastructure is depreciating. Ratios higher than 1:1 (for example, 2:1) indicate that they are. It is a longer-term indicator, because capital expenditure can often be deferred if there are insufficient funds available from operations and borrowing is not an option.

This ratio improved significantly in 2004-05, which indicated that local governments were maintaining existing investment levels. However, 32 councils had ratios less than 1:1 in 2004-05.

Conclusion

Local governments as a group are performing well against the above 5 indicators. However, a number are not doing well on at least one, and often more, of the indicators.

Recommendation

14.1 That each of Victoria's local governments:

- **review their performance over the past 3 years using indicators for underlying result, liquidity, indebtedness, self-financing and investment gap**
- **use the results of their review to set targets for each indicator for each of the next 4 years.**

14.3 Results of financial audits

14.3.1 Audit opinions issued

We issued clear audit opinions on the financial statements of all 79 local governments and 14 regional library corporations, except for Gannawarra Shire Council and Moira Shire Council, for which we issued qualified audit opinions.

Last year, we qualified our audit opinion on the financial statements of Swan Hill Shire Council because of the valuation of some categories of infrastructure assets. We removed the qualification this year. However, the new qualifications for Gannawarra Shire Council and Moira Shire Council also related to valuations of infrastructure assets. Neither council could demonstrate that the value at which they carried some categories of infrastructure assets in their financial statements was accurate. Neither had updated or reviewed valuations that were several years old and, in one case, dated back to 2000.

For 2004-05, municipal councils and regional library corporations were required to prepare 4 "standard" statements that compared actual amounts with approved budgeted amounts. These statements are required under amendments to the *Local Government Act 1989* made in 2003-04. The Act also requires our Office to express an audit opinion on these "standard" statements.

We issued qualified audit opinions on the 2004-05 standard statements of Gannawarra Shire Council and Moira Shire Council, and of the North Central Goldfields Regional Library Corporation. Our qualification of the Gannawarra and Moira standard statements was a consequence of the qualification of their financial statements. North Central Goldfields' statements were qualified because the corporation did not include all of its standard statements in its approved budget document.

Local governments are also required by the Act to produce performance statements and to have these audited. Last year, we issued qualified opinions on the performance statements of 2 councils (Buloke Shire Council and Wodonga Rural City Council). We removed these qualifications in 2004-05. However, we issued 2 new qualifications on the performance statements of Melton Shire Council and Gannawarra Shire Council.

Under the amendments to the Local Government Act, local governments were required for the first time to include key strategic activities in their 2004-05 performance statements. For the first time, they were also required to include this information in their approved annual budget document, instead of in their 4-year council plan[2].

Our audits of performance statements showed that a large number of local governments did not fully comply with the Act's revised requirements. Many included their performance measures and targets in their council plan and not in their approved budget documents. Many did not clearly state their key strategic activities, nor did they link them well with their performance measures. We did not qualify the performance statements of these local governments. Although they did not comply with the letter of the Act, our view was that these were inadvertent beaches in what was a transitional year, and that local governments had substantially complied with the intent of the legislation.

However, we qualified the performance statements of Melton Shire Council and Gannawarra Shire Council because either they did not include key strategic activities or related performance measures and targets in their approved budget documents, or in any other approved plans.

Recommendation

14.2 That all local governments review their 2005-06 approved budget documents to ensure that they include, as required by the Act:

- **standard statements in the form, and containing the matters, required by the Act's regulations**
- **a description of the activities and initiatives to be funded in their budget**

[2] This plan was previously known as the corporate plan.

- **a statement showing how the activities and initiatives will contribute to achieving the strategic objectives in the council plan**
- **separately identified key strategic activities to be undertaken during the financial year, and performance targets and measures for each key strategic activity.**

As in previous years, we issued clear audit opinions on the financial statements of 8 of the 9 other entities (trusts, companies and joint ventures) that were controlled by local governments. We again qualified the financial statements of the Wimmera Development Association because it again deferred recognising grant revenues it received until the grant money was spent. Accounting standards do not permit grant revenues to be treated this way.

RESPONSE provided by the Chief Executive Officer, Moira Shire Council

Council has focused much of its resources on the design of a sophisticated condition assessment and defect inspection system to ensure compliance with the requirements of the Road Management Act. Council has and will continue to implement this system across the remaining asset categories of which it has control.

Council has also experienced difficulty recruiting the required expertise to resource its asset management and its broader engineering services.

Nevertheless, a detailed implementation plan has been completed to ensure all asset categories are appropriately recorded, validated and valued with an accurate condition assessment by April 2006.

RESPONSE provided by the Acting Chief Executive, Shire of Melton

Council accepts the above recommendation.

14.3.2 Timeliness of reporting

Under section 126 of the *Local Government Act 1989*, local governments and regional library corporations must submit their annual reports (including audited financial and standard statements) to the relevant minister by 30 September each year. Local governments must include their performance statements in their annual reports.

Figure 14D and 14E shows how well local governments and regional library corporations performed in having their audited financial statements completed by 30 September.

FIGURE 14D: TIMELINESS OF AUDITED FINANCIAL STATEMENT COMPLETION, MUNICIPAL COUNCILS

Number of weeks after end of financial year audited financial statements were finalised	2003-04		2004-05	
	Number of entities	Per cent (cumulative)	Number of entities	Per cent (cumulative)
Less than 2 months	2	3	2	3
2 to 3 months (September 30 deadline)	76	99	76	99
3 to 4 months	1	100	1	100
Over 4 months	-	100	-	100
Total	**79**	..	**79**	..

This year, the Minister for Local Government again granted Gannawarra Shire Council an extension of the 30 September deadline, to 31 October 2005.

FIGURE 14E: TIMELINESS OF AUDITED FINANCIAL STATEMENT COMPLETION, REGIONAL LIBRARY CORPORATIONS

Number of weeks after end of financial year audited financial statements were finalised	2003-04		2004-05	
	Number of entities	Per cent (cumulative)	Number of entities	Per cent (cumulative)
Less than 2 months	1	7	-	-
2 to 3 months (September 30 deadline)	13	100	13	93
3 to 4 months	-	100	1	100
Over 4 months	-	100	-	100
Total	**14**	..	**14**	..

The Minister for Local Government granted the North Central Goldfields Regional Library Corporation an extension of the deadline, to 14 October 2005, which it met.

At the time of preparing this report, we had finished auditing the 9 local government companies, trusts and joint ventures. We finalised 3 in August, 3 in September and 3 in October.

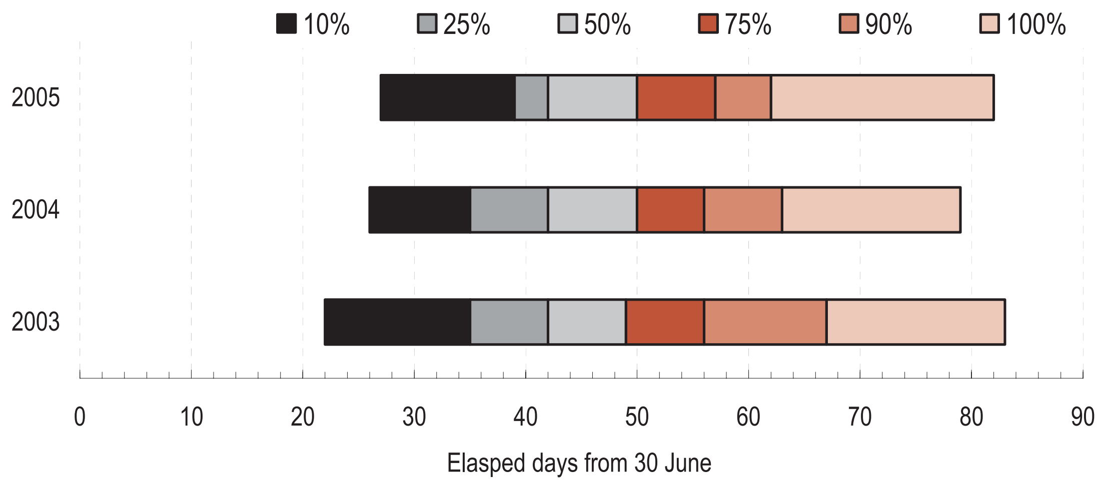
While all local governments again met their approved deadline for lodging their annual reports, their timeliness in providing draft financial statements to our Office slipped slightly this year. However, we consider this reasonable given the extra work required this year to assess and disclose the impact of new Australian equivalents of International Financial Reporting Standards on their future financial statements.

Figure 14F shows (in percentile bands and for the past 3 years) the time after 30 June that local governments provided a first acceptable draft set of financial statements to our Office. In 2004-05, 10 per cent submitted their draft statements for audit within 39 days of 30 June. All local governments, except Gannawarra Shire Council submitted their draft statements within 82 days of 30 June.

Figure 14F shows that in each of the last 3 years, the time taken for 90 per cent of local governments to submit draft statements has steadily reduced.

The average elapsed time in 2005 was 51 days, compared with 50 days in 2004 and 49 days in 2003. Best practice (that is, what the quickest 10 per cent of local governments did) was less than 39 days. The quickest (Ararat Rural City Council) submitted draft statements for audit 27 days after 30 June.

FIGURE 14F: TIME TAKEN BY LOCAL GOVERNMENTS TO PROVIDE DRAFT STATEMENTS



From the date of receipt of the first draft, it took on average 26 days for a local government to obtain final audit clearance and arrange for its statements to be signed.

The adoption of Australian equivalents of International Financial Reporting Standards for the 2005-06 year is likely to mean that local governments will need more time to prepare their financial statements. It is, therefore, important that local governments find ways to maintain/improve the timeliness of their reporting processes. One way would be for local governments to prepare "shell" statements and obtain audit sign-off on these statements before 30 June. These statements would include reclassified and restated (if necessary) 2004-05 comparative figures that comply with Australian equivalents of International Financial Reporting Standards, and any additional disclosures required by those standards.

Recommendation

14.3 That local governments prepare "shell" statements for 2005-06 before the end of the financial year.

14.3.3 Financial reporting issues

Generally, the quality of 2004-05 reporting by sector entities remained good. However, the 2 financial reporting issues below continued to present challenges for local governments.

Valuation of infrastructure assets

This year, we again observed a number of large adjustments to infrastructure asset balances. Local governments wrote-on to their statements a total of $370.2 million of assets that they controlled but that they had not included in their asset registers. They also wrote-off $80.2 million of assets. They wrote-off some road assets because they transferred control of them to the state government. However, other write-offs and most of the write-ons were due to asset records not being complete or accurate.

We are concerned that local governments continue to make such significant adjustments. While these adjustments help to improve the accuracy of asset records, local governments need to pay greater attention to ensuring that their records of all significant assets are complete and accurate.

One reason for incomplete and inaccurate asset values in local governments' financial reports is the lack of integration between accounting records and the asset management systems used by engineering staff. A number of local governments base the asset records they use to prepare financial statements on spreadsheets which are inherently less reliable than specific-purpose asset software applications. The data in these records may either be at a summary level only; may be based on financial records of payments; or may have to be extracted from the asset management system used by the engineering staff. In these instances, there is considerable scope for errors to occur and remain undetected.

Recommendation

14.4 That local governments plan to integrate their asset management systems with their accounting records to the extent practicable. Where this is not practicable, they should implement adequate reconciliation controls.

Measurement of landfill remediation provisions

For the first time, the 2003-04 financial statements of several local governments included a liability in relation to their obligation to remediate, rehabilitate and provide aftercare for landfill sites.

At 30 June 2004, 20 local governments had booked a total of $22.3 million to provide for future remediation works on both operational and closed landfill sites. They recognised $17.1 million of this amount as an expense in 2003-04.

In 2004-05, a further 12 local governments made new remediation provisions. At 30 June 2005, the total provision balance was $67.8 million. Of this amount, $38.7 million was recognised as an expense in 2004-05.

Some other local governments decided that they could not reliably estimate their liability, and disclosed this in a note to their financial statements. These local governments have yet to recognise in their financial statements liabilities in relation to landfill sites.

Recommendations

14.5 That all local governments continue to review the need for landfill remediation provisions.

14.6 That all local governments that have an obligation to remediate determine a methodology to reliably estimate the cost of remediation, so that they can recognise the provision as a liability.

14.4 Adequacy of councils' risk management

Our audits this year examined local governments' approaches to risk management. We found that approximately 95 per cent had a formal risk policy and a risk management strategy. However, we noted some areas that could be improved.

Some local governments introduced formal risk policies and risk management strategies in 2004-05, while others have had policies in place for many years. However, many of those with longstanding policies had not reviewed them recently to find out if they were still appropriate for their current structure or for the volumes and nature of the services they provided.

Some local governments did not have a comprehensive risk register to track all significant risks. Some were in the process of establishing a register, and were progressively identifying and assessing risks.

Some local governments emphasised the identification and management of public liability and occupational health and safety risks, these risks being subject to review by their insurers. These and other local governments placed less emphasis on identifying and assessing other types of risks such as financial reporting, legal, financial and contract risks.

Many local governments had sound processes to monitor risk treatments and report to senior managers. However, others did not have clearly defined processes for how and what risks to report to councillors, in order to assure their council that they were effectively managing significant risks.

Recommendation

14.7 That each local government review its risk management framework to ensure that:

- **risk policies and risk management strategies remain current and appropriate to their needs**
- **risk registers and treatment plans consider all categories of risk**
- **councillors are updated on the effectiveness of risk management activities**
- **significant risks and proposed risk treatments are promptly reported to council.**

14.5 Adequacy of local government control systems

Our audits of local government internal control systems each year generally find that they operate effectively, given each local government's resource constraints. However, the assignment of incompatible duties to staff is an area of ongoing concern.

Incompatible duties are duties involving the authorisation and processing of transactions which, if conducted by one person without oversight, raise significant risks of error and fraud. As a general principle, more than one person should be involved in processing any financial transaction. Ideally, a person who initiates a purchase should not also be able to authorise that purchase, certify that the goods or services were provided, approve the payment to the supplier and record the payment in the accounting system.

A second check by an independent person helps to detect any inadvertent errors, and can also help to deter fraud.

Our audits found that 10 local governments allowed a staff member to initiate, authorise, certify and approve purchases, provided the amount of the purchase fell within their delegated financial limit. In some cases, the delegated limit was expressed as the staff member's total approved budget. In other cases, the delegation was a per-transaction dollar limit. We noted that some senior officers had large dollar value delegations.

Eleven local governments also allowed accounts payable and payroll staff to add, delete and amend master file records without any independent checking or other oversight. Further, some local governments did not separate the collection, recording and (in some cases) banking of receipts among several staff.

We acknowledge that smaller local governments have limited resources, which is a reason for inadequate separation of duties. Inadequate separation by larger local governments (that do not face the same resource constraints) has largely been a risk management decision.

Local governments that inadequately separate duties are exposed to greater fraud risks. Last year, the City of Yarra reported a payroll fraud in excess of $1 million that was largely attributable to inadequate separation of duties.

Our auditors were also made aware of several proven or alleged frauds, all of which involved a lack of separation of duties. Four local governments identified actual or alleged frauds involving the theft of cash receipts, 2 of which they believed to amount to more than $200 000 each. Four other local governments identified expenditure frauds that also exceeded $200 000 in total.

The frauds were detected either as a result of staff changes or by investigations of the suspicions of other staff. This highlights the importance of a staff rotation policy and active promotion of fraud awareness.

Recommendation

14.8 That all local governments:

- **establish a fraud control policy and assess the risks of fraud as part of their broader risk management framework**
- **review the adequacy of their separation of incompatible duties**
- **where separation is inadequate, either change their policies and procedures to achieve separation, or ensure adequate management oversight of incompatible duties.**

14.6 Adequacy of local government monitoring and review of controls

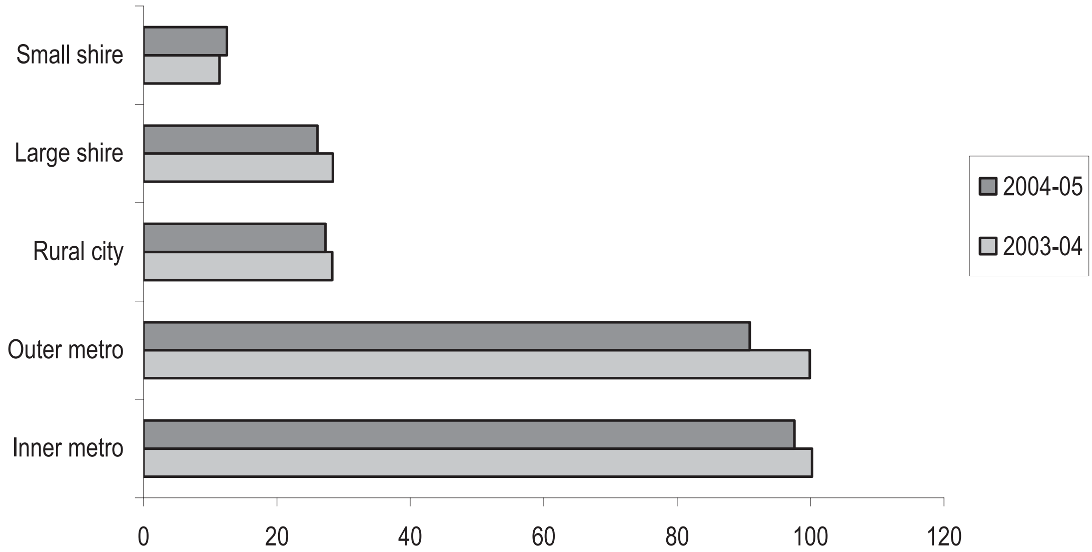
Last year, we reported that a number of local governments did not have an internal audit function. For 2004-05, we again note that 12 local governments did not have an internal audit function. Nine of these have not had an internal audit function for at least the past 2 years.

The amount and nature of resources allocated for internal audits by local governments continues to vary widely. Eight local governments used their own staff for internal audits, and 6 used both staff and external contractors. The remainder fully outsourced their internal audit function.

In 2004-05, 11 local governments spent more than $100 000 on internal audits. The average expenditure was $54 200, a small reduction from last year. The amount allocated to internal audits usually varied according to the size of the local government.

Figure 14G shows the average expenditure on internal audits for the past 2 years, by type of local government.

FIGURE 14G: AVERAGE LOCAL GOVERNMENT INVESTMENT IN INTERNAL AUDITS ($'000)



Note: Given its size and nature, we included Geelong City Council in the outer metro group for this analysis. It invested in internal audits significantly more than did other rural cities.

Conclusion

We were concerned to see that total expenditure by the sector on internal audit fell slightly in 2004-05, particularly considering the increases in total local government expenditures in the past 2 years.

As reported last year, a significant proportion of local governments either did not have an internal audit function, or spent small amounts on internal audits compared with other similar local governments.

Recommendation

14.9 That all local government audit committees annually review their expenditure on internal audits, and benchmark their expenditure on internal audits against similar local governments.

Results of other audits

15. Progress of the EastLink project

15.1 Audit conclusions

In October 2004, the government entered into a contractual arrangement (in the form of a concession deed) with a private sector consortium (ConnectEast) for the construction, operation, maintenance, financing and tolling of the proposed EastLink freeway. This new freeway will provide 45 kilometres of new road connecting the Eastern Freeway to the Frankston Freeway through the Scoresby corridor, and is expected to be completed by late 2008.

A private-public partnerships model was used for this project, similar to that used for the Melbourne CityLink project. Under the model, ConnectEast will construct and operate the tolled freeway for a period of about 39 years, after which time it will hand back ownership of the freeway to the state (in a fully maintained condition) at no cost. A key distinguishing feature of the EastLink arrangements (compared with CityLink) is that the concessionaire is not obliged to pay concession fees to the state, in return for the right to operate the toll road.

Our audit examined the analysis conducted to support the government's decision to proceed with the project, the project tendering arrangements, the allocation of project risks between the state and other parties, and the project's ongoing governance and management arrangements.

We found that, while a comprehensive business case was prepared to guide the government's decision on whether (and how) to proceed with the freeway, the business case should have included the results of a "public interest test"[1], based on the finally proposed project (that is, a single project incorporating the former Scoresby Freeway and Eastern Freeway Extension projects) using a toll funding model. It didn't.

Although a public interest test was conducted for the 2 proposed (non-tolled) predecessor projects, one was not conducted for the (tolled) freeway. A toll road has different impacts on privacy, security, consumer rights, public access and equity. *Partnerships Victoria* guidelines require such a test to be completed prior to a project being put to the market. The Southern and Eastern Integrated Transport Authority (the authority) believes that the agreed concession arrangements address public interest considerations under the guidelines, including matters related to privacy, security, consumer rights, public access and equity.

[1] The "public interest test" examines the potential impacts of project proposals, inter alia, on privacy, security, consumer rights, public access and equity.

Deployment of the *Partnerships Victoria* policy is generally pursued by the government where it is considered likely to deliver better value-for-money than traditional delivery methods. Under the policy, a public sector comparator[2], which estimates the cost of the most efficient form of public sector delivery, is used as a key means to test for value-for-money. The release of a project brief is a significant milestone in the procurement process as it signals that the government is prepared to proceed with a project, provided that a conforming bid offering value-for-money in comparison with the public sector comparator is received.

In the case of EastLink, the request for proposals from private sector bidders had 2 overall requirements. First, that the proposals must meet the requirements set out in the request for proposals[3] and, second, that they must offer value-for-money by bettering the public sector comparator[4].

The authority concluded that the 2 proposals were conforming proposals (i.e. they met the minimum requirements) and that they satisfied the value-for-money test against the comparator.

A key factor underpinning the Southern and Eastern Integrated Transport Authority's recommendation to the minister, to accept the ConnectEast project proposal, was the results of its value-for-money assessment using the public sector comparator. While it is generally accepted that the use of the comparator as the sole means of assessing value-for-money has inherent limitations, given that it is based on many long-term assumptions with high sensitivity and data limitations, the comparator nevertheless provides a useful tool to benchmark against private sector bids.

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[2] The public sector comparator estimates what a project would cost if it was delivered by the state rather than by the private sector. It is used as a quantitative indicator to help determine whether proposals for private investment in the provision of public infrastructure offer better value-for-money than would delivery by the state (on a risk adjusted basis).

[3] The request for proposal document stated that a conforming proposal was one which met the requirements of the request for proposal, the proponent deed and any other expressed requirements of the state.

[4] The request for proposal document stated that proposals must offer value-for-money in comparison with the public sector comparator. In assessing value-for-money, an assessment was to be made of any net additional value offered by a proposal and whether this value was justified against the comparator. The overall assessment of value-for-money focused, in particular, on the toll levels to be imposed on users of the freeway.

We observed that some of the key assumptions used to determine the comparator (about forecast traffic levels, total toll revenue and construction costs) were significantly different from those used in the project proposals received from the 2 private sector proponents. As allowed by the *Partnerships Victoria* policy, in view of these significant differences and the government's decision to change the project scope after the comparator was determined (by including the Dandenong Southern Bypass and revising the minimum traffic lane requirements for the project), the comparator should, in our view, have been recalculated.

The use of the comparator, without revision, to support the authority's assessment that the successful proponent's proposal offered better value-for-money than an alternative public sector delivery model, in our opinion, diminished the reliability of the comparator as an assessment tool. We acknowledge that a number of other indicators were also used by the authority to judge the value-for-money offered by the proponents' proposals. These included: the cost to users of the freeway; innovations proposed offering improved value-for-money (such as setting tolls based on the time of day or day of week basis); the proposed approach to the delivery of the project; the financial and risk consequences for the state of any proposal; the length of the concession period; proposals for state participation in revenue or profit sharing with the concessionaire; the toll reduction regime; and any other requests by proponents for state facilitation of their proposals.

Consideration of these indicators supported the decision to give preference to the successful proponent (from a value-for-money perspective). However, we remain of the view that bettering the public sector comparator was so fundamental to bid evaluation and negotiation that it should have been revised to take account of any required changes in key assumptions and the scope of the project since it was previously calculated.

The authority's recommendation to the minister considered the value-for-money offered by the 2 private sector proposals by comparing the total toll revenue users would pay during the concession period under each proposal. It did not compare these 2 amounts with what users would have paid under a public sector provision model (as estimated in the public sector comparator). This comparison would have enabled a more complete consideration of the impacts of the alternative delivery models on users (the community).

The project's probity arrangements were generally sound and had several strengths. These included the appointment of a probity auditor, the development of a comprehensive probity plan consistent with government policy and the requirement that proponents appoint their own probity auditors. This last requirement was to ensure that proponents, consortium members and related parties complied with the tender process.

The tender evaluation process was sound. Its strengths included:

- comprehensive requests for expressions of interest and proposals documents, and plans for evaluating them
- an appropriate structure for evaluating proposals
- a contractual requirement on proponents to comply with tendering procedures (including a "security for process bond" of $10 million)
- the requirement to sign a commitment deed after proposals were evaluated, which compelled the proponents to enter into the agreed contract documents if the state accepted their proposal
- comprehensive evaluation reports
- timely completion of the process.

The successful proponent (ConnectEast) had not contracted a tolling system provider at the time of signing the concession deed (October 2004). However, the tolling system contractual arrangements were subsequently finalised during May 2005.

Risk has been allocated under the concession deed in accordance with *Partnerships Victoria* policy. That is, risks have generally been allocated to the party best able to manage those risks.

At the time of preparing this report, the construction of the freeway had commenced and the Southern and Eastern Integrated Transport Authority was establishing appropriate ongoing project management and governance arrangements.

RESPONSE provided by the Chief Executive Officer, Southern and Eastern Integrated Transport Authority

The authority, which has had carriage of the EastLink project since 1 July 2003, notes the overall satisfactory appraisal of the analysis, tender, evaluation, awarding and implementation of the arrangement for this complex project.

Given its significance, the project had input from a number of other government departments, in particular the Department of Treasury and Finance in relation to Partnerships Victoria. This input was continuous through the procurement phase, including the evaluation and preparation of recommendations.

RESPONSE provided by the Chief Executive Officer, Southern and Eastern Integrated Transport Authority - continued

The 3 audit recommendations in the report largely relate to future Partnerships Victoria projects. The Department of Treasury and Finance has prepared a separate response to these recommendations [which is included later in this part of the report, following the recommendations]. *The issues for comment by the authority follow:*

Public interest test – Agree

The authority notes the audit finding that the test was completed for the separate projects initially, and that the final documented project adequately deals with the issues relating to the public interest test, but accepts that the process contemplated in the Partnerships Victoria guidance material of a formal test for the final project was not repeated once the project was to be delivered on a tolled basis.

At each relevant stage of the project; release of the request for proposal and associated draft contract documents, preparation of the project specific legislation and final approval of the contract documents, the government was able to see in considerable detail how the various public interest considerations had been addressed.

The authority contends that it adequately addressed the detailed requirements of public interest, without filling in the template contemplated in the Partnerships Victoria guidance material. The Auditor-General has not expressed any concerns about the coverage of those public interest matters contemplated by the Partnerships Victoria policy.

Public sector comparator – Disagree

The authority has advised the Auditor-General that the report is incorrect in its coverage of the role of the public sector comparator (PSC) in the process of evaluation and making recommendations to the government.

The PSC was not a 'key factor' in the process. It was merely one part of the comprehensive range of matters considered as part of the evaluation of value-for-money. It should be noted that EastLink differs to most other Partnerships Victoria projects in that it is funded by its own revenue stream and has no ongoing government contributions.

Further, the evaluation was conducted against the backdrop of a government decision to proceed with the project as a private toll road on the basis that it was beyond the capacity of the state budget for the public sector to deliver the project within a reasonable time frame.

RESPONSE provided by the Chief Executive Officer, Southern and Eastern Integrated Transport Authority - continued

Value-for-money was comprehensively assessed and, in particular, value-for-money for EastLink users was considered in detail. Contrary to the incorrect statement in the Auditor-General's report, toll levels and revenues were compared between the 2 bidders and the PSC.

Importantly, the authority would like to make the following points:

- *the procedures detailed in the Partnerships Victoria documentation were followed and Department of Treasury and Finance representatives were actively involved at all stages*
- *a conscious decision was taken, based on the facts available and the advice of expert consultants, not to revise the PSC for enhancements that had been identified by the bidders as part of the competitive bidding process nor for different assumptions and methodologies adopted by the bidders*
- *revising the PSC in the manner contemplated by the Auditor-General would not have enhanced the value-for-money equation and, therefore, served no useful purpose.*

Probity and tender evaluation process – Agree

The authority notes the positive assessment of the process. Probity was a paramount concern at each stage of the process.

Commitment of a tolling system at the time of signing – Disagree

The status of the tolling system at the time of the signing of the concession deed is consistent with the requirements of the bid process and was fully contractually supported by documentation with the concessionaire and its design and construct contractor. This was, in turn, supported by the commitment of the contractors' parent and a substantial construction bond.

The interests of the state and EastLink users were fully protected through binding contractual arrangements.

Risk allocation – Agree

Contract management - Partially agreed

It is now over one year since the concession commenced and arrangements for contract management and governance are well developed. The language in the report refers to the situation that existed in early 2005.

The contract management plan was prepared, as required, in February 2005 and subsequently a contract administration manual was prepared. Contract management processes and governance generally are updated regularly and have been satisfactorily subject to internal audit.

15.2 Background

In September 2002, the government announced the amalgamation of the formerly proposed Scoresby Freeway and Eastern Freeway Extension projects into a single project, now known as EastLink (the freeway), to be delivered under *Partnerships Victoria*[5].

The *Southern and Eastern Integrated Transport Authority Act 2003* and the *Mitcham-Frankston Project Act 2004* subsequently established the legislative framework for the project.

The *Southern and Eastern Integrated Transport Authority Act 2003* established the Southern and Eastern Integrated Transport Authority, which will facilitate the project on behalf of the state. Prior to the authority's creation in July 2003, the Department of Infrastructure (DoI) managed the development of the business case, and the tender process, for the freeway.

The *Mitcham-Frankston Project Act 2004*[6] authorised the Minister for Transport to enter into a concession deed. The deed is the key contractual document between the state and the concessionaire, ConnectEast. The bid consortium included Macquarie Bank Limited, Thiess Pty Ltd and John Holland Pty Ltd.

Under the concession deed, the concessionaire (the ConnectEast entities) will design, finance, construct, operate and maintain the freeway.

Figure 15A shows the location of the freeway, which will comprise 45 kilometres of new road connecting the Eastern Freeway to the Frankston Freeway, 39 kilometres of which will be tolled. Two sections of the new road will not be tolled (a 2-kilometre enhanced bypass of Ringwood and a new 4.75 kilometre bypass of Dandenong). These sections will be handed over to the state at no cost once construction is complete.

The tolled road will include 2 approximately 1.5 kilometre (3-lane) tunnels, and include some 90 bridges and 17 major interchanges.

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[5] *Partnerships Victoria* is the Victorian Government's framework for establishing partnerships with the private sector for the provision of public infrastructure and related ancillary services.

[6] The Act was amended in May 2005 to include the Dandenong Southern Bypass in the project and to change certain tolling and other provisions.

FIGURE 15A: THE EASTLINK PROJECT

Source: Southern and Eastern Integrated Transport Authority.

The total cost of the freeway (including capital and financing costs) is estimated to be about $3.8 billion. This includes an estimated construction cost of $2.5 billion.

The concessionaire will operate the freeway for a period of about 39 years, after which the infrastructure and all operational activities will be handed over to the state at no cost. The infrastructure is to be built (and maintained) so it will have a specified design life. Tunnels, underpass structures and roadway support structures will have a 100-year design life, while tolling system structures will have a design life of 40 years and freeway road pavements will have a 30-year design life.

The concessionaire will lease state land to be used for the freeway, including works on the Eastern Freeway extension east of Springvale Road, for a nominal rent (the state land and works have been valued at $318 million). The concessionaire paid the state $15 million, resulting from movements in interest rates between the bid period and the finalisation of the concessionaire's financial arrangements in November 2004. It has also paid the state $20 million during July 2005 as a contribution to public transport and community infrastructure in the corridor serviced by the freeway.

One of the distinguishing features of the arrangements established for EastLink, compared with CityLink (the state's other toll road), is that the concessionaire is not required to pay the state fees in return for the state granting it the right to operate a toll road. In the case of CityLink, the operator is required to pay concession fees, with an estimated nominal value of about $3 billion, over the life of that project (approximately 34 years).

EastLink's tolls will be calculated in accordance with the provisions of the concession deed. Figure 15B shows the estimated toll rates for passenger vehicles in 2008, when the freeway is expected to be completed.

Under the concession deed, tolls may increase by up to the movement in the annual consumer price index. The deed includes provision for regular customers to obtain toll credits, up to a total value of $15 million annually, if the concessionaire does not meet customer service, road condition, landscape, architecture and environmental key performance indicators. Sections of the freeway will be opened on completion, even if the tolling system is not ready.

FIGURE 15B: CONCESSION DEED, ESTIMATED TOLL RATES FOR PASSENGER VEHICLES

Section	Section start	Section end	Estimated 2005 tolls ($)	Estimated 2008 tolls ($)
1	Springvale Road	Maroondah Hwy	2.11	2.28
2 to 5	Maroondah Hwy	High Street Road	0.31	0.34
6 to 11	High Street Road	Greens Road	0.48	0.51
12 to 13	Greens Road	Frankston freeway	1.06	1.14
Toll cap			**4.54**	**4.91**

Note: Under the concession deed, tolls may increase by up to the movement in the consumer price index. We estimated the 2005 tolls by applying the concession deed provisions and the actual CPI for December 2004. The estimated 2008 tolls are calculated using the state's CPI forecasts in the *2005-06 Budget Papers* (being 2.75 per cent for 2006 and 2.5 per cent thereafter).

Tolls for motorcycles are half the tolls for cars. Tolls for light commercial vehicles are 1.6 times the tolls for cars. Tolls for heavy commercial vehicles are 2.65 times the tolls for cars. Discounts of 20 per cent apply for all cars on weekends and discounts of 20 per cent apply to local trips, for travel on one toll zone on any week day (excluding the twin 1.5 kilometre tunnels). The concession deed also includes a schedule of other charges and fees payable by users of the freeway.

While the concession deed makes provision for resetting agreed toll prices, at the time of preparing this report no such adjustment had been agreed by the state.

Source: Concession deed.

Figure 15C shows the project timelines for EastLink, from the initial conceptual work through to the projected completion date.

FIGURE 15C: EASTLINK PROJECT TIMELINES

Milestone	Date
Government publicly announced its decision to build the Mitcham-Frankston Freeway (now known as EastLink) and terminate a tender process for the tunnel component of the former Eastern Freeway Extension Project (a).	September 2002
A business case for the combined Mitcham-Frankston Freeway project (without tolls) was presented to the government, and endorsed.	March 2003
Financial analysis for tolling the freeway was presented to the government, and the government publicly announced its decision to toll the freeway.	April 2003
Government approved the release of the request for expressions of interest document for the project.	May 2003
Two responses were received to the request for expressions of interest.	June 2003
Southern and Eastern Integrated Transport Authority (the authority) created (after the expressions of interest had been evaluated by the Department of Infrastructure)	July 2003
Government approved the issue of the request for proposals document (including draft contractual documents) to the 2 respondents previously expressing interest in the project (b).	October 2003
The authority received proposals from 2 interested proponents (c).	April 2004
The authority issued the commitment deed (and revised draft contract) to each proponent (d).	September 2004
Proponents returned executed commitment deeds.	September 2004
Minister for Transport entered into the concession deed with the successful proponent, the ConnectEast consortium.	October 2004
Concession deed (the key contractual document between ConnectEast and the state) tabled in parliament.	November 2004
Concession period commenced (e).	November 2004
Construction planned to be completed (f).	October 2008
State to receive the Dandenong Southern Bypass and enhanced Ringwood Bypass.	October 2008
Tolling system to be completed.	November 2008
State to receive the freeway (on completion of the concession period) (g).	November 2043

(a) In August 2002, business cases were presented to the government for the Scoresby Integrated Transport Corridor Project and the Eastern Freeway Extension Project (which included tolls to be levied on commercial vehicles, as a funding option). These were rejected, with the government asking for the development of a new business case for a combined project.

(b) The state received comments on the draft contract documents from respondents in December 2003 and issued revised draft contract documents to respondents in February 2004.

(c) The authority issued further revised draft contract documents to proponents in July 2004 and received revised proposals in August 2004.

(d) The commitment deed committed the proponents to signing-off on the transaction documents (that is, the final negotiated draft contract documents, including the concession deed, that had been agreed with that proponent) if the state accepted their proposal.

(e) Although the concession deed was entered into in October 2004, the concession period commenced in November 2004.

(f) The concession deed provides for section 5 of the freeway to be completed by June 2008.

(g) The concession deed provides that the concession period can be terminated earlier under certain specified circumstances and, equally, may be extended under certain specified circumstances.

Source: Various authority documentation.

15.2.1 Audit objective

This audit examined the progress made on this project, with a focus on assessing whether:

- adequate analysis was undertaken to support the government's decision to proceed with the project
- the tender process was well managed
- project risks were appropriately allocated between the state and other parties
- the ongoing governance and management arrangements for the project are adequate.

15.3 Was the analysis supporting the decision to proceed with the freeway adequate?

Partnerships Victoria policy highlights that:

- the choice between public and private provision of infrastructure will be made on practical grounds. Such choices will be based on an assessment of the needs of each project and will be tested against a rigorous public interest test that will examine the potential impact (inter alia) upon privacy, security, consumer rights, public access and equity
- deployment of the *Partnerships Victoria* policy will be vigorously pursued where it is likely to deliver better value-for-money than traditional delivery methods. A public sector comparator, which estimates the cost of the most efficient form of public sector delivery, will be constructed to test for value-for-money
- release of the project brief is a significant milestone as it signals that the government is prepared to proceed with a project provided that a conforming bid offering value-for-money in comparison with the public sector comparator is received.

Preparation of a comprehensive business case is a key element of the *Partnerships Victoria* policy, in support of decisions by government to proceed with a project and seek private sector bids. This includes estimation of a public sector comparator, which is one of the tools used to assess the value for money offered by private bids. The comparator formed part of the evaluation criteria used by the authority to assess proposals from the private sector for the freeway.

In assessing whether the analysis supporting the government's decision to proceed with the freeway was adequate, we sought to determine whether:

- a comprehensive business case, including a cost-benefit analysis and other key requirements of the *Partnerships Victoria* policy (including the use of a public sector comparator and a public interest test), had been prepared
- the business case clearly established the project objectives, scope, timelines, budgeted cost, risk allocations, user needs and intended benefits of the project.

15.3.1 Business case

In March 2003, the government endorsed the business case for the then Mitcham-Frankston Freeway Project. The business case set out the project's objectives and scope, timetable, estimated cost, risk allocation, traffic forecasts and included a draft public sector comparator. The public sector comparator estimates what a project would cost, on a risk inclusive whole-of-life cost basis, if it was delivered by the state rather than by the private sector. It is used in the development of business cases to promote a full consideration of costs and, in later stages of the procurement process, it generally plays a major role in the assessment of the value-for-money offered by private sector proposals.

The business case did not include tolls as a funding option.

EastLink freeway at Ringwood - a proposed concept illustration.
(Photo courtesy of the Southern and Eastern Integrated Transport Authority.)

Cost-benefit analysis

The business case was based on the detailed cost-benefit analysis completed for 2 predecessor projects in August 2002 (the Scoresby Integrated Transport Corridor project and the Eastern Freeway Extension project).

The cost-benefit analysis that had been undertaken for the Scoresby project formed part of a much broader triple bottom line analysis that looked at direct benefits to transport users (such as savings in travel time, travel costs and accidents) and environmental and social benefits (such as savings in greenhouse gas and noxious emissions from transport). That analysis predicted that the Scoresby project would deliver significant improvements in the corridor's economic performance, freight efficiency, travel times, congestion and transport safety with largely neutral or manageable environmental and social impacts. This was predominately due to the anticipated additional transport choices arising from the completion of the Scoresby project.

Early in April 2003, the government requested DoI to prepare additional financial analysis on using tolls to fund the then Mitcham-Frankston Freeway project[7]. DoI's analysis was provided to the government in early April and considered:

- alternative toll prices, traffic growth and freeway avoidance (diversion) rates
- funding options (including estimated Commonwealth and state contributions and/or the likelihood of private funding)
- possible project scope changes
- development of other public transport infrastructure in the corridor
- allocation of project risks.

DoI's April 2003 analysis estimated that a tolled freeway would require a total government budget contribution of $200 million (in nominal dollar terms). This assumed that the state would recover about $324 million from the concessionaire for costs of land acquired, road network upgrades, design and project management, and program administration.

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[7] DoI submitted its analysis on tolling the freeway to the Minister for Transport on 5 and 6 April 2003, and to the Premier, Treasurer and Minister for Transport on 7 April 2003. On 8 April 2003, a further paper on tolling the freeway was presented to the government.

Public interest test

Partnerships Victoria guidelines require, as part of a business case, for proposals to be subject to a "public interest test". This test examines the potential impacts of a proposal on project effectiveness (meeting government objectives), accountability and transparency, affected individuals and communities (their ability to contribute at the planning stages), privacy, security, consumer rights, public access and equity. The guidelines state that the public interest test is a threshold question, asked before a project is put to the market.

The business case for the freeway (including the analysis prepared in April 2003) did not include the results of a public interest test. A public interest test had been completed for the 2 predecessor (non-tolled) projects in August 2002. However, a toll road has different impacts on privacy, security, consumer rights, public access and equity.

The authority believes that the agreed concession arrangements address the public interest considerations under the guidelines, including matters related to privacy, security, consumer rights, public access and equity. For example, the concession deed expressly requires the concessionaire to comply with the Information Privacy Principles in the *Information Privacy Act 2000*.

Conclusion

While a comprehensive business case was prepared to guide the government's decision on whether (and how) to proceed with the freeway, the business case should have included public interest considerations (the required public interest test) for a toll funded project. It didn't. Consequently, the result of the public interest test, a threshold question asked before a project is put to the market, was not included in the business case put to government.

Value-for-money - The public sector comparator

The preparation of a public sector comparator, a requirement of *Partnerships Victoria* policy, was a key quantitative indicator used by the authority to assess if proposals from the private sector proponents achieved the best overall value-for-money for the state, and for freeway users. The request for proposal had 2 overall requirements for proposals from the private sector. First, that the proposal must be a conforming proposal and, second, that it must offer value-for-money in comparison with the public sector comparator.

A conforming proposal was one which met the requirements of the request for proposal, the proponent deed and any other expressed requirements of the state. In assessing value-for-money against the comparator (the other overall requirement for proposals), an assessment was to be made of any net additional value offered by a proposal and whether this value is justified against the comparator. The overall assessment of value-for-money was to focus, in particular, on the toll levels to be imposed on users of the freeway.

The request for proposal also set out the detailed evaluation criteria to be used to assess proposals. The criteria covered: whether a conforming proposal had been submitted; risk allocation; satisfaction of the project objectives; project management; tolling regime and customer service; technical aspects; urban design and social amenity; safety and industrial relations; community and stakeholder relationships; land requirements; value-for-money; commercial structure; conflicts of interest; compliance with government policies; and other considerations.

The authority concluded that the 2 proposals were conforming proposals (i.e. they met the minimum requirements) and that they had exceeded its expectations against the evaluation criteria. The authority also assessed the successful proponent as having satisfied the value-for-money test against the public sector comparator and having greater commercial strengths (toll levels, risk allocation, construction and operating costs, and financial structure) than the alternative private sector bid. Comment on the authority's evaluation processes follow later in this part of the report.

As mentioned earlier, comparison against the comparator, as part of the value-for-money criterion, was one of the criteria to be used to evaluate project proposals.

While it is generally accepted that the use of a comparator as the sole means of assessing value-for-money has inherent limitations, given that it is based on many long-term assumptions with high sensitivity and data limitations, the comparator nevertheless provides a useful tool to benchmark against private sector bids.

The authority advised that this project had 2 significant characteristics that set it apart from most other *Partnerships Victoria* projects. First, the freeway was being delivered against the backdrop of significant budgetary constraint and, in this context, the usual *Partnerships Victoria* option of public sector delivery was not a realistic prospect. Second, the freeway was to be a project that would be fully funded by its own revenue (*Partnerships Victoria* guidance material is mostly directed at projects that are not self-funded). In this context, the authority argued that the role of the comparator was less significant than would otherwise be the case for other *Partnerships Victoria* projects. Nevertheless, one of the 2 overall requirements for the project set by the government was that proposals must demonstrate value-for-money against the comparator.

The value-for-money evaluation criteria for this project sought to establish the overall best value-for-money outcome for the users of the freeway and the state, by comparison with the comparator. It also considered other factors such as the cost to users of the freeway; innovation proposed offering improved value-for-money; the proposed approach to the delivery of the project; the financial and risk consequences for the state of any proposal; the length of the concession period; proposals for state participation in revenue or profit sharing with the concessionaire; the toll reduction regime; and any other requests for state facilitation.

In February 2004, the authority undertook a final review of a draft public sector comparator that had been prepared in March 2003. This later final comparator estimated that a state-owned and operated tolled freeway would cost the state budget around \$150 million[8] in net present value terms, over the concession period**.** Unlike the April 2003 estimate, it did not assume that the state would recover its costs of land acquisition, road network upgrades, design and project management and program administration from the concessionaire, or include those costs (on the basis that they would not materially vary under either state or private provision of the freeway).

Following the receipt of project proposals from the 2 private sector proponents, it became apparent to the authority that some of the key assumptions used in the final comparator were significantly different from those made by the proponents. The final comparator's projections were substantially lower than both proponents' projections for traffic flows and, consequently, for estimated toll revenues. (Traffic flow projections are one of the key assumptions used to determine the comparator's estimate of the net cost to the state budget of a state-owned and operated tolled freeway.)

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[8] The comparator assumed the freeway would be built and operated on the same terms and conditions, and to a reference design for the project, as reflected in the request for proposals.

The comparator's estimated construction costs were significantly lower than the proponents. This difference is largely due to proposals for higher than expected lane capacity, between the Princess Highway and Thompson Road, and the construction of the 4.5 kilometre Dandenong Southern Bypass (the Dandenong Southern Bypass was not part of the original reference design in the request for proposals). However, both proponents' original proposals included a bypass, which the government later included in the project scope (based on the government's preferred configuration).

The authority commissioned a review of the proponents' traffic forecasts by its traffic consultants, with the aim of understanding the nature and behaviour of the differing traffic models when compared with the comparator's traffic projections. This review identified a number of factors contributing to the substantially lower traffic projections in the comparator. The main ones were:

- differences in the formula used to convert daily traffic projections to annual traffic projections (this was identified by the authority's consultants as the major contributing factor to the large discrepancies in traffic forecasts)
- an assumed higher level of traffic that will avoid using the freeway[9]
- lower assumed traffic growth rates (the proponents' assumed that the community's average value of time, based on real increases in average weekly earnings, will increase at a greater rate than toll levels, therefore contributing to higher traffic levels in future)
- the impact of the Dandenong Southern Bypass and additional freeway lanes proposed by the proponents (but not factored into the comparator)[10].

[9] The calculation of toll road diversion rates takes into account several different factors, including travel time on the quickest untolled route and the tolled route, and toll levels. The successful proponents' proposed toll levels were approximately half that assumed in the comparator (based on the peak toll cap rate per kilometre) and were set below the revenue optimising level in order to reduce the risk of traffic diversion (refer ConnectEast Group, *Product Disclosure statement*, 14 October 2004. pp. 38 and 93).

[10] The final report of the technical evaluation panel noted that the reference design which proponents were required to observe (and the basis of the comparator) identified the minimum freeway standards, the required connections with the road network, and the minimum lane configuration. That is, in the panel's view there was limited opportunity for the proponents to submit markedly different proposals. The panel noted that traffic forecasts from both proponents had indicated that traffic volumes on some sections of the project would be higher than those expected by the state. Following analysis of these forecasts, the authority confirmed a revised minimum traffic lane and auxiliary lane requirement for the project. In effect, the panel noted that this resulted in the core scope for both proposals being very similar.

Other less significant factors in the comparator related to the proposed tolling strategy (that is toll levels), lower population growth predictions in the corridor[11], higher assumed traffic levels on competing roads and an expectation by proponents that the freeway's traffic capacity will increase in the future (due to improved vehicle technology, changing driver behaviour and the spreading of the peak period).

Partnerships Victoria policy states that "… in general, an adjustment [to the comparator] will be justified if significant new information indicates that the comparator is incomplete or not credible" (for example, "… if bids have relatively consistent demand forecasts at a particular level, while the comparator is an outlier, it may indicate the comparator is mistaken"). However, the policy also states that the comparator "… should not be altered to reflect alternate or more efficient service delivery methods by a bidder or bidders".

The comparator was not recalculated after the proposals were received despite:

- both proponents forecasting significantly higher traffic levels (which were independently prepared by experts engaged by the proponents)[12]
- the state's decision to include the Dandenong Southern Bypass (at an estimated $80 million additional construction cost) and revised minimum traffic lane and auxiliary lane requirements in the revised project scope.

The authority advised that it had reviewed the proponents' data and assumptions, and satisfied itself as to the reasons for the differences - concluding that the comparator was robust and that, as required by *Partnerships Victoria* policy, no change should be made to the comparator. The authority was unable to provide to us formal evidence of this conclusion, including formal consideration of the causes of the differences in key assumptions, in the reports of the board, the project assessment group or the relevant evaluation panel.

[11] The comparator's projections were based on relevant government policies such as 20 per cent of journeys being on public transport and *Melbourne 2030* (the government's 30-year plan to manage growth and change across metropolitan Melbourne and the surrounding region).

[12] Following analysis of the proponent's higher traffic volume forecasts, the authority confirmed a revised minimum traffic lane and auxiliary lane requirement for the project. However, the comparator was not adjusted accordingly.

The authority's recommendation to the minister advised that the successful proponent's proposal represented best value-for-money when compared with the public sector comparator (based on the net financial impact of the project on the state budget). The authority's recommendation to the minister did refer to a number of other indicators of the value-for-money offered by the proponents' proposals (based on the value-for-money evaluation criteria).

The authority concluded that the 2 proposals had exceeded its expectations. It assessed the successful proponent as having satisfied the value-for-money test against the public sector comparator and having greater commercial strengths (related to toll levels, risk allocation, construction and operating costs, and financial structure) and, on balance against all evaluation criteria, was therefore chosen.

The authority's recommendation to the minister considered the value-for-money of the 2 private sector project proposals, by comparing the total toll revenue users would pay during the concession period under each proposal. However, it did not compare these 2 amounts with what users would have paid under a public sector provision model (as estimated in the public sector comparator). The authority advised that this comparison was nevertheless made as part of the deliberations of the commercial evaluation panel, but we note that it did not form part of the reports issued to the proposal assessment group by the evaluation panels, project assessment group or the board.

The recommendation noted that toll levels under both private sector proposals were comparable with (or less than) CityLink tolls, and that the proposed tolls for EastLink by the private sector proponents (based on toll rates per kilometre) were on average well below the comparator - which was set at a level consistent with CityLink but with a much higher trip cap.

Conclusions

The request for proposals from private sector bidders for the freeway had 2 overall requirements. First, that the proposals must meet the request for proposals' requirements (be a conforming proposal) and, second, that they must offer value-for-money when compared with the public sector comparator.

The authority concluded that the 2 proposals were conforming proposals (i.e. they met the minimum requirements), that they satisfied the value-for-money test against the comparator, and they had exceeded its expectations against the evaluation criteria.

A key factor underpinning the authority's recommendation to the minister, to accept the ConnectEast project proposal, was the results of its value-for-money assessment using the public sector comparator as a quantitative indicator. While it is generally accepted that the use of the comparator as the sole means of assessing value-for-money has inherent limitations, given that it is based on many long-term assumptions with high sensitivity and data limitations, the comparator nevertheless provides a useful tool to benchmark against private sector bids.

We observed that some of the key assumptions used to determine the comparator (about forecast traffic levels, total toll revenue and construction costs) were significantly different from those used in the project proposals received from the 2 private sector proponents. In view of these significant differences and the government's decision to change the project scope after the comparator was determined (by including the Dandenong Southern Bypass and revising the minimum traffic lane and auxiliary lane requirements for the project), the comparator should, in our view, have been recalculated.

The use of the comparator, without revision, as part of the authority's recommendation to the minister that the successful proponent's proposal offered better value-for-money than an alternative public sector delivery model, in our opinion, diminished the reliability of the comparator as a quantitative assessment tool. We acknowledge that a number of other indicators (the evaluation criteria) were also used by the authority to judge the value-for-money offered by the proponents' proposals. Consideration of these indicators supported the decision to give preference to the successful proponent (from a value-for-money perspective). However, we remain of the view that bettering the public sector comparator was so fundamental to bid evaluation and negotiation that it should have been revised to take account of any required changes in key assumptions and the scope of the project since it was previously calculated.

The authority considered the value-for-money of the 2 private sector project proposals by comparing the total toll revenue users would pay during the concession period under each proposal. It could have, but did not, compare these 2 amounts with what users would have paid under a public sector provision model (as estimated in the public sector comparator). This comparison would have enabled a more complete consideration of the impacts of the alternative delivery models on users (the community).

Recommendations

15.1 That, consistent with the requirements of the *Partnerships Victoria* guidelines, public interest tests should for future projects be based on the final approved financing approach, in this case as a tolled rather than as an untolled freeway.

15.2 That, future *Partnerships Victoria* projects should revisit the public interest test near to contractual close to confirm the appropriate inclusion of any identified measures necessary to protect the public interest.

15.3 That, consistent with the requirements of the *Partnerships Victoria* guidelines, public sector comparators used to support value-for-money assessments should be recalculated where subsequent information becomes available that is likely to affect the value-for-money assessment (such as significant variations in some of the key assumptions used to determine the comparator compared with those used in project proposals received from private sector proponents).

RESPONSE provided by the Acting Secretary, Department of Treasury and Finance

Recommendation 15.1 – Public interest test

The Department of Treasury and Finance (DTF) agrees with recommendation 15.1, but believes that it has very limited application to future Partnerships Victoria projects. Few Partnerships Victoria projects are self-funding and it is expected that any future decisions to use a self-funding approach will be made at the same time as the decision to pursue Partnerships Victoria delivery.

Recommendation 15.2 – Public interest test

DTF agrees with the Auditor-General's recommendation. The existing Partnerships Victoria guidance material places an obligation on project officers, either at defined milestones or when material events occur, to recheck that the project meets the public interest test. While the audit recommendation extends the literal requirements in existing Partnership Victoria guidance material, it accords with the practice typically employed in Partnerships Victoria projects.

RESPONSE provided by the Acting Secretary, Department of Treasury and Finance - continued

Recommendation 15.3 – Public sector comparator

The public sector comparator (PSC) received significant attention in the audit report. However, a key piece of Partnerships Victoria guidance was not referred to or discussed. Partnerships Victoria PSC Supplementary Technical Note (page 17 – Q2), states that:

> *"… when government would not undertake the project itself a PSC would not be built … however, even in such cases … government still needs to construct a value-for-money benchmark".*

The Auditor-General has not reflected this guidance in the audit observations and has not made it clear throughout the report that the PSC was only one element of this benchmark.

The Auditor-General's recommendation appears to be consistent with Partnerships Victoria guidance; however, Partnerships Victoria guidance also says that where it is clear that subsequent information is not likely to affect the value-for-money assessment, an adjustment to the comparator is not necessary. In addition, what happened on the EastLink project, and the recommendation as drafted, appears contrary to other statements in the Auditor-General's report.

The Auditor-General states that key assumptions (traffic forecasts, total toll revenue and construction costs), that were the basis of bids, were significantly different from the PSC and thus the PSC should have been recalculated. DTF agrees that the key assumptions were significantly different, however, after advice from expert consultants, the Southern and Eastern Integrated Transport Authority (SEITA) deemed it unnecessary to change the PSC's assumptions as these were considered to be the government's best estimate. This is consistent with Partnerships Victoria guidance material. The PSC Supplementary Technical Note (page 15) states that:

> *"… if the PSC contains numbers in which the agency is confident, it should not adjust the PSC just because the numbers in the bids are different".*

DTF cannot agree with the Auditor-General's view that the PSC necessarily should have been recalculated in light of differences with the bidders' key assumptions.

The Auditor-General also states in the report that the inclusion of the Dandenong Southern Bypass and other assets over and above the project brief should have been included in the PSC and recalculated. DTF understands that SEITA performed high-level analysis that clearly demonstrated that this would have only widened the value-for-money gap between the PSC and the bids, and thus been an unnecessary exercise.

15.4 Management of the tender process

15.4.1 Were probity arrangements adequate?

In assessing whether the project's probity arrangements were adequate, we sought to determine if:

- a comprehensive probity/tendering plan was prepared and approved before the release of the request for expressions of interest document
- whether such plan provided for a fair tendering process (by detailing tender evaluation criteria, policy about conflicts of interest, confidentiality and security requirements, arrangements for handling non-conforming tenders and tender questions, a negotiation regime and communication protocols)
- the plan was consistent with government policy (including *Partnerships Victoria* policy) and good practice
- a probity auditor was appointed at an appropriate point in the tendering process
- reports and advice were received from the probity auditor and acted on during critical stages of the tender process.

In February 2003, before the request for expressions of interest document was publicly issued, DoI appointed a probity auditor to independently assess whether the tender process was an open and fair process, and complied with probity principles. The probity auditor was also required to endorse the probity plan that had been drafted, and was to be presented to DoI's project steering committee (which reported to the secretary of the department), and to report on adherence to the plan.

In June 2003, DoI's project director approved a revised draft probity plan. However, this plan was not approved by the steering committee or the secretary, nor formally endorsed by the probity auditor. The authority advised that prior to its formal establishment in July 2003, its prospective board members were provided with a copy of the probity plan (during May and June 2003).

In November 2003, after the request for proposals had been issued, the authority's board[13] approved a revised probity plan. This plan had been endorsed by the probity auditor and was consistent with the original revised draft probity plan.

[13] As previously mentioned, the Southern and Eastern Integrated Transport Authority was established in July 2003 to facilitate the project on behalf of the state.

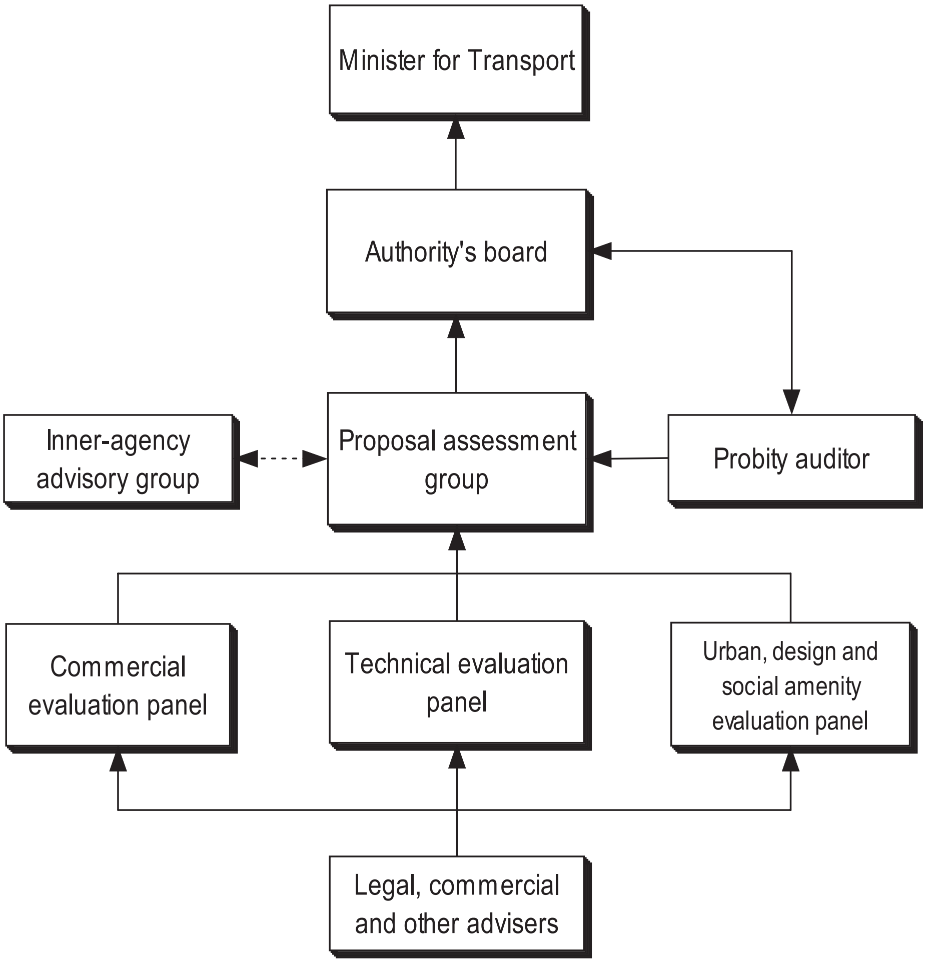
The probity plan sets out the following probity principles in order to achieve an equitable, justifiable and sound procurement process:

- fairness and impartiality
- use of a competitive process
- a consistent and transparent process
- security and confidentiality
- compliance of the tender process with legislative requirements and applicable government policies (that is, *Partnerships Victoria*)
- identification and resolution of probity issues.

The probity plan included guidance about conflicts of interest, confidentiality, handling of proprietary information, record keeping, and communication with proponents, the government and the media. The expression of interest and request for proposal documents included the evaluation criteria and were both appropriately approved before being issued, consistent with the requirements of the plan.

The probity plan also set out the project management structure to apply during the request for proposal phase of the project. Figure 15D provides an overview of the project management structure, highlighting the reporting relationships between the probity auditor and the authority.

FIGURE 15D: EASTLINK PROJECT MANAGEMENT STRUCTURE DURING THE REQUEST FOR PROPOSALS PHASE



Note: The proposal assessment group was chaired by the authority's chief executive officer and comprised the chairs of each of the evaluation panels and other advisers (including legal and commercial advisers). The evaluation panels comprised senior officers of the authority, 2 consultants and an academic. The Department of Infrastructure used a similar project management structure during the expression of interest phase (before the authority was established).

The inner-agency advisory group's role was to provide input about government policy relevant to the project. It comprised a senior representative of the Department of Infrastructure, Department of Treasury and Finance, Department of Premier and Cabinet and VicRoads.

Source: Victorian Auditor-General's Office.

The probity auditor was involved during the expressions of interest and request for proposals evaluation phases. The probity auditor attended meetings of the project assessment group and had standing invitations to attend all evaluation panel and board meetings.

At various times, the authority also sought separate legal advice on probity issues.

During the tender process, the probity auditor advised the authority's board on a number of probity matters. The auditor verbally advised the board that he accepted actions taken to address these issues and provided unqualified written reports about the tendering process as a whole.

The authority required the 2 proponents to appoint their own probity auditors to ensure that they, the consortium members and related parties, complied with the tender process (and the proponent deed)[14]. The state's probity auditor received reports from each of the proponent probity auditors. These reports advised that, in all material respects, the continuing obligations of the proponent deed were not breached, nor was the integrity of the bid process.

In all, the state's and proponents' probity auditors collected some 2 500 confidentiality deeds and conflict of interest declarations from people who were directly involved in preparing or evaluating proposals for the freeway.

In October 2004, the state's probity auditor confirmed that, in all material respects, and based on the probity framework, the process was undertaken in accordance with the probity principles in the probity plan and *Partnerships Victoria*.

Conclusion

The probity arrangements had several strengths. These included the appointment of a probity auditor, the development of a comprehensive probity plan (consistent with government policy) and the requirement that proponents appoint their own probity auditors. This last requirement was to ensure that proponents, consortium members and related partes complied with the tender process.

The probity plan should have been formally approved before expressions of interest were sought from proponents, not after requests for proposals were issued. However, we acknowledge that a draft probity plan was prepared, and a probity auditor appointed, before the request for expressions of interest document was issued, and that a final probity plan was approved before proposals were received.

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[14] The proponent deed required proponents to comply with the tender process.

EastLink will join the Frankston freeway at Seaford.
(Photo courtesy of the Southern and Eastern Integrated Transport Authority.)

15.4.2 Were expressions of interest and project proposals adequately evaluated?

In assessing whether expressions of interest and project proposals received from the 2 proponents were adequately evaluated, we sought to determine if:

- the request for expressions of interest and proposals documents were comprehensive (by including conditions of tendering, evaluation criteria and required outcomes and deliverables for the project) and were appropriately approved before being issued
- request for proposals (and expression of interest) documents were consistent with the business case and with the approved probity plan
- technical and commercial aspects of proposals were evaluated against the criteria by separate committees (with appropriately qualified members) working independently but under one steering committee
- all staff involved in evaluating tenders were appropriately trained and qualified to do so
- evaluation committees evaluated tenders against the specified criteria
- any amendments or changes to the issued request for proposals and expression of interest documents were made in accordance with the approved probity plan
- evaluation committee reports complied with the probity plan and clearly set out the reasons, in terms of the evaluation criteria, for accepting or rejecting tenders

- the probity auditor issued unqualified reports on the process
- the evaluation process was timely and fair, and consistent with the approved plan.

We found that the request for expressions of interest and request for proposal documents were:

- comprehensive
- approved at an appropriate level before being issued
- consistent with the business case and the probity plan.

The authority developed plans to evaluate the expressions of interest and proposals received. Both plans included its methodology for assessing responses and were appropriately approved before documents for the phases were issued. The plans included:

- the principles and organisational structures for the evaluations, including the use of separate evaluation panels reporting to the proposal assessment group (as previously mentioned in this report). Panel members had the necessary qualifications and training to conduct evaluations
- the evaluation process to be followed (including procedures for proposal clarification and negotiation of draft contractual documentation with each proponent)
- a process to handle the clarification, receipt, distribution and storage of proposals
- communication protocols with proponents
- evaluation criteria (which were the same as those included in the expression of interest and the request for proposals documents) to be used by the evaluation panels
- an indicative timetable.

At the beginning of the request for proposal phase, proponents were required to sign a proponent deed. The deed required the proponent to comply with the tender process and to provide a “security for process bond” of $10 million. This would be forfeited to the state if a proponent breached the requirements of the tender process.

At that stage, the authority issued key draft contractual documents (including a draft concession deed, construction tripartite agreement, operation tripartite agreement, crown land lease, construction licenses and construction security bonds) to each proponent. It also issued the project scope and project requirements documents. These outlined the scope of works, standards and technical requirements, and the state’s detailed technical research documents (such as geo-technical survey reports, drainage data and reference design drawings).

During the request for proposals stage, the authority referred any aspects of proposals that exceeded (or changed) the minimum project requirements, and required changes in government policy, to the inner-agency advisory group. This, for example, led to the government including the Dandenong Southern Bypass in the freeway (a version of which had been included in both proponents' proposals), and resulted in a change in the project scope.

At the end of the request for proposal phase, each proponent was required to sign a commitment deed. This contained the final negotiated draft contract documents (that had been agreed with that proponent and were based on a common minimum project scope) which included final commitments from consortium members, equity and debt providers. The deed required the proponents to sign all contracts if the state accepted their proposal.

The requests for expressions of interest to design, construct, finance, lease, maintain and operate the freeway and the related tolling system were issued in May 2003. Ten evaluation criteria were established for this phase, including a procurement capability criterion (that is the respondent's ability to successfully procure and manage the design and construction in line with the project objectives).

The successful proponent's expression of interest did not identify a committed operator for the freeway (but noted that discussions were underway with 3 possible operators), nor a tolling system provider. Consequently, it was not possible at that time to conclude that the proponent had adequate capability and experience in these areas (the authority noted that this was part of a strategy by the proponent to preserve competition until the latest point so it could obtain the best value-for-money for its proposal). Nevertheless, this proponent (being one of only 2 respondents to the request for expressions of interest) was assessed as having the required capability to deliver the project and progressed to the request for proposal stage.

Requests for proposals to design, construct, commission, finance, toll, operate, maintain, repair and hand over to the state the freeway were made in October 2003. There were 15 evaluation criteria for proposals, including a technical criterion which considered the proposed tolling system.

In October 2004, the technical evaluation panel concluded that components of the successful proponent's proposed tolling system were individually proven but noted that the proposed system had not put been put into operation elsewhere. However, a similar system was being installed in another country at that time and was planned to be fully operational by November that year. The other proponent offered an existing operational system which would be enhanced.

At the time the authority recommended the successful proponent, contractual arrangements with the proposed tolling system provider were not finalised.

The authority's evaluation plan and proponent deed did not expressly require proponents to have a committed tolling system provider. Rather, it required them to propose a tolling system. The concession arrangements require the state's approval if the concessionaire seeks to subcontract the provision of the tolling system to another party. The state can withhold approval of the final tolling system design and supply agreement if it considers the agreement:

- does not appropriately transfer risk and responsibilities to the subcontractor
- does not incorporate the state's rights in respect of the tolling system
- results in a breach of the concession arrangements
- will be detrimental to the state, users of the freeway or other members of the general public.

We were advised that the contractual arrangements for the tolling system were finalised during June 2005, with the state's consent, but using a different roadside equipment supplier.

Reports of the evaluation panels, and of the proposal assessment group, clearly set out how each body used the evaluation criteria to accept one proposal over the other.

The proponent deed required the proponents to bear all costs of preparing their proposals. Under certain limited circumstances, the state may be required to reimburse certain costs of the unsuccessful proponent. The authority subsequently accepted a request for reimbursement of certain costs from the unsuccessful proponent and an amount of $3 million was paid to that proponent during June 2005.

Project timeliness

Figure 15E sets out the extent to which the business case target dates for the project were achieved at the time of preparing this report.

FIGURE 15E: PROGRESS AGAINST EASTLINK PROJECT TIMELINES

Milestone	Target dates (a)	Actual/forecast dates
Invitations for expressions of interest released	April 2003	May 2003
Government approval to the issue of the request for proposal document (including draft contract) to the 2 respondents	3rd quarter 2003	October 2003
Project proposals received by authority	1st half 2004	April 2004
The Minister for Transport enters into the concession deed with the successful bidder	2nd half 2004	October 2004
Contractual close	2nd half 2004	October 2004
Project construction commences	2nd half 2004	(b) December 2004
Construction complete	2008	October 2008

(a) Project timelines are taken from the Mitcham-Frankston Freeway Business Case, March 2003.

(b) The first construction licence was issued during December 2004. The authority advised that site establishment works commenced during the lead up to Christmas 2004.

As shown in Figure 15E, the project is progressing generally in line with the planned timelines.

Conclusions

The tender evaluation process had several strengths. These included:

- comprehensive request for expressions of interest and proposals documents, and plans for evaluating them
- an appropriate structure for evaluating tenders (including 3 evaluation panels reporting to a proposal assessment group)
- a contractual requirement on proponents to comply with tendering procedures (including a "security for process bond" of $10 million)
- the issue of draft contractual documents to proponents at the request for proposal stage
- the requirement to sign a commitment deed after proposals were evaluated
- comprehensive evaluation reports
- timely completion of the process.

The contract with the tolling system provider was not finalised at the time of signing the concession deed. As the authority's evaluation plan and proponent deed did not expressly require proponents to have a committed tolling system provider, this element of the project was outstanding at that time. However, the contractual arrangements for the tolling system were subsequently finalised during May 2005.

15.5 Was risk appropriately allocated?

In assessing whether project risk was appropriately allocated, we examined the concession arrangements to see if they:

- clearly set out the project objectives, key milestones and targets, and allocated key responsibilities between the parties
- allocated risks in line with the *Partnerships Victoria* policy.

The concession deed sets out the project objectives and timing of the works. It also allocates key responsibilities and risks between the parties. *Partnerships Victoria* guidelines provide that risks should be allocated to the party best able to manage the risks at the least cost, taking into account public interest considerations. Figure 15F provides a high level summary of the allocation of risks under the concession arrangements and the *Partnerships Victoria* guidelines.

FIGURE 15F: ALLOCATION OF KEY RISK FACTORS BETWEEN PARTIES, EASTLINK PROJECT

***Partnerships Victoria* indicative risk allocation**	**Risk allocation under the concession arrangements**
Market risk (comprising demand and price risk), to be assigned to the private sector party (a)	The concession deed requires the concessionaire to accept traffic and tolling risks. The deed limits toll price increases to the movements in the consumer price index for the duration of the concession period. However, under certain prescribed circumstances, the concessionaire can be compensated through increased toll prices, changes to the concession period or lastly via a contribution from the state. For example,the state may be required to compensate the concessionaire if it fails to manage and maintain principle road interfaces with the freeway, or interferes with traffic flows on those interfaces.
Site risk, to be allocated to the private sector party, except where the government takes back or shares risks associated with defects in the existing infrastructure, pre-existing environmental liabilities, planning and environmental approvals, native title issues and process costs.	The concessionaire bears all risks relating to the condition of the land used for the project, including pre-existing or new contamination, artefacts and latent defects, and any pollution coming from the land. The concessionaire must also comply with the *Native Title Act 1993*. However, the state may be required to compensate the concessionaire for certain native title events (for example, through increased tolls, an increased concession period or lastly via a contribution by the state).
Design, construction and commissioning risk, to be allocated to the private sector party, except where the government initiates a change in design or construction process.	The concession deed requires the concessionaire to accept all risks relating to the project, including cost increases, time delays, technical obsolescence, weather, construction, interface, utility infrastructure, approvals, insurance and safety. The freeway will be constructed under a fixed time, fixed price contract. The construction contractor, therefore, bears the principal risk that the freeway will not be completed on time, within budget and to the agreed specifications. However, under certain prescribed circumstances, the completion dates for construction can be extended under the concession arrangements. Further, the concessionaire must correct all defects in the Dandenong Southern Bypass and enhanced Ringwood Bypass for 2 years and must obtain and maintain insurances ($1 billion for construction works and $500 million for public liability). The state and the project's independent reviewer (b) may review or comment on the design and construction program.

FIGURE 15F: ALLOCATION OF KEY RISK FACTORS BETWEEN PARTIES, EASTLINK PROJECT - continued

***Partnerships Victoria* indicative risk allocation**	**Risk allocation under the concession arrangements**
Operating risk, to be allocated to the private sector party, except where the state initiates a change or otherwise interferes in operations through changes in law or policy.	The concessionaire is required to maintain, operate and repair the freeway (including the tolling system, the Dandenong Southern Bypass and the enhanced Ringwood Bypass) and to meet all such costs. The state has rights under the concession arrangements to inspect and observe the use, operation, maintenance or repair of the freeway. Further, the state is to be provided with details of the concessionaire's annual maintenance and repair budget and a copy of its forecast maintenance program (which is to be updated each 5 years and requires the state's agreement). The concessionaire has agreed to a number of key performance indicators covering customer service, road condition, landscape and architecture, tolling accuracy and the environment (c). If the concessionaire does not meet these indicators, it will receive demerit points each year. These accumulate and, at prescribed demerit point levels in a year, the concessionaire must credit prescribed amounts in the accounts of all customers with whom it has contracts. The state has set the maximum penalty payable at up to $15 million (indexed) a year. The state is obliged to ensure that interoperability agreements with CityLink are on commercial terms reflecting the net incremental marginal cost to the toll provider (d).
Industrial relations risk, should be transferred to the private sector party.	The concessionaire is responsible for all industrial action and industrial relations issues in connection with the freeway. The concessionaire may, however, be entitled to an extension of time to complete construction where it can be demonstrated that the industrial action is a result of the act, or omission, of the state directly in relation to the freeway.
Asset ownership risks, to be allocated to the private sector party.	The concession deed provides that the concessionaire accepts all risks relating to the project, including technical obsolescence, law and taxes, approvals, insurance and safety. The concessionaire bears the risk of loss or damage to the project and other related facilities, with limited exceptions. At the end of the concession period, the freeway (including state land and state works) is to be provided to the state at no additional cost.
Sovereign risk, to be allocated to the state for changes in state laws and to the private sector party for changes in Commonwealth law.	The state may be required to compensate the concessionaire for the impact of any discriminatory change in state law, a change in law (including Commonwealth, state and local laws), a change in state policy for the enforcement of tolls and penalties, an act of prevention by the state or any of its associates (through increased tolls, an increased concession period or, in some cases, a contribution by the state). There are several defined circumstances of default by the concessionaire (which may relate to one or more of the risk events) that could result in early termination of the concession deed by the state without compensation, if not remedied. Any such termination by the state will entitle the state to recover all losses from the concessionaire. A remedy period is provided to allow the concessionaire to diligently pursue the remedy of any default. Alternatively, the state may "step in" and take control of the freeway to the extent required. In this case, tolling revenue would be available to fund state costs after payment of the concessionaire's operating expenditures. The state, however, may be required to compensate the concessionaire for any costs arising from certain environmental and/or biodiversity conservation impacts (through increased tolls, an increased concession period or lastly, in some cases, via a contribution by the state).

FIGURE 15F: ALLOCATION OF KEY RISK FACTORS BETWEEN PARTIES, EASTLINK PROJECT - continued

***Partnerships Victoria* indicative risk allocation**	**Risk allocation under the concession arrangements**
Network and interface risk, to be distributed between the state and the private sector party.	The concession deed provides that the concessionaire accepts all risks relating to the project, including interface risks. The state may make certain alterations to the freeway such as new connections. However, in certain circumstances the state has agreed under the deed to compensate the concessionaire for any net adverse impact.
Insurable force majeure risks, to be allocated to the private sector party. However, uninsurable force majeure risks are to be shared.	Should a force majeure event occur, the state may step in and repair or reinstate the relevant damage. The state would have access to net tolling revenue during the step in period. The concessionaire must then resume performance of its obligations and to repair and maintain the freeway. In the event of an uninsurable force majeure event, and in the event that the cost to repair is likely to result in the equity return being less than certain prescribed returns, then termination of the relevant part of the concession may occur. The state may be required to compensate, through agreeing to increased tolls or an increased concession period, the concessionaire if an uninsurable force majeure event occurs.
Sponsor and certain financial risks, may be shared or assumed by the state.	If, as a result of state action regarding a modification to the freeway, the concessionaire is affected in its ability to pay debt or equity return, then the state may be required to compensate through increased tolls, an increased concession period or changes to the term of the freeway lease. If modifications produce a material enhancement in the position of the concessionaire, then the concessionaire will provide to the state (or returns to users of the freeway) the proportion of that benefit which is in excess of any part of the benefit which is necessary for the concessionaire to retain in order for the concessionaire to be able to give relevant equity returns to the equity investors.

(a) If project revenue exceeds the annual forecast revenue at a particular time, the concessionaire will be required to pay a proportion of the additional revenue to the state. The concession deed contains a table setting out the proportion of the additional revenue for each year of operation that will be paid to the state. In addition, if state action (such as changes to the surrounding road network) increases the concessionaire's revenue, then the state is entitled to share 50 per cent of the revenue increase due to the change. The state share can be "paid" by a direct payment or by reduced tolls, or it may be used to offset the impact of certain other prescribed events. Payment is to be made at the end of each financial year, but can be deferred if the concessionaire is unable to meet operating expenditure or service debt on a payment date.

(b) In November 2004, the authority and the concessionaire appointed an independent reviewer to be responsible for general oversight of the freeway through the checking of design and construction works. The independent reviewer will certify the works before the freeway is open to traffic. The concessionaire will pay the first $20 million of the independent reviewer's costs, and thereafter costs will be met on a 50:50 basis by the state and the concessionaire.

(c) The concessionaire is required to provide a quarterly customer services report to the state. An independent auditor will conduct an annual audit of customer services. Under the concession deed, the customer services audit report may be publicly disclosed.

(d) An interoperability agreement would enable a CityLink customer to pay the CityLink concessionaire for the use of EastLink, and for the CityLink concessionaire to reimburse the EastLink concessionaire accordingly – or vice versa.

Source: Victorian Auditor-General's Office.

Conclusion

Based on our review of the concession arrangements, project risks have been allocated in accordance with the *Partnerships Victoria* guidelines. That is, risks have generally been allocated to the party best able to manage those risks.

15.6 Are the ongoing project governance and management arrangements adequate?

In assessing whether the state's ongoing governance and management arrangements for the project appeared adequate, we sought to determine if:

- project management and governance arrangements included a contract manual and issues register, strategic plans, a risk management plan, an agreed implementation timetable, and regular monitoring, evaluation and reporting on project progress
- project management arrangements were regularly and independently reviewed.

At the time of our audit, the authority was undertaking an organisational restructure in line with its changing role (from managing a tendering process to managing the concession arrangements, including freeway construction).

During the tendering phase, the authority established a risk register. It subsequently updated the register to address risks:

- allocated to the state in the concession deed
- arising from issues not resolved at the time the deed was signed (such as the concessionaire's contractual arrangements with the tolling system provider and the establishment of construction licences, both of which have now occurred)
- that could arise if public sector management is inadequate
- that could arise from any changes to the contractual arrangements.

In April 2004, the authority engaged an internal auditor. The internal auditor's Strategic Internal Audit Plan 2004–2008 includes an ongoing audit of the authority's risk register (which has commenced) and audits of the authority's management of the contract with the concessionaire.

Under *Partnerships Victoria* guidelines, a contract management plan must be lodged with the government 3 months after the “financial close” of the arrangements (in this case, by February 2005). The authority prepared a contract management plan[15], which was reviewed by the Department of Treasury and Finance and approved by the authority’s board in February 2005.

In the same month, the authority also developed (as required by the guidelines) a contract administration manual. The manual sets out the tools, policies and processes that it will use to administer the concession arrangements[16]. The authority’s board received this manual during June 2005.

The concession deed requires the establishment of a senior project group. This group will meet regularly throughout the life of the project to monitor progress of the freeway and its integration into the road network. The senior project group comprises representatives of the state and the concessionaire, the independent reviewer and an independent chair. The parties established the senior project group in December 2004 and it held its first meeting during January 2005.

The independent reviewer was jointly appointed by the state and the concessionaire during November 2004. The independent reviewer was engaged as an independent expert to carry out all the functions conferred on that role in the concession deed and related documents. The independent reviewer has a key role in the overview of the delivery of the freeway; including design, construction, commissioning and testing, and has the critical task of the certification of the completion of the works.

The concession deed also requires the establishment of a project liaison group. This group will watch over public safety matters, including the conduct of incident planning and emergency exercises. The group will comprise representatives of the concessionaire, the authority, VicRoads and emergency services agencies. The group held its first meeting in May 2005.

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[15] The contract management plan sets out the expected outcomes of the project, contract management objectives, key success factors, the scope of contract management and roles and responsibilities for contract management.

[16] The administration manual details the obligations of the state and the concessionaire under the concession deed, and how these will be managed. The manual also includes an analysis of the contract management risks under the concession deed and the authority’s plans for compliance and performance monitoring, reporting, relationship management and dispute resolution, and processes for contract variations.

Conclusion

The authority is taking appropriate steps to establish effective project management and governance arrangements for the project for future years. The strengths of the current arrangements include a senior project group, a project liaison group, a contract management plan, an administration manual (focusing on risk management and performance monitoring) and a plan for ongoing audits of the authority's management of the concession arrangements by its internal auditor.

We will monitor the ongoing project management and governance arrangements during the life of the concession period.

16. Management of the Commonwealth Games Athletes' Village project

16.1 Audit conclusions

The objective of this audit was to examine the adequacy of the controls established by the Office of Commonwealth Games Coordination (OCGC)[1] for the Commonwealth Games Athletes' Village project. The audit examined:

- systems for management and control of progress of the development, including the integration of the project, its scheduling, the quality of the village, risk management, staff capability and stakeholder communications
- aspects of the contracting process, including governance, probity, tendering, short-listing, evaluation, contract development and negotiation.

We concluded that all systems of management control are sound. We did note, however, some area for improvement relating to the broader public sector risk management of sites in long-term public use, and have made a recommendation on this issue.

The contracting process for the village was rigorous and transparent, with conformance between the development of the tender specification, the short-listing and evaluation of the bid, and the negotiation and awarding of the contract.

There were significant scope changes approved by the government late in 2004 at an additional cost of $52.83 million, $43.38 million of which relate to the construction of the Village and $9.45 million operational costs for the games overlay[2]. These gross costs are offset by expected increases in revenue of $30.47 million.

We concluded that these major scope changes were driven by external pressures, especially demands for higher standard and less crowded athlete accommodation than was originally envisaged. These scope changes were made to address the improved standards required by the Commonwealth Games Federation. They were restricted to the "games mode" aspects of the village and were adequately managed.

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[1] The Office of Commonwealth Games Coordination is an agency within the Department for Victorian Communities.

[2] "Overlay" works are temporary facilities in the village to accommodate and service athletes and team officials. This would include items such as the main dining pavilion, transport mall, medical clinic, gymnasium and overall furniture, fittings and equipment.

On the estimation of the village project costs, we concluded that:

- a business case for the Parkville site should have been developed to benchmark against private sector bids
- a formal cost-benefit analysis should have been conducted for the project.

On OCGC's setting and control of the village budget, we concluded that the cash outflows in the village project budget are being managed well by OCGC.

The village budget would have been more complete if it:

- was based on the value that the project would deliver
- included the change between the market value and the impaired value of the contributed land
- included the estimated value of retained assets and public amenity as well as the market value of the land.

The changes in the value of the contributed land, the increases in estimated revenue from profit share of sales from the development and the scope changes enabled the government to announce a net increase in cost of only $4 million from the budgeted 2002 figure of $85.4 million to the 2004 figure of $89.4 million. We concluded that an explanation of these major changes between the 2002 and 2004 budget announcements would have been more explicit than announcing a final net increase figure.

Further, based on our analysis of the value of the project to the state, we concluded that the net contribution by the state to the village project is estimated to be $41 million, for which the state will have met its obligations to accommodate 6 000 athletes and officials in the games village and delivered assets and amenity of benefit to the community.

RESPONSE provided by the Secretary, Department for Victorian Communities

The objective of this audit was to examine the adequacy of the Office of Commonwealth Games Coordination's (OCGC's) controls in relation to the athlete's village for the 2006 Commonwealth Games.

The Department for Victorian Communities (DVC) welcomes the audit conclusions that:

- *OCGC's systems for management control are sound*
- *the contracting process was 'rigorous and transparent'*
- *the changes in scope in 2004 were driven by external processes and were adequately managed*
- *the cash outflows of the budget are being managed well.*

RESPONSE provided by the Secretary, Department for Victorian Communities - continued

Risk management

DVC notes the recommendation to the state in regard to the contribution of land to projects where sites have had long-term occupancy by public sector users and will take this issue up at a whole-of-government level.

Business case

We note the audit comments that a business case for the Parkville site should have been prepared and further note the inference in the report that, in accordance with the Partnerships Victoria framework, such a business case was a requirement of government policy at the time. It should be noted that the village project is not a Partnerships Victoria project and as such that policy framework did not apply. Moreover, DVC is confident that the market pressure of a highly competitive process was a no less effective mechanism of achieving a positive commercial outcome than the process of establishing a "public sector comparator".

In addition, prior to the tender being issued in October 2001, Major Projects Victoria engaged external consultants to prepare cost and revenue estimates for the development of the Parkville site in games and post-games modes. For practical purposes, this work achieved the same effect as a business case by developing and analysing internal cost and revenue estimates for the project.

During 2002, these cost and revenue estimates were used as a basis to assess the private sector bids. The estimates were reviewed as the bids progressed through the tender process.

Further, as noted by audit, prior to the final decision on Village Park Consortium, OCGC undertook a cost-benefit based review comparing the Parkville proposal with a variety of other non-market options for the village.

The review revealed that, when compared with the non-market options, the Parkville option represented better value-for-money, provided a stronger legacy, represented less risk in project delivery and would not cause excessive disruption to existing communities.

Consideration of other options

Audit comments on the consideration of non-market options for the games village prior to the finalisation of the decision to proceed with the Village Park Consortium proposal. Audit was provided with details of the reasons for the non-acceptance of these options and these reasons have been summarised on the bottom of page 248 of the report.

RESPONSE provided by the Secretary, Department for Victorian Communities - continued

DVC's view is that it would have been clearer if the reasons for non-selection of each non-market option were individually reported on in the table, i.e. public housing refurbishing was not accepted as an option because of the cost risks and community impacts involved; the cruise ships option was not accepted because of the significant cost, the lack of legacy and the high risk of non-delivery; and the temporary village was not accepted because of the high cost and lack of legacy.

Value of land

We note audit's comments on the changes to the value of the village land. The village budget prepared in October 2004, when the changes in scope were approved and the costs of contamination assessed, correctly included the land contributed to the developer at the impaired value as required by accounting standards.

As noted in the report, the nett effect of the changes in scope, the costs of contamination and the adjustment to the land value together with changes in revenue was to increase the village budget from a nett $85.4 million to a nett $89.4 million, an increase of approximately $4 million which was announced.

The government's commitment in relation to the games' budget has always been around the cap on the nett contribution of the state to the games. The changes to the village budget in 2004 did not affect this nett contribution.

Budget issues

As outlined by audit on page 255 of the report, the approved village budget of $89.4 million is made up of:

- *the value to the state of the land contributed*
- *the cash contribution to the development*
- *<u>less</u> the estimated revenues directly associated with the project.*

This is in line with accepted budget practice and consistent with a commonsense approach.

We note audit's assessment that the nett cost of the village is $41 million when retained assets and enduring public amenities are counted.

This analysis is a valuable contribution to the triple bottom line assessment of the games which is intended to be undertaken after the games. When that assessment is undertaken, DVC will be in a better position to estimate the full economic, social and environmental benefits and costs of the village.

16.2 Background

Melbourne will host the 18th Commonwealth Games from 15 to 26 March 2006. The games will involve 71 countries, competing in 16 sports, and will be staged over 12 days of competition at venues in Melbourne and regional Victoria.

One of the key requirements of a host city, under the contract with the UK-based Commonwealth Games Federation, is to provide accommodation for the athletes and officials who will visit and compete in the games. In December 2003, the government entered into an agreement with Village Park Consortium[3] to build the 2006 Commonwealth Games Athletes' Village as part of a larger, integrated private and social (public) housing development. The private houses will be sold by the developer, with a share of profits to be returned to the state. The social housing will be retained by the state for future community use.

The village is currently under construction and is expected to be completed by the end of November 2005.

16.2.1 The games village

The games village will accommodate up to 4 500 athletes and 1 500 team officials, and will contain facilities for residential accommodation, dining, recreation, administration, training, and medical, security and domestic services.

It will be open for 25 days, with each nation occupying a specified area, and will contain:

- 155 detached houses
- 32 studio units
- 25 town houses
- approximately 105 apartments
- around 115 demountable housing units
- a major dining hall
- a transport mall
- a medical clinic
- athlete focused services, such as therapeutic massage
- shops
- entertainment facilities.

[3] Village Park Consortium comprises Citta Village Park Pty Ltd and Bayslore Pty Ltd (developer), Australand Holdings Limited (guarantor) and Babcock and Brown Pty Ltd (underwriter).

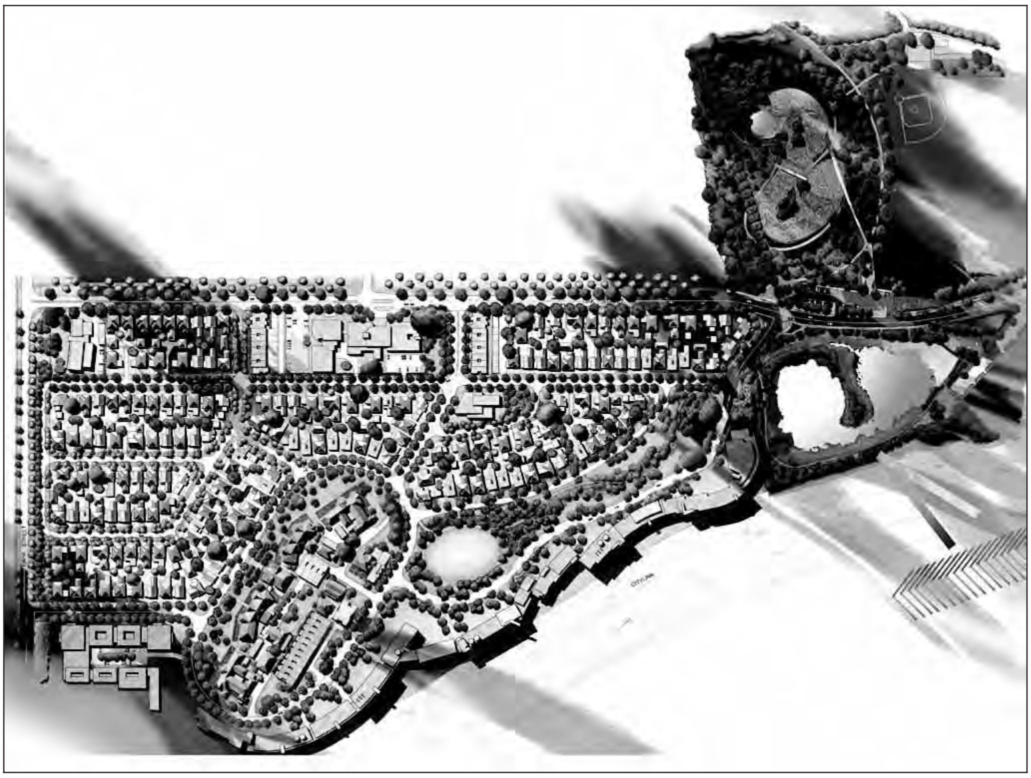
During the games, the Melbourne 2006 Commonwealth Games Corporation (M2006)[4] will operate the village and will be responsible for management and delivery of services such as catering, housekeeping, security, and traffic and transport management.

16.2.2 Location

The village is located in the inner Melbourne suburb of Parkville.

The games village will form an integral part of a private and public housing estate that will be fully completed after the Commonwealth Games as per an agreed master plan (see Figure 16A).

FIGURE 16A: ILLUSTRATION OF THE VILLAGE SITE MASTER PLAN



Source: <http://www.dvc.vic.gov.au/ocgc/Village/Masterplan_Large.jpg> accessed on 22 June 2005.

16.2.3 Future of the village

The games village is to be commissioned and made available to M2006 on 30 November 2005 for the pre-games operational fit-out in the lead up to the March 2006 games.

[4] M2006 is the Victorian statutory authority responsible for the organisation, delivery and operation of the Melbourne 2006 Commonwealth Games.

In May 2006, the village will be handed back to the developer, the Village Park Consortium, which will retrofit the dwellings and complete the remainder of the estate development. From this point, no financial assistance from the government will be required.

On completion of the development, the developer will have provided 20 per cent of the permanent dwellings in the development to the state as social (public) housing in a mix of town houses and apartments, including an aged persons' hostel containing up to 100 beds.

The integrated housing estate is to be completed by 31 December 2011, with possible extensions until 31 December 2021 if market conditions for residential sales are poor. However, extension of the project term beyond 2011 is dependent on the completion of the aged person's hostel by this date.

16.2.4 State outlays

Under the contract with the developer, the state's cash (excluding land) contribution to the construction of the games village is estimated at approximately $53.8 million. A further $35.1 million for social housing, $15.6 million in environmental enhancements and $12.7 million in project management were estimated. In 2004, an additional $43.3 million in scope changes brought the total gross cash contribution (excluding land) to $160.5 million.

The state has contributed 12 hectares of land to the developer. The remaining 8 hectares of the 20-hectare site are retained by the state for the social housing component of the project and public space.

The state will receive revenue for each private dwelling sold after the games, based upon a sliding scale percentage of the sales. The Department for Victorian Communities has estimated that the state will receive $82.9 million made up of the net present value of house sales under the agreement ($66.3 million), sale of houses in the heritage precinct ($13.6 million) and proceeds from the sale of demountable athlete accommodation units ($3 million) used during the games.

16.3 Audit purpose

16.3.1 Objectives and scope

The objective of this audit was to examine the adequacy of the controls established by OCGC for the games village project, including aspects of the contracting process.

This involved assessing:

- systems for management and control of progress of the development, including the integration of the project, its scheduling, the quality of the village, risk management, staff capability and stakeholder communications
- the level of conformance between the development of the tender specification, the short-listing and evaluation of the bid, and the negotiation and awarding of the contract. This assessment included a comparison of the original scope of works with the final product, and an examination of OCGC's estimation and control of costs.

16.3.2 Audit criteria

Figure 16B sets out the criteria used for this audit.

FIGURE 16B: AUDIT CRITERIA

Audit scope	Project management functions[5]
Systems of management and control of the project	Project integration Scheduling Quality of the village Risk management Staff capability Stakeholder communications
Conformance from tender to final contract	Procurement process Project scope change Government control of costs

Source: Victorian Auditor-General's Office.

[5] The American Project Management Institute's knowledge areas for project management, known as PMBOK, is a collection of processes and knowledge areas generally accepted as best practice within the project management discipline. See <www.pmi.org>.

16.3.3 Agencies examined

We audited OCGC in the Department for Victorian Communities. This agency is coordinating the games for the Victorian Government, and is responsible for the management of the delivery of the games village, and other infrastructure projects for the games.

Other agencies whose activities were of interest included:
- Major Projects Victoria (a division of the Department of Infrastructure)
- Melbourne 2006 Commonwealth Games Corporation (M2006).

16.4 Systems for management and control

In order to assess whether OCGC was effectively managing the games village project, we examined the following areas of project management and delivery:
- project integration
- scheduling
- quality of the village
- risk management
- staff capability
- stakeholder communications.

16.4.1 Project integration

We assessed whether the management of the project was effectively integrated by examining the governance and coordination arrangements that were established.

Major Projects Victoria manages the games village project for OCGC. It operates under a formal memorandum of understanding with OCGC and with powers delegated by the secretary to the Department for Victorian Communities.

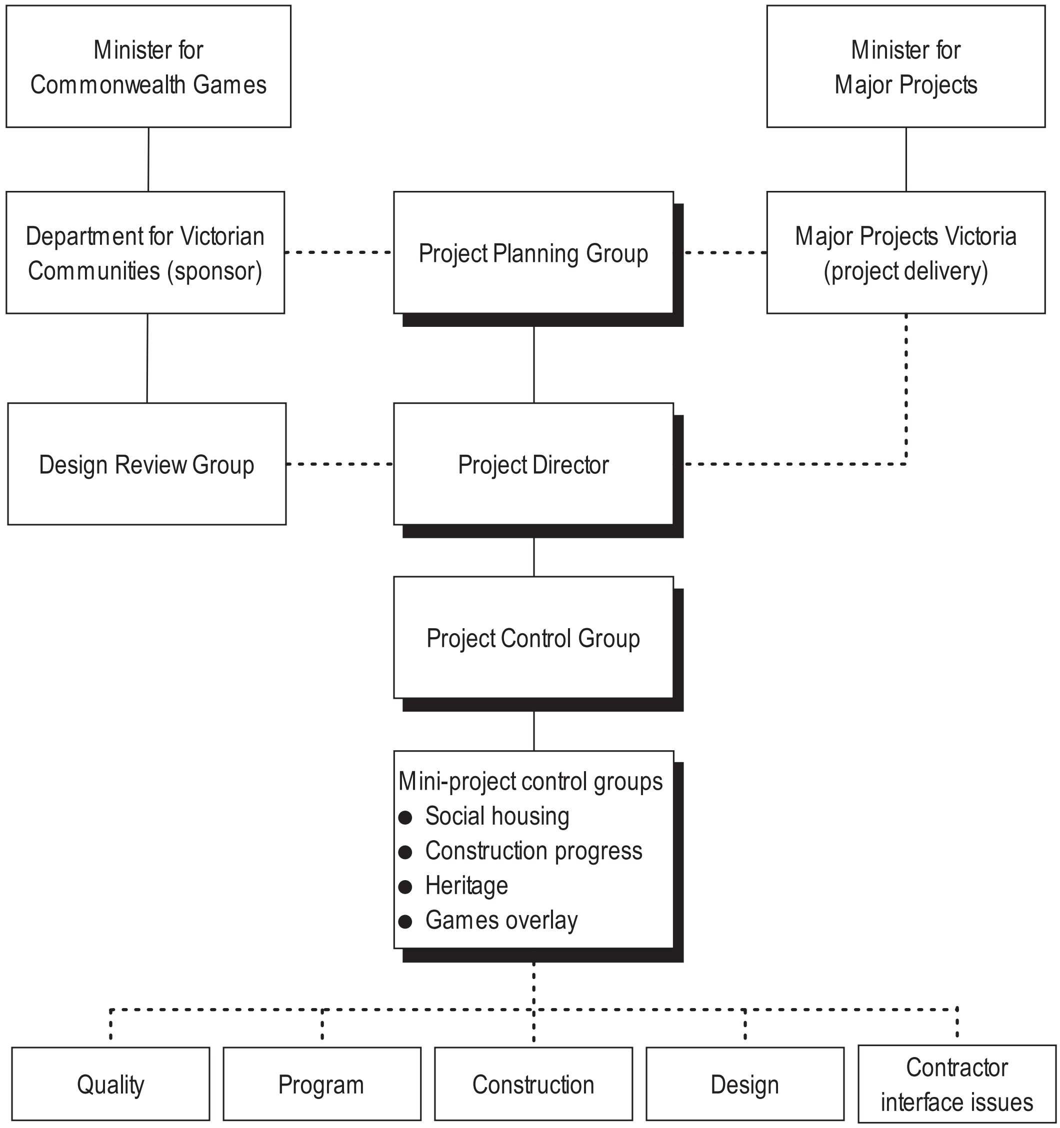
Project Planning Group

The project is governed by a Project Planning Group, comprising senior executives from:
- OCGC (Department for Victorian Communities)
- Department of Infrastructure
- Department of Treasury and Finance
- Department of Premier and Cabinet
- Department of Human Services
- M2006.

The Project Planning Group is responsible for the overall guidance of the project. A sub-group called the Project Control Group, which includes representatives from Village Park Consortium, is the key project interface between the private and public sector parties. It is responsible for delivery of the project, and primarily focuses on technical and construction issues.

Figure 16C sets out the governance arrangements for the project.

FIGURE 16C: GOVERNANCE ARRANGEMENTS FOR THE VILLAGE PROJECT



Source: Victorian Auditor-General's Office, based on information provided by OCGC.

Conclusion

These committees and mechanisms have helped the various parties to the project to participate actively and effectively in the governance of the project and to communicate their particular interests effectively. Meetings of the groups have been held regularly, have been well-documented, and have provided a clear record of decisions and discussions related to the village project.

Governance arrangements effectively integrate management of the project.

16.4.2 Scheduling

To assess whether project timelines were being managed and delivered effectively, we examined the procedures used by Major Projects Victoria and OCGC to set, analyse and control the construction milestones and schedule for the games village project.

Project milestones were negotiated in detail between Major Projects Victoria and Village Park Consortium as part of finalisation of the contract (known as the Project Delivery Agreement). These contract milestones realistically estimated the completion dates required for meeting games' obligations, such as site handover to M2006, security lock-down, retrofit, and hand-back to the developer.

The project construction schedule was designed on the basis of "normal" domestic house construction, without a requirement for accelerated works. Early delays due to inclement weather and site contamination caused some slippage of the schedule. At the time of preparing this report, many tasks were on the critical path for the agreed completion and handover date.

As a worst case contingency for non-completion prior to 30 November 2005, the Project Planning Group has developed a plan to isolate and focus the developer's resources on incomplete precincts so that the games-specific fit-out by M2006 can continue uninterrupted in other finished precincts of the village.

To support the monthly Project Control Group meetings where all agencies involved in the project are given progress reports by the developer, Major Projects Victoria hired construction scheduling experts to independently verify and analyse the schedules provided by Village Park Consortium and to inspect the site for actual progress. As a result, Village Park Consortium, OCGC and Major Projects Victoria have a very good understanding of outstanding tasks and the effort and resources required to meet the agreed milestones.

The contract with Village Park Consortium specifies a further formal control in the schedule monitoring process by linking "practical completion"[6] to an incremental hand-back of the developer's bank guarantees by the government. At the time of preparing this report, the state had handed back $9 million of the total $15 million held in bank guarantees. The balance of the bank guarantees are to be handed back to the developer when the 30 November 2005 deadline is achieved.

Conclusion

Major Projects Victoria has required the developer to provide a project delivery plan to ensure that deadlines will be met. The developer gives Major Projects Victoria a weekly update of progress on a house-by-house basis, to ensure that handover will occur as planned in late November 2005.

At the time of preparing this report (mid-November), there were adequate systems in place to effectively manage and meet the agreed project milestones. It was expected that the construction of the village would meet pre-games deadlines.

Houses under construction in the athletes' village.
(Photo courtesy of Major Projects Victoria.)

[6] In late July 2005, the last completion milestone prior to handover, the project's independent certifier had assessed the project as having achieved 75 per cent practical completion.

16.4.3 Quality of the village

A key element in judging the success of the project is the quality of the village before and after the games.

Pre-games quality is about ensuring that the amenities offered to visiting teams and athletes will meet the standard specified by the Commonwealth Games Federation to enable participants to compete effectively and to enjoy their stay. Although the developer is responsible for the quality of the *built environment*, M2006, as the village operator, is responsible for the quality of the *games overlay*, which includes most athlete-focused facilities and the final fit-out and furnishings of the accommodation.

Post-games quality relates to the final form of the housing development, which will be a "master planned" inner-urban residential estate. Quality during this phase of the village construction is particularly important to the state to ensure that it can:

- maximise its share of profits when houses are sold on the market
- provide high quality social housing assets for future use by the community.

Major Projects Victoria has commissioned an accredited quality auditing expert to give it an independent opinion on construction quality. The quality auditor has made on-site inspections of the work of the various building trades (such as steel fabricators, carpenters and bricklayers) at various stages of construction.

The quality auditor has paid detailed attention to the quality of the social housing construction, as these assets will be retained by the state for community use for a period long after the games.

The quality audit results have been regularly reported to the Project Control Group, where any required rectification notices have been discussed and quality issues resolved by the relevant project stakeholders.

Conclusion

There is a robust quality monitoring and inspection system that gives high level assurance of assessment and control of the quality of the construction of the pre- and post-games village.

16.4.4 Risk management

To assess whether project risk was adequately identified and treated, we examined:

- whether all key risks had been identified
- whether mitigation strategies and controls were in place.

Major Projects Victoria, as project manager, has been proactive in identifying and documenting all key categories of risk related to the project, in conjunction with the whole-of-games risks documented by OCGC and M2006.

Major Projects Victoria's risk management documentation is comprehensive, and over the period February 2003 to February 2005, it regularly updated the Village Risk Management Plan.

In consultation with an external consultant, Major Projects Victoria developed project delivery risk management and mitigation reports incorporating a third-party expert opinion to tease out critical risks that remain up to the completion of the project.

However, unidentified or unquantified hazards can be a major source of risk. In the case of the games village, Major Projects Victoria's risk management plans identified "further pockets of site contamination" as a potential and continuing source of risk.

Risk related to newly discovered contamination on Crown land is generally retained by the state, as it is usually the party in the best or optimal position to manage the risk[7]. Before the state handed over the site in November 2002, it undertook some investigations (including soil sampling) for this risk and obtained a certificate[8] from an environmental auditor.

Although Major Projects Victoria fulfilled its legal obligations under the legislation and the Project Delivery Agreement, the environment audit did not identify all buried contaminated waste (attributed to former state-sector users of the site) due to the site's size, its history of complex use, and the poor documentation of services and infrastructure.

Due to this, unanticipated and unbudgeted remediation works on newly discovered contamination at the site are estimated to cost $4 million to $5 million.

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[7] This is in line with the government's Partnerships Victoria risk allocation guidance which can be found at <www.partnerships.vic.gov.au>.

[8] A certificate of environmental audit is the highest level of approval for site remediation under the Environment Protection Act, and complies with the Minister for Planning's Ministerial Direction No. 1: Potentially Contaminated Land.

New services and utilities being installed in the heritage precinct.
(Photo courtesy of Major Projects Victoria.)

Conclusion

Contamination at the Parkville site was higher than expected due to the site's complex history and inadequate infrastructure records. This situation is not unique to the Parkville site, and may also occur at other public sites currently held for sale.

This experience from the Parkville project highlights the importance of the state understanding the environmental risks that may arise from long-term state occupancy.

Apart from the impact of the unanticipated and unbudgeted decontamination works, we consider that all other key risks to the project have been identified by Major Projects Victoria and OCGC.

Recommendation

16.1 That the state, when contributing land to projects where sites have had long-term occupancy by public sector users, develop tighter provisions to ensure more detailed and rigorous examination and mitigation of site risks.

16.4.5 Staff capability

To assess whether appropriately skilled staff were oversighting the project on behalf of the state, we examined the skills profile of staff involved in the project and investigated whether expertise was bought in or developed in-house as required.

As the state's project manager, Major Projects Victoria directly manages the games village project on behalf of OCGC. Both agencies have recruited staff to oversight various components of the project.

Major Projects Victoria has employed a relatively small project team to plan and monitor the developer's progress. To augment their skills as required, it has also purchased expertise, such as legal, financial, quantity surveying, inspection, environmental auditing, engineering, construction quality and building schedule experts.

Because Major Projects Victoria simultaneously manages a number of major projects, it has to plan its staffing requirements up to 18 months in advance.

As a result, it uses a capability and development framework to match individual project staff with the needs of its projects. It provides staff with appropriate development opportunities; for example it sent a village project manager to Manchester to work as an operations coordinator at the Commonwealth Games Athletes' Village in 2002. Major Projects Victoria believes that this experience has given the project management team a unique insight into the operational issues that can arise in an athletes' village.

OCGC also adequately planned for a capability to deliver specific components of the Commonwealth Games, including the village. It has developed position descriptions and skill profiles for staff and has recruited them as needed since the project started.

Many of OCGC's staff are also heavily involved in other infrastructure and venue projects related to the Commonwealth Games, and this gives them broad and practical experience of complex construction projects.

Conclusion

OCGC and Major Projects Victoria have appropriately skilled staff oversighting the village project.

16.4.6 Stakeholder communications

To assess the adequacy of communications on the project, we examined whether internal and external stakeholders were reported to regularly on progress and performance.

As shown earlier in Figure 16C, the Commonwealth Games Athletes' Village management and delivery structure is complex, with the Project Planning Group in charge of management and the Project Control Group oversighting the delivery of the project. These 2 groups are the main interface between internal stakeholders, including OCGC, Major Projects Victoria, M2006, the developer and various consultants.

Communication and reporting within both of these groups has been frequent and detailed, and departmental officers have regularly briefed ministers on progress of the village and, where necessary, requested ministers' advice on key matters.

The developer reports to Major Projects Victoria on a regular basis. Target-based reporting of components of the project, such as housing and infrastructure, occurs on a weekly basis and consultants' reports and senior management meetings typically occur on a fortnightly to monthly basis.

A communications program for external stakeholders has been in place since mid-2002 and both a formal and informal public consultation process took place in early to mid-2004. A Community Liaison Committee meets on a 6-weekly basis to inform external project stakeholders on issues that directly affect them. It includes representatives from OCGC, Major Projects Victoria, Victoria Police, local councils, the developer and public interest groups, such as residents' and lobby groups and concerned businesses. After each meeting, tasks requiring action are agreed and documented with stakeholders, with follow-up reports given on progress at later meetings.

A public relations strategy, which includes government press releases and the OCGC website[9], communicates progress on the village and other information to the general public.

Conclusion

Project communication is adequate and there is regular reporting on project progress and performance between internal and external stakeholders.

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[9] Found at <http://www.dvc.vic.gov.au/ocgc/building/village.htm>

16.5 Project procurement

We assessed whether the evaluation of the bids and the awarding of the contract had been rigorous and transparent, and examined the following aspects of the procurement process:

- probity and governance
- tendering, short-listing and evaluation
- contract development and negotiation.

This assessment also included a comparison of the original scope of works with the final product, and an investigation of OCGC's assessment and control of costs.

16.5.1 Procurement process

The procurement process for the games village was lengthy and exhaustive, and involved detailed evaluation of complex and competing proposals and concepts from private sector bidders. The key dates are detailed in Figure 16D.

FIGURE 16D: KEY STEPS AND DATES FOR THE GAMES VILLAGE TENDER

Tender step	Date	
Advertisements for Expressions of Interest (EOI)	17 and 24 July 2001	
EOIs received	17 August 2001	
Pre-qualifiers evaluated	23 August 2001	
Pre-qualifiers announced	17 September 2001	
Requests for Proposal (RFP) issued to pre-qualified bidders	19 October 2001	
2 pre-qualified bidders withdraw	Late 2001	Approx. 15 months
4 proposals received	4 February 2002	
Evaluation report on proposals	April 2002	
Jolimont rail proposal excluded	May 2002	
3 final proposals evaluated	May-October 2002	
Successful proposal agreed	4 October 2002	
Successful proposal announced	22 October 2002	
Heads of agreement signed	4 November 2002	
Planning Advisory Committee and public consultation	November 2002 – August 2003	
Project Delivery Agreement and final proposal negotiated	November 2002 – October 2003	Approx. 13 months
Project Delivery Agreement signed	December 2003	

Source: Victorian Auditor-General's Office, from information provided by OCGC.

Probity and governance

The Project Planning Group was responsible for the procurement process and gave regular briefings to its member agencies, who then briefed the relevant ministers on progress and key decisions.

The Minister for the Commonwealth Games is responsible for the village project, although in the early phases of the project, the Minister for Major Projects and the Minister for Health had an interest in specific aspects of the project.

The Project Planning Group engaged a probity adviser and a probity auditor to oversee the tender evaluation and subsequent negotiations. The probity adviser developed a probity plan and wrote a detailed report which approved of the probity of the process.

We reviewed the working papers that the probity adviser used to form this view. There was high level and active involvement of the probity adviser in key process and decision points of the procurement. The plans and working papers were well-documented and were audited by the probity auditor.

Tendering, short-listing and evaluation

The project followed a procurement approach where a field of pre-qualified bidders was first identified and assessed, followed by an evaluation of the offers received in response to the Request for Proposal (RFP). For this project, the RFP was issued to 6 pre-qualified bidders and not publicly released.

The proposals from pre-qualified bidders were subject to a 2-stage assessment, with submissions evaluated by specialist assessment teams (made up of a mixture of internal and external experts) against the following criteria:

- vision
- finance
- function and "buildability"
- social integration.

In the second stage of the process, the specialist assessment teams reviewed the project proposals using the following weightings:

- 40 per cent - Concept and design (including functionality during the games)
- 40 per cent - Costing and finance
- 10 per cent - Social housing
- 10 per cent - Environment.

Although Parkville was the preferred site for the village, bidders were able to nominate other sites within 5 kilometers of the central business district, as long as they could demonstrate that any alternative site would cost the state the same amount or less.

Of the 6 pre-qualified parties, 2 withdrew from the process. One of the 4 proposals (to build the village on decking over the Jolimont railway yards) was excluded in May 2002, which left 3 bidders remaining in the evaluation process.

The tendering, short-listing and evaluation process was consistent with better practice guidance of the Victorian Government Purchasing Board and followed a typical approach to competitive tendering.

Consideration of other options

While the bids were being evaluated, OCGC reconsidered other non-market options for a games village so that it could compare with the 3 final bidders' costs and to have a possible contingency project if the negotiations with market bidders failed.

Various non-market options were considered by the Project Planning Group in 2002 against the 3 remaining market bid estimates at that time.

Figure 16E shows the final costs for the non-market and market options that were considered by the Project Planning Group.

FIGURE 16E: ANALYSIS OF COSTS OF NON-MARKET OPTIONS VS MARKET BIDS ($MILLION)

	Total estimated net cost
Non-market options -	
Cruise ships moored at Station Pier	85.0
Temporary village (at Docklands, Royal Park or Albert Park)	157.7
Public housing refurbishment (North Richmond) (a)	71.0
Public housing refurbishment (Carlton) (a)	71.0
Market bids -	
Urban Pacific (Parkville)	158.69
Village Park Consortium (Parkville)	131.1
Lend Lease (Docklands)	167.0

(a) This figure is the estimated net games-related cost to the state. To achieve this option, other social housing funding would have had to be re-programmed and accelerated to achieve the fit-out in the required time frame for the games. The cost of this social housing funding for North Richmond was estimated to be an additional $148 million and, for Carlton, an additional $164 million.

Source: Victorian Auditor-General's Office, from information provided by OCGC.

Of the non-market options considered by the Project Planning Group between June and October 2002, none was developed further as they had at least one of the following deficiencies:

- lack of environmental or social legacy
- lack of social housing component
- extreme disruption to an existing community
- high risk of non-delivery, including availability of cruise ships.

Evaluation of bids

The final assessment team report of October 2002 (which recommended Village Park Consortium as the preferred bidder) clearly documented evaluation decisions and criteria rankings for each bidder.

The probity adviser and the probity auditor both commented that the evaluation criteria were clearly documented and applied in a consistent manner for all bidders. They were both involved in all relevant steps of the process, and actively engaged in key evaluation steps and decisions. The probity adviser also oversaw discussions and negotiations with the proponents.

Contract development and negotiation with winning bidder

After Village Park Consortium was confirmed as the preferred bidder and the Heads of Agreement had been signed in late 2002, a series of activities occurred, including:

- formal public consultation on the proposal, held under the Minister for Commonwealth Games Advisory Committee process, and the release of his final determinations
- detailed technical review of the developer's proposal against athlete accommodation requirements
- negotiation of legal clauses of the proposed contract
- site clean-up and demolition works prior to site handover to the developer.

The site was handed over to the developer in late November 2003 and the Project Delivery Agreement was signed in December 2003.

Public consultation

The Planning Advisory Committee consulted with more than 30 organisations and representatives from State and Local Government authorities and bodies as well as private industry groups, including planning and architectural advisors. The committee considered over 50 written submissions and conducted more than 3 weeks of public hearings.

In August 2003, the *Commonwealth Games Planning Advisory Committee (Games Village) Report* was issued and included 130 recommendations mainly focused on site design and layout, building design, acoustics, landscape, traffic and transport, water management, environmental initiatives, social infrastructure, heritage, games mode, construction phase, planning controls and processes, and environmental management plans.

The government supported, or supported in principle, 128 of the recommendations via a ministerial determination. Recommendations which related to design components of the village were addressed in the Project Delivery Agreement with the developer. Other recommendations were addressed through consultation between government departments, agencies or the developer.

Project Delivery Agreement

Prior to the tender process, the government had developed a project risk matrix to allocate risk between parties. This was included in the Request for Tender, the Heads of Agreement and the final Project Delivery Agreement, which is a detailed contract specifying each party's roles and responsibilities in the games village project.

The Project Delivery Agreement between the state and Village Park Consortium encompasses the government's goal of delivering a project that:

- is environmentally responsible, both during and after the games
- is innovative and imaginative in its design and operation, both during and after the games
- is user-friendly for both able-bodied and disabled athletes
- is physically and socially integrated with its surroundings after the games
- includes social housing, which is to be integrated into the overall concept plan for the project.

Under the Project Delivery Agreement, the developer is responsible for planning, designing, constructing, financing, maintaining, marketing and selling the development. As well, the developer is also contracted to:

- make the games village available for the Commonwealth Games
- provide estate management services during the games
- make payments to the state upon the sale of individual dwellings
- share any project surplus, subject to meeting certain performance hurdles.

In summary, under the agreement, the state contributes cash and land to the developer, in return for the use of the Parkville site as a games village for a total period of 5 months, construction of social housing and other amenities, and a proportion of the proceeds of property sales from the housing estate in accordance with a financial revenue formula specified under the agreement.

The contract negotiations were well documented and detailed, and were overseen by the probity adviser, whose advice was sought at key negotiation points.

The probity auditor gave a formal sign-off of the process from the identification of the preferred bidder to the signing of the Project Delivery Agreement, and confirmed that, in their view, the elapsed time of the negotiations had had no material difference on the offer provided.

Conclusion

We conclude that the procurement process for the project was rigorous and transparent.

16.5.2 Project scope changes

To assess whether scope changes to the project were adequately managed, we examined whether the project scope (as specified in the Project Delivery Agreement) had been amended and if any other changes had been made to the project.

The original project scope, as negotiated in the Project Delivery Agreement, has not changed in any fundamental way for the "post-games" village. There were, however, a number of substantial changes to the "Games mode" village following a decision made in October 2004.

The government agreed to changes to the project scope in response to external representations about the proposed games village accommodation. Although the developer's original design complied with the accommodation standards specified in Melbourne's host city contract, the Commonwealth Games Federation subsequently indicated to government that their previous standards would not be adequate.

M2006 and the Commonwealth Games Federation were concerned that the village, as originally designed, would be too cramped, have little open space and that the athletes' houses would have inadequate living areas. Other issues such as lengths of beds, sizes of bedrooms, noise levels due to overcrowding, and appropriateness of the outdoor and temporary ablutions were publicly canvassed by some teams, including the Australian team.

The Commonwealth Games Federation had formed a view that the accommodation provided in Manchester in 2002 (which included bunk beds in university dormitories for some athletes), was no longer of the standard they supported, and expressed the view that expectations had increased about appropriate accommodation for athletes. These changed expectations had also been reinforced by positive experiences of the athlete accommodation provided at the Sydney 2000 and Athens 2004 Olympic Games.

We understand that M2006[10], which has a representative on the Project Planning Group, was not aware of these changes in the Commonwealth Games Federation's view before the developer signed the Project Delivery Agreement.

The concerns from the Commonwealth Games Federation were considered by the government following representation from the federation and the Australian Commonwealth Games Association in mid-2004. OCGC then prepared a number of options on possible village scope changes for the government.

A preferred option was approved in principle just prior to the Commonwealth Games Federation General Assembly in Athens in August 2004, with a fully costed option approved in October 2004.

The major scope changes to the village construction included:

- temporary housing for athletes comprising 89 backyard units, 26 demountable units and 50 additional bathrooms ($19.59 million)
- bringing forward the final fit-out of the heritage buildings on the site and the building of 3 new houses ($21.14 million)
- contingency and other costs ($2.65 million).

Included in the scope changes were a further $9.45 million of operational costs related to the "games mode" overlay[11], including:

- off-site accommodation of 300 beds
- additional costs of village operations and athletes services, due to location change and use of temporary facilities, such as marquees.

These additional costs of $52.83 million are offset by:

- items already budgeted for and approved under fixed cost contracts ($11.6 million),
- revenue from sales of housing in the heritage precinct ($15.87 million)
- sales of backyard and demountable housing ($3 million).

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[10] M2006 has a representative of the Australian Commonwealth Games Association on its board.

[11] These operational overlay costs are managed by M2006.

This results in an estimated net cost for the scope changes of $22.36 million.

Figure 16F sets out the village scope changes approved in October, 2004.

FIGURE 16F: VILLAGE SCOPE CHANGES APPROVED IN OCTOBER 2004

Scope change elements	$million
Village construction for "games mode" -	
Demountables (26 x 14-bed units), including infrastructure	8.30
Backyard relocatable accommodation (89 units), including infrastructure	10.70
50 additional bathrooms	0.59
3 extra houses	0.56
Heritage precinct fully built to final fit-out stage	20.58
Other costs -	
Contingency	1.95
Traffic and minor works	0.20
Operational allowance (managing Oak St closure – traffic and Mental Health Research Institute)	0.50
Sub-total	**43.38**
M2006 village games overlay -	
Off-site accommodation for 300 beds	2.53
Athlete services (additional cost due to location change)	2.52
Heritage precinct operational costs	3.25
Village Operational Services for Athletes on soccer field	0.53
Contingency	0.62
Sub-total	**9.45**
Total (gross)	**52.83**
Revenues and offsets -	
Budget items already approved (a)	11.60
Revenue – sales from heritage precinct (b)	15.87
Revenue – sales of backyard and demountable housing	3.00
Sub-total	**30.47**
Net cost of scope changes	**22.36**

(a) Items approved in previous budgets, but not expended include relocatables, demountables and social housing contingency for demountables. Consequently, these are included as an offset.

(b) This revenue includes $13.6 million from the buy-back of the heritage precinct by the developer and an extra $2.27 million from house sales.

Source: Victorian Auditor-General's Office, from information provided by OCGC.

Village Park Consortium was involved in the development of the design of these scope changes, which it is implementing on a "cost plus margin" basis. A supplemental deed to the Project Delivery Agreement, which specified these changes, has been negotiated and is awaiting legal clearance prior to execution.

Funds to cover these costs have been reallocated from contingency funds within the whole-of-games' budget.

Conclusion

The scope changes made late in 2004 were driven by external pressures, especially demands for higher standard and less crowded athlete accommodation than was originally envisaged. These major scope changes were made to address the improved standards required by the Commonwealth Games Federation. They were restricted to the "games mode" aspects of the village, and were adequately managed.

16.5.3 State control of project costs

To assess whether costs of the project were adequately estimated and controlled, we examined whether OCGC had:

- adequately estimated project costs
- effectively set and controlled the project budget.

Estimation of village project costs

Although some early work was done on estimating costs, no formal process of cost estimation occurred until proposals had been received from tenderers.

The Project Planning Group hired an external expert to conduct modelling of the 3 short-listed bids. This model standardised the cost assumptions in these proposals into a form that could be used for comparison and analysis. We reviewed these models and found them to be detailed and rigorous.

As described earlier in this part of the report, OCGC developed business cases for a number of non-market options[12] which were used as comparisons for the market proposals. However, a business case for an athletes' village at Parkville was not developed.

The preparation of a business case is a basic element of effective project development. Such a business case would have assisted in the negotiations with the private sector for this complex and expensive project. It would have been a useful tool for OCGC.

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[12] Options included cruise ships, refurbishment of social housing high-rise estates and a temporary village at Docklands.

This is recognised in current government guidance and practice (as explained in Partnerships Victoria policy[13]) which requires, among other things, that a business case be developed to establish a benchmark to help evaluate market offers.

Cost-benefit analysis

There was no evidence that a comprehensive cost-benefit analysis had been done in the lead-up to the tender, although advice provided to the Premier in 2001 (by the Inter Departmental Committee that preceded the Project Planning Group) estimated that the state's contribution would be about $40 million, plus social housing costs.

Development of a cost-benefit analysis would not only have helped OCGC understand the full costs and benefits that would arise from the project, but also would have canvassed other possibilities for the tender, such as "cost neutral" or "revenue positive" outcomes for government.

Also, such an analysis would have enabled estimation of the economic value that could emerge from the project's amenities, including:

- environmental enhancements
- heritage protection
- urban regeneration
- the project's relationship to any benefit generated for the state economy by the Commonwealth Games.

Setting and control of village project budget

OCGC's budget for the village is made up of state contributions to the developer of cash and land, offset by revenue from the development. In simple terms, the budget is made up of:

- cash contributions to the developer
- cash costs for social housing, environmental enhancements and project management
- 12 hectares of Crown land contributed to the developer
- revenue from profit share of house sales from the development
- revenue from sales of demountables.

OCGC's budgets, approved at the significant milestones of Heads of Agreement in 2002 and following the scope changes in October 2004, are set out in Figure 16G.

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[13] Published in June 2000, the Partnerships Victoria policy applies to the provision of public infrastructure and any related ancillary services which involve private investment or financing. It applies to projects where the present value of payments by government exceeds $10 million over the life of the project.

FIGURE 16G: OCGC APPROVED BUDGETS FOR THE GAMES VILLAGE PROJECT ($MILLION)

	Dec. 2002 (At time of Heads of Agreement)	Oct. 2004 Final budget
Outflows -		
Land -		
State contribution of land	33.0	11.8
Cash -		
State contribution of cash	50.7	52.3
Project Delivery Agreement adjustments		1.5
2004 scope change contributions (gross)		43.3
Project management services	10.0	12.7
Environment works	15.6	15.6
Social housing	35.1	35.1
Total outflows	**144.4**	**172.3**
Inflows -		
Revenue (house sales)	(59)	(66.3)
Revenue (heritage precinct)		(13.6)
Revenue (demountables sales)		(3.0)
Total revenues	**(59)**	**(82.9)**
Net contribution	**85.4**	**89.4**

Source: Victorian Auditor-General's Office, using data provided by OCGC.

Cash contributions to the developer

The state is contributing $53.8 million in cash to the developer. Payments are specified in the Project Delivery Agreement and have a defined disbursement schedule and fixed values. Regular cost reports are made to meetings of the Project Planning and Project Control Groups. Variations and other invoices are analysed by OCGC to ensure budget discipline.

The social housing aspect of the village was negotiated as part of the Project Delivery Agreement and has remained fixed at an additional cost of $35.1 million. This includes agreement to build 200 units of social housing over the life of the development, as well as 20 large demountable homes which will be transferred to the Department of Human Services' Office of Housing after the games.

The Project Delivery Agreement also specifies that a 100-bed aged persons hostel will be built on the site. There is no cost to the state for this facility, as it was offered by the developer as part of its commercial terms for the overall development[14]. Further, the ownership of this asset, when built, is yet to be agreed between the developer and the state.

Project management services and environmental works on the site are itemised as cash costs in the village project budget.

Land contributed to the developer

The 12 hectares of land contributed to the developer is part of a larger site of 20 hectares. Eight hectares are retained by the state for the social housing development and public space.

Prior to the tender process, in February 2002, the 20 hectares of land was valued by the Valuer-General at a market value of $33 million, on the basis of the site being developed as a high density residential development.

This value was used in OCGC's cash modelling of bids during the tender process in 2002 and 2003. It also was used, inaccurately, as the value of the contributed land in the October 2002 announcement of the net cost of $85.4 million[15] for the village project. Using this value of the total site of 20 hectares, not the amount contributed to the developer of 12 hectares, had the effect of overestimating the outflows in OCGC's 2002 budget, and the net contribution as announced by the government in October 2002, by about $13 million.

In October 2003, shortly before the signing of the Project Delivery Agreement, the Valuer-General increased his valuation of the site to $46.6 million. OCGC continued to use the earlier $33 million value in finalising the agreement, as the increase in land value was thought to be fiscally neutral (i.e. any increase in land value would be recouped via the state's profit share of development sales).

In June 2004, the Department of Human Services transferred the 20 hectares of land to the Department for Victorian Communities at a value of $16.8 million. The Department for Victorian Communities' annual accounts for the 2003-04 financial year recognised the land transfer, applying separate values to the 2 land components to take account of the village project.

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[14] The Minister for Commonwealth Games placed a value of $12 million on this facility on 8 June 2005. Parliamentary Accounts and Estimates Committee. *Inquiry into Budget estimates 2005-06*, 8 June 2005. <http://www.parliament.vic.gov.au/paec/inquiries/budgetestimates_2005-6/transcripts/8-6/PAEC_Commonwealth_8_6_05.doc>. Accessed 25 October 2005.

[15] Office of the Premier, press release dated 23 October 2002. <http://www.dpc.vic.gov.au/domino/Web_Notes/MediaRelArc02.nsf/4d9fa39283ff510d4a256b36001bd4e0/f34cf86e402d1268ca256c5c000382b5!OpenDocument>. Accessed on 25 October 2005.

The 8 hectares of land retained by the state was valued at $18.2 million, based on the October 2003 market valuation of $46.6 million for the total 20 hectares.

The 12 hectares of land to be contributed to the developer had a market value of $28.4 million at that time. However, as the state no longer had control of this portion of the land, an impairment test[16] was applied to the 12 hectares to take account of the terms of the agreement with the developer.

As a consequence, the 12 hectares of contributed land had an impaired value of $11.8 million at the end of 2003-04. The impaired value is calculated from the difference between the net present value of the inflows and outflows of the project.

The $16.6 million reduction in the value of the contributed land – from the market value of $28.4 million to the impaired value of $11.8 million - is a direct result of the negotiated agreement between the state and the developer.

The impaired value of the 12 hectares will need to be re-assessed annually to reflect any change in the net present value of the inflows and outflows from the project. For example, this reassessment would be triggered by lower than expected revenues (inflows), or higher than planned costs (outflows) than those used in the initial impairment test of 2003-04.

This $11.8 million value for the contributed land was used by OCGC to calculate its most recent announced net village project budget of $89.4 million[17].

This changing value of the land, from the market value of the whole site in the 2002 budget ($33 million) to the impaired value of the contributed 12 hectares in 2004 ($11.8 million), effectively absorbs more than $21 million of the cost of the 2004 scope changes.

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[16] See Australian Accounting Standard AASB 1010 *Recoverable Amount of Non-Current Assets* (December 1999).

[17] Minister for Commonwealth Games. Parliamentary Accounts and Estimates Committee, *Inquiry into Budget estimates 2005-06,* 8 June 2005. <http://www.parliament.vic.gov.au/paec/inquiries/budgetestimates_2005-6/transcripts/8-6/PAEC_Commonwealth_8_6_05.doc>. Accessed on 25 October 2005.

Revenue from the development

OCGC revenue from the village project in 2002 was estimated to be $59 million. Following scope and other variations, this profit share from sales from the development, and sales of demountables, backyard units and other relocatables, was estimated to be $82.9 million in 2004 – an increase of $23.9 million.

The increased revenue estimates, when combined with other budget changes between 2002 and 2004, have enabled the government to announce a net budget increase of $4 million. However, the changes in the project's budget parameters – particularly the adjustment from the inaccurate 2002 estimation of the value of the contributed land to its 2004 impaired value, and the adjustments from the 2004 scope changes – were not announced publicly.

An explanation of these major changes between the 2002 and the 2004 budget announcements would have been more explicit than announcing a final net cost increase figure.

Value of the village project to the state

In broad terms, there are a variety of budgets that can be used in managing projects. These include:

- a budget to manage cash receipts and payments
- a budget to manage revenues and expenditures
- a budget to establish the value that the project will deliver.

The budget used by OCGC combines part of each of these. Broadly, it is based on the difference between the total cash and land contributions, and the estimated return from profit share of sales from the development.

While OCGC effectively managed project payments, the values attributed to components of the budget are a mix of cash and estimated value.

For example, it includes the expected revenue from the sale of the private houses (including the market value of the land) but does not include the $16.6 million, which is the difference between the market and impaired value of the contributed land. Nor does it include all the items that reflect the value the project is expected to deliver.

Any estimation of the net contribution or return needs to include the value of retained assets and amenities that have resulted from the project. Currently, OCGC's village budgets do not include the value of retained assets or the enduring public amenity of the development.

For example, while the cost of building the social housing is included as a cash contribution, the return to the state from this social housing is not included.

As well, the amenity derived from the cost of environmental works and permanent improvements to the site are not included.

Likewise, the residual value of the land retained by the state is not included.

Figure 16H sets out our analysis of the value to the state of the games village project. This analysis results in an estimated contribution by the state of $41 million for the project.

FIGURE 16H: VALUE ANALYSIS OF GAMES VILLAGE PROJECT

Item		($million)
Contributions by the state to the village project -		
State contributions of land (impaired value)	11.8	
State contributions of land (difference between market value and impaired value) (a)	16.6	28.4
State retained land component		18.2
State contributions of cash		52.3
Project Delivery Agreement adjustments		1.5
2004 scope change contribution (gross)		43.3
Social housing		35.1
Project management services		12.7
Environment works		15.6
Total outflows		**207.1**
Return to the state from the village project -		
Revenue (house sales)		(66.3)
Revenue (heritage precinct)		(13.6)
Revenue (demountables sales)		(3.0)
Rent (free of charge) (b)		(3.9)
Social housing (at cost)	35.1	
Social housing (discount on improvements) (c)	8.7	(43.8)
Environmental works – amenity (d)		(15.6)
State retained land component	18.2	
State retained land component (e)	1.7	(19.9)
Total inflows		**(166.1)**
Net contribution by the state		**(41.0)**

(a) The $16.6 million represents the reduction in the value of the contributed land, from the market value of $28.4 million to the impaired value of $11.8 million.

(b) The rent free of charge is valued at the market value of the rent of the housing owned by the developer, which is being used by the state in the village for the games period.

(c) This figure is calculated by dividing the budgeted cost of the social housing ($35.1 million) by an estimate of the discount on improvements (25 per cent) that arises from building these assets on an inner urban site at fixed cost. The discount is derived from a fixed cost contract and a consequent reduction in the builder's margin.

(d) This figure is calculated at cost ($15.6 million) to represent the value of the environmental enhancements that have arisen from the project.

(e) This estimate is based on the land value and a premium attaching to the social housing component that recognises the replacement cost of an equivalent social housing development site in the inner residential suburbs of Melbourne.

Source: Victorian Auditor-General's Office, based on information from OCGC and our additional analysis.

Conclusion

On the estimation of the Village project costs, we concluded that:

- a business case for the Parkville site should have been developed to benchmark against private sector bids
- a formal cost-benefit analysis should have been conducted for the project.

On OCGC's setting and control of the village budget, we concluded that:

- the cash outflows in the village project budget are being managed well by OCGC.
- the village budget would have been more complete if it:
  - was based on the value that the project would deliver
  - included the change between the market value and the impaired value of the contributed land
  - included the estimated value of retained assets and public amenity as well as the market value of the land.

The changes in the value of the contributed land, the increases in estimated revenue from profit share of sales from the development and the scope changes enabled the government to announce a net increase in cost of only $4 million from the budgeted 2002 figure of $85.4 million to the 2004 figure of $89.4 million. We concluded that an explanation of these major changes between the 2002 and 2004 budget announcements would have been more explicit than announcing a final net increase figure.

Further, based on our analysis of the value of the project to the state, we concluded that the net contribution by the state to the village project is estimated to be $41 million, for which the state will have met its obligations to accommodate 6 000 athletes and officials in the games village and delivered assets and amenity of benefit to the community.

17. Harness racing industry reforms - Adequacy of consultation

17.1 Audit conclusions

In March 2005, Harness Racing Victoria (HRV) released a document titled *Vision Value Victoria (V3)* which, among other things, made public the HRV Board's decision to discontinue TAB harness racing meetings at 7 racetracks in country Victoria and to transfer the meetings to alternative venues from 1 July 2005.

We undertook an investigation in response to concerns raised with our Office that HRV had not consulted with the 7 affected clubs prior to the release of the *V3* document. The *Racing Act 1958* was amended in August 2004 to expand the purposes of the board to include consultation with harness racing industry participants. Section 38 (1) of the *Racing Act 1958* defines a "harness racing participant" as including "a harness racing club (other than the Board)".

HRV confirmed that no communication or consultation occurred with any harness racing clubs prior to the release of the *V3* document. We consider that in the event that formal consultation procedures had not been finalised, consultation should have occurred directly with the 7 affected clubs prior to the release of the *V3* document. In our view, this lack of consultation with harness racing industry participants prior to announcement of the board's decision to transfer TAB harness racing meetings was not consistent with the intention of the amendments to the Act.

While acknowledging the right of HRV to determine the future strategy for the industry, we also believe that the specific statutory amendments concerning consultation have resulted in a "legitimate expectation" on the part of harness racing industry participants that consultation would occur.

17.2 Background

Harness Racing Victoria is a statutory body which officially commenced operations as the Trotting Control Board in January 1947. The function of the HRV Board as set out in the *Racing Act 1958* is to control the sport of harness racing; to conduct harness races; and to consult with harness racing industry participants and facilitate consultation among harness racing participants.

The mission of HRV is to develop a "vibrant harness racing industry which promotes participation, integrity and racing excellence, grows wagering and maximises returns to its stakeholders".

A harness race meeting in progress.
(Photo courtesy of HRV.)

In 2000-01, HRV initiated a process to develop a 5-year strategic plan for the harness racing industry in Victoria. The plan was informed by advice to HRV's Board from a 17-member Strategic Planning Advisory Panel that was selected following a call for expressions of interest. Industry input was also provided through open forums held at 25 harness racing clubs throughout Victoria involving around 700 people.

The strategic plan *Harnessing the Future,* was adopted in 2001 by HRV. The plan outlined 34 goals each supported by performance objectives describing how each goal was to be achieved. Ten priority goals, clustered under 5 headings, were targeted for immediate attention:

- financial accountability
- communication/consultation
- marketing
- industry governance
- industry performance.

The 2 goals described under the heading of communication/consultation stated that:

- the industry will be advanced through the promotion of, and engagement in, meaningful statewide consultation that empowers participants
- HRV will invest in initiatives that will deliver clear and informative communication.

In August 2004, the *Racing Act 1958* was amended to "make the racing industry more competitive and participative" and ensure that racing industry stakeholders were adequately consulted by their governing bodies[1]. The amendments to the Act require that HRV "consult with harness racing participants and facilitate consultation amongst harness racing participants" (s. 44ba) and also that the "Board must establish proper procedures to consult with harness racing participants and to facilitate consultation amongst harness racing participants" (s. 44B). In addition, HRV is required to report on these consultations in every report of its operations under Part 7 of the *Financial Management Act 1994*.

Since 2001, HRV has been gradually implementing its strategic plan. In March 2005, HRV released an industry action plan titled *Vision Value Victoria* (*V3*) outlining a number of further actions to address the goals of maximising industry income and returns to owners, and creating racing centres of excellence in strategic locations .

The *V3* document made reference to the results of a venues study undertaken by HRV which had evaluated all venues against 12 performance criteria and 3 cost criteria. Based on this assessment, HRV estimated that upgrading all racetracks to meet HRV's standards and to meet occupational health and safety requirements would cost the industry $31.4 million. The *V3* document reported that the cost-benefit analysis of the venues study illustrated that:

- *the industry will progress and grow by upgrading tracks and investing $21 million in regional harness centres*
- *the industry cannot afford nor justify spending $10 million (32 per cent of the required capital expenditure) to upgrade 7 tracks that collectively host only 6 per cent of TAB meetings and generate only 4 per cent of industry turnover.*

On the basis of this information and information contained in its strategic plan, HRV had decided to discontinue holding TAB meetings at 7 country harness racetracks and transfer their race meetings to neighbouring venues. Table 17A provides details on the harness racetracks where TAB meetings have been discontinued and the replacement race venues, as announced in the *V3* document.

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[1] Victoria, Legislative Assembly 2004, *Parliamentary debates*, 4, 5, 6 May, Book 4, p.1 054.

FIGURE 17A: HARNESS RACETRACKS WHERE TAB MEETINGS HAVE BEEN DISCONTINUED AND THE REPLACEMENT VENUES

"Home" club	No. of TAB meetings in 2004-05	No. of "away" meetings as per *V3* action plan	New meeting venue
Boort	2	2	Charlton
Gunbower	2	2	Echuca
Hamilton	5	5	Horsham and Terang
Ouyen	7	8	Mildura
St Arnaud	5	5	Charlton
Wangaratta	5	(a) 5	Shepparton
Wedderburn	2	4	Charlton

(a) Number as advised by HRV.

The *V3* document also outlined that affected clubs would be paid generous subsidies to offset any costs associated with running meetings at neighbouring venues, and that all venues would be retained for training and club trials.

As indicated previously, concerns have been raised with our Office that HRV did not consult with the 7 affected clubs prior to the release of the *V3* document.

17.3 Our assessment

The *V3* document was not the subject of specific consultation with any of Victoria's harness racing clubs, including those affected by the transfer of TAB meetings. HRV advised that its board considered the *V3* document to be part of the ongoing implementation of the industry's strategic plan, *Harnessing the Future*. We were advised that the HRV's Board took the view that as extensive consultation had taken place with the industry in the development of that plan in 2001, there was no further requirement for consultation and that HRV's obligation was to implement the plan. However, this consultation occurred some 4 years previously and did not canvass options directly involving specific harness racing clubs.

We note that the 2001-2005 strategic plan contains 34 goals, each with a number of associated objectives. Goal 20 relates to the creation of racing centres of excellence in strategic locations and lists 9 associated performance objectives. None of these objectives contains any suggestion that race meetings would be discontinued at any of the existing harness racing venues.

While acknowledging the right of HRV to determine the future strategy for the industry, we believe that the board of HRV did have a requirement under the Act to consult with industry participants about the proposed transfer of race meetings from 7 country clubs to other venues, and did not do so. We consider that the specific amendments concerning consultation have resulted in a "legitimate expectation" on the part of harness racing industry participants that consultation would occur.

As indicated previously, one of HRV's goals included in its own strategic plan states that the board should "*advance the industry through the promotion of and engagement in meaningful statewide consultation that empowers participants*". This suggests that harness racing clubs would have expected to be consulted about the decision to transfer race meetings.

Communities generally now expect governing bodies to make decisions in an open, accountable and consultative manner. A number of studies have highlighted the benefits of public participation and consultation, which include raising the chances of successful implementation and reinforcing the legitimacy of the decision-making process and its final results[2].

The lack of consultation by HRV denied the affected communities any opportunity to develop creative alternative proposals.

HRV advised that it "did not formally consult with harness racing clubs prior to the release of the *V3* document as HRV was not required to. Nor could HRV have formally consulted at this time as it had not finalised the development of its 'proper procedures' in accordance with section 44B of the *Racing Act 1958*". As indicated above, we consider that consultation should have taken place and that this could have occurred directly with the 7 affected clubs, even if formal consultation procedures had not been finalised prior to the release of the *V3* document.

In respect of the consultation procedures required by section 44B of the *Racing Act 1958*, we note that HRV commenced developing these procedures in September 2004, and has now established formal consultation procedures with 5 groups representing various classes of harness racing participants. We also note that the HRV's Board, at its meeting in February 2005, determined to enter into a formal consultation arrangement with 5 associations, including the Association of Victorian Country Harness Racing Clubs Inc. This decision was communicated to that association in March 2005 and a formal consultation meeting was held in April 2005, at which time a *Charter for Consultation* was signed between HRV and the Association of Victorian Country Harness Racing Clubs Inc.

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[2] For example, Caddy & Vergez (2001), *Citizens as Partners: Information, Consultation and Public Participation in Policy Making*, OECD, Paris; Department of Premier and Cabinet, Western Australia (2002), *Consulting Citizens,* Citizens and Civics Unit, Perth.

We have also been informed that HRV undertakes numerous other forms of consultation, including regular meetings of club secretaries and presidents and twice-yearly industry consultation forums.

17.3.1 Conclusion

The *Racing Act 1958* requires the HRV Board to consult with harness racing participants and to facilitate consultation among harness racing industry participants. We would have expected that once the HRV Board had developed the specific option to transfer selected TAB meetings to other venues that, at the very least, it would have discussed this option with the 7 clubs directly affected by this proposal. It chose not to do so.

We consider that the release of the *V3* document, announcing the decision to transfer TAB race meetings from 7 low-use harness racetracks in country Victoria to alternative country venues, occurred without consultation with any harness racing industry participants, including those clubs most affected by the decision and, therefore, was not consistent with the intention of the amendments to the *Act*.

RESPONSE provided by the Chief Executive Officer, HRV

The Auditor-General has concluded in his report that the decision of Harness Racing Victoria (HRV) to release its Vision Value Victoria document, which included a decision to transfer race meetings from 7 low-use country harness racing venues to alternative country harness racing venues, was not consistent with the intention of the amendments to the Racing Act 1958.

HRV respectfully disagrees with the Auditor-General's conclusion and has received independent legal advice to support this position.

HRV believes its decision to release Vision Value Victoria, or V3 in short, and to document a 10-point action plan to secure the future of the harness racing industry was, and remains consistent with, the functions and powers vested in it under the Racing Act 1958.

The amendments to the Racing Act 1958, which took effect from August 2004, imposed an obligation on HRV to establish formal proper procedures for consultation with harness racing industry participants. Specifically, section 44B of the Racing Act 1958 provides:

> *"The Board must establish proper procedures to consult with harness racing industry participants and to facilitate consultation amongst harness racing industry participants".*

RESPONSE provided by the Chief Executive Officer, HRV - continued

HRV has complied with this requirement to develop formal consultation procedures. Following the commencement of the new provisions in August 2004, HRV undertook a number of steps to ensure its compliance with establishing formal proper procedures for consultation with harness racing industry participants.

HRV based its procedures on those adopted by Racing Victoria Limited which had entered into arrangements with industry participant groups after its establishment in December 2001. Listed below is a timetable detailing the steps which were taken by HRV to develop formal consultation procedures:

August 2004	*Amendments to the Racing Act commence.*
August to September 2004	*HRV considers amendments and HRV Board approves a process to establish proper procedures for consultation in accordance with section 44B.*
October 2004	*HRV writes to all kindred bodies setting out the proposed procedures and invites groups to apply for consideration to be the bodies which HRV consults with in accordance with the legislation.*
31 January 2005	*HRV receives comments and applications from the kindred bodies wishing to be involved in the consultation procedures being established by HRV.*
21 February 2005	*HRV Board approves procedures for consultation and approves a Charter for Consultation which is to be entered into with the 5 bodies selected for consultation.*
1 March 2005	*HRV writes to all bodies enclosing the Charter for Consultation and setting out the proper procedures it wishes to establish pursuant to the Racing Act. HRV also writes to the Minister for Racing advising of its procedures.*
11 and 12 April 2005	*First round of consultation meetings are successfully held in accordance with HRV's proper procedures.*
August 2005	*Further round of consultation meetings are successfully held in accordance with HRV's proper procedures.*
October 2005	*HRV lodges its Annual Report with the Minister for Racing which in accordance with section 44C sets out the consultation procedures it has established pursuant to section 44B and also details the decisions made following consultation.*

RESPONSE provided by the Chief Executive Officer, HRV - continued

HRV submits that until such time as the formal proper procedures had been established, HRV could not have performed any formal consultation in purported compliance with the Racing Act 1958. HRV's legal advice suggested that to have done so would at least have been misleading, deceptive and unconscionable and could have been unlawful.

HRV also respectfully disagrees with the Auditor-General's view that the specific decision relating to the transfer of race meetings from 7 low-use harness racing venues ought to have been the subject of consultation under the Racing Act 1958 or that the harness racing clubs had a legitimate expectation that they would be consulted about the decision.

HRV's view – and that of our independent legal advisors – is that there is nothing in the Racing Act 1958 which suggests that HRV had a legislative requirement to consult in relation to the decision to transfer race meetings to other venues. The legislative requirement was to establish formal proper procedures during the period 1 August 2004 and 30 June 2005, consult in accordance with those procedures and when the annual report for that period is prepared, publish the procedures and other required details. Harness Racing Victoria has complied with these requirements.

It is also notable that the amendments to the Racing Act 1958 are silent as to the nature of matters required to be the subject of consultation. Nothing in the amendments to the Racing Act 1958 or the Second Reading Speech of the Minister or indeed any other information provided to HRV prescribed matters to be the subject of formal consultation.

In respect of the actual decision of HRV to transfer race meetings from 7 low-use race venues to neighboring race venues, this was one of 10 action points documented in the Vision Value Victoria Business Plan. This plan is the direct outcome of HRV's continuing implementation of the industry strategic plan Harnessing the Future which was the subject of detailed consultation when it was developed in 2001.

The Board of HRV is mindful of the need for strong leadership to be demonstrated as the industry had in the past failed to implement important reform measures, which in the Board's view had been detrimental to the industry.

HRV believes Vision Value Victoria will deliver the following benefits to the harness racing industry:

- *sustained wagering growth to enable prize money increases totalling 60 per cent over 7 years - $37 million extra from 2005-06 to 2011-12*
- *a capital investment of more than $20 million into regional Victoria*
- *the creation of racing centres of excellence in strategic regional locations*

RESPONSE provided by the Chief Executive Officer, HRV - continued

- *safer, fairer and more competitive racing*
- *OH&S improvements for participants and patrons*
- *better designed racetracks to protect and nurture our horse population*
- *a financial lifeline for clubs struggling with sub-standard facilities*
- *a significant boost to regional Victoria*
- *improved financial returns to key stakeholders.*

The initiatives outlined in V3 have been overwhelmingly supported by the majority of the industry. HRV has received support from a wide range of parties involved in the industry, including trainers, drivers, owners, breeders, clubs, business partners and punters.

HRV has also received strong support for V3 from its kindred bodies, including the Victorian Standardbred Breeders and Studmasters' Association, the Harness Racing Owners' Association, the Association of Victorian Country Racing Clubs and the Victorian Bookmakers' Association. This is particularly evidenced by the fact that at its consultation meeting in April 2005 with HRV, the Association of Victorian Country Harness Racing Clubs made it clear that it had voted internally against deferring the implementation of V3.

In respect of the Auditor-General's assertion that HRV "denied affected communities any opportunity to develop creative alternative proposals", HRV rejects this.

HRV is empowered to control the sport of harness racing in Victoria and it views its responsibility first and foremost to the harness racing community. In this regard, HRV has at all times acted in the bests interests of the harness racing community.

In terms of providing the harness racing community with an opportunity to develop creative alternative proposals, HRV remains ready and willing at all times to consider such proposals.

HRV has publicly stated its commitment to review Vision Value Victoria during the first quarter of 2006. All relevant parties will have the opportunity to participate in the review process. In addition, HRV has commenced discussions with one of the clubs affected in relation to the future viability of their venue as a racing venue.

18. Interim report on the Regional Fast Rail project

18.1 Background

The Regional Fast Rail project forms part of the government's *Linking Victoria* initiative. Launched in February 2000, this initiative is the blueprint for some $3.5 billion of transport infrastructure development to be undertaken within Victoria[1].

The aim of the project is to reduce passenger journey times between Melbourne and the regional centres of Ballarat, Bendigo, Geelong and the Latrobe Valley. Delivery of the project is to be achieved by undertaking infrastructure works that will allow trains to run at speeds of up to 160 kilometres per hour (around 30 kilometres per hour faster than existing speed levels) and the introduction of faster rolling stock. The infrastructure works will involve the upgrading of 500 kilometres of existing track, construction of new sections of track and installation of new signalling equipment.

18.2 Audit activity

Since this project commenced in 2001, we have:

- reviewed the feasibility study for the project, and the tender evaluation and selection process for the project
- reviewed progress, including risk management
- planned a review of the Department of Infrastructure's (DoI's) management of the project, including progress against expected timelines and cost.

The following is a summary of our work to date.

[1] Linking Victoria. Labor's plan for safe, efficient and reliable transport, Australian Labor Party, Melbourne, 2002.

18.3 Report on the Finances of the State of Victoria, 2001-02

In our October 2002 *Report on the Finances of the State of Victoria, 2001-02*, we reviewed the feasibility study for the project, and the tender evaluation and selection process for the project. The feasibility study, undertaken by external consultants in September 2000, forecast that the project would help overcome many of the obstacles to growth in regional Victoria and provide a major boost in terms of the state's economy, population, employment and quality of life.

As part of the feasibility study, the government set *maximum* express journey travel time targets to be achieved for the 4 rail lines based on a financial commitment by the government for the project of $550 million. The government also identified *target* express journey times for each of the rail corridors. DoI engaged consultants to provide independent expert advice on the extent and cost of works necessary to achieve both target and maximum express journey times. The total estimated cost was:

- $810 million to achieve target express journey times
- $550 million to achieve maximum express journey times.

We concluded that, as the majority of current timetabled train services for these rail lines are not express, the focus of the cost-benefit analysis for the project on express journey times could be considered narrowly focused. As such, this analysis did not provide a meaningful analysis of the time savings potentially available to many of the passengers using these rail corridors. The Department of Treasury and Finance indicated that it was incorrect to assert that the analysis was narrowly focused because improved travel times flow to the semi-express and "stopping-all-stations" services as well. Consequently, the project provides similar benefits to commuters along the fast rail corridors.

Originally, the government announced its intention to contribute $550 million of the $810 million required to achieve preferred target express journey times, and to seek the support of the private sector to fund the additional $260 million. Subsequently, due to value-for-money considerations, the government announced that its commitment of $550 million in nominal terms would fund the full cost of the project to meet less stringent maximum express journey times.

Following approval of the project, the Rail Projects Group was established within DoI and given responsibility to manage the tender evaluation and selection process for the project. In June 2002, the government endorsed the Rail Projects Group recommendation of the preferred tenderer for each of the Country Works Infrastructure Packages. At June 2002, the estimated project cost was $556 million in nominal terms.

18.4 Report on the Finances of the State of Victoria, 2002-03

In March 2003, as outlined in our November 2003 *Report on the Finances of the State of Victoria, 2002-03*, DoI conducted an assessment of project risks. The identification of a number of potential risks formed the basis for its submission for additional funding for the project. In March 2003, the government approved additional capital funding of $35 million, increasing the capital budget from $582 million (excluding expected operating cost savings of $25 million) to $617 million.

At 30 June 2003, $111.5 million of the forecast $147.7 million had been spent on project design, procurement of materials and site mobilisation. The under-expenditure of $36.2 million was attributed to delays in completing work, including:

- the failure of contractors to complete the required design and accreditation documentation by the required dates
- operational issues between V/Line Passenger and the then Freight Australia
- difficulties experienced by the department in acquiring land.

These issues had resulted in delays in the development of the 4 corridors, ranging from 4 to 18 weeks. Despite these delays, DoI advised that the original completion dates for construction of 2 of the corridors - Ballarat (June 2005) and Geelong (February 2005) – would be met. Expected completion dates for the other 2 corridors were, however, extended - Bendigo (October 2004 to June 2005) and Latrobe (March 2004 to February 2005).

We concluded that while the budget for the project included a contingency sum to cover unexpected expenditure, a number of issues and risks needed to be carefully managed for the project to remain within the revised budget and timelines.

18.5 Planned coverage in 2005-06

Our *2005-06 Annual Plan* indicated that we would continue to examine projects which impact on the renewal and replacement of infrastructure that are important to the delivery of services to the community.

In July 2005, we commenced a further audit on the Regional Fast Rail Project. The objective was to examine the adequacy of DoI's planning and management of the project. Preliminary work has focused on progress of the project against expected timelines and budgeted costs across the 4 corridors, including reasons for any delays, management of contractors, and identification and ongoing management of risks to project delivery.

In December 2004, the government approved additional funding of $133 million, increasing the capital cost of the project from $617 million to $750 million. A third of this additional budget related to the extension of the safety braking system (Train Protection Warning System) to cover all the 4 lines, with the remainder covering additional insurance and compensation costs for freight companies affected by line closures during construction works.

The government has not met the revised targets for completion of construction works on any of the 4 corridors (as reported in our November 2003 *Report on the Finances of the State of Victoria, 2002-03).*

The revised practical completion dates[2] for infrastructure works are:

- December 2005 for the Bendigo and Latrobe corridors
- March 2006 for the Geelong and Ballarat corridors.

In our November 2003 *Report on the Finances of the State of Victoria 2002-03*, we reported that a number of issues had resulted in delays in the development of the 4 corridors, ranging from 4 to 18 weeks. The revised completion dates now extend these delays to between 9 months (Ballarat) to 21 months (Latrobe).

Figure 18A details the estimated investment in the project, expenditure and estimated expenditure from 2001-02 to 2005-06.

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[2] These are contractually determined completion dates, which in layman's terms can be described as the completion of all rail infrastructure and the fulfilment of the contractor's other obligations under the contract, including completion of reliability trials and performance tests to enable the operation of passenger rail services utilising regional fast rail rolling stock to achieve the country express run time. Some of these obligations can only be met after services are operational on the new infrastructure. The actual dates of completion are subject to ongoing progress of works.

FIGURE 18A: REGIONAL FAST RAIL PROJECT EXPENDITURE PERFORMANCE ($MILLION)

Year	Total estimated investment	Expenditure to date	Estimated expenditure	Actual expenditure	Remaining expenditure
2001-02	550.0	-	37.0	2.9	513.0
2002-03	556.9	2.9	147.7	111.5	406.2
2003-04	556.9	114.4	296.0	302.3	146.5
2004-05	616.8	416.7	193.5	197.0	6.6
2005-06	750.6	613.7	136.9	-	-
Total	**750.6**	**613.7**	**-**	**613.7**	**-**

Source: Budget Information Paper No.1. Public Sector Asset Investment Program for 2001-02, 2002-03, 2003-04, 2004-05 and 2005-06, Department of Treasury and Finance, Victorian Government Printer, Melbourne.

Figure 18A indicates that the estimated project investment has increased from $550 million in 2001-02 to $751 million in 2005-06, or by 36.5 per cent, with the estimated project investment increasing by 21.7 per cent in 2005-06.

In both 2003-04 and 2004-05, actual expenditure exceeded the estimated expenditure.

From our work to date, a number of issues have contributed to additional increases to the project budget and further delays in completion of construction works across the 4 corridors. These include:

- assessment of an increasing number of claims by contractors for variations on the design and construction contracts
- ongoing failure of contractors to complete the required design and accreditation documentation within the required timelines and delays in the approval of these changes
- requested changes to the project scope by the then Freight Australia, Pacific National and the Safety Regulator in order to meet additional operational and/or safety requirements
- assessment of the impact on the project scope, cost and timelines of implementing changes to the safety regulatory regime since the commencement of the project
- phased (rather than simultaneous) completion of the signalling work across the 4 corridors due to limited availability of signalling resources within Australia and internationally.

The project has now reached a critical phase with the installation and commissioning of an upgraded signalling system across the 4 corridors. In addition, DoI is involved in complex and sensitive negotiations to address many of the issues raised above.

These activities are placing significant demands on the project team and limiting their availability to participate in this audit. I have, therefore, decided to defer the audit and recommence in early 2006.

RESPONSE provided by the Secretary, Department of Infrastructure

Despite the difficult commercial environment, the department continues to make good progress in delivering modern infrastructure across the 4 corridors, with the final phase - installation of the new signalling system - well under way.

The department is continuing to carefully manage all the key issues and project risks tightly, conducting regular risk reviews and negotiating with all the commercial parties and stakeholders to ensure the earliest possible delivery of the project, in line with the project's specifications and the revised budget.

The infrastructure works have been progressively completed over the last 2 years, with rail users gaining the benefit of improved infrastructure, particularly track work.

Appendix A
Status of audits with 30 June 2005 balance dates[1]

[1] Also includes the status of audits that were incomplete at the date of preparing my May 2005 report on the *Results of financial statement audits for agencies with other than 30 June 2004 balance dates, and other audits.*

Parliament

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
Parliament of Victoria	15 Aug. 2005	✓	15 Aug. 2005
Victorian Auditor-General's Office (a)	25 Aug. 2005	✓	26 Aug. 2005

(a) The Victorian Auditor-General's Office was audited by a private sector auditor.

Education and Training

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
Department of Education and Training	7 Sep. 2005	✓	7 Sep. 2005
EDUCATION AND TRAINING			
Adult, Community and Further Education Board	6 Sep. 2005	✓	9 Sep. 2005
NMIT International Ltd	21 Sep. 2005	✓	21 Sep. 2005
Victorian Curriculum and Assessment Authority	16 Sep. 2005	✓	16 Sep. 2005
Victorian Institute of Teaching	22 Sep. 2005	✓	22 Sep. 2005
Victorian Learning and Employment Skills Commission	19 Sep. 2005	✓	19 Sep. 2005
Victorian Qualifications Authority	22 Sep. 2005	✓	22 Sep. 2005
Victorian Tertiary Admissions Centre	7 Oct. 2005	✓	7 Oct. 2005
COMPLETED AUDITS – WITH OTHER BALANCE DATES (a)			
POST-COMPULSORY EDUCATION INSTITUTES			
Monash International SRL (24 Sep. 2003 to 31 Dec. 2004)	7 July 2005	✓	7 July 2005
Monash Learningfast Pty Ltd	18 Oct. 2005	✓	18 Oct. 2005
RMIT (Malaysia) SDN BHD	6 May 2005	✓	6 May 2005
EDUCATION			
Telematics Course Development Fund	5 May 2005	✓	12 May 2005
INCOMPLETE AUDITS – AS AT 31 OCTOBER 2005 (a)			
Learningfast Inc.	*Audited financial statements yet to be finalised.*		
International Training Australia Ltd	*Audited financial statements yet to be finalised.*		

(a) Financial statements with 31 December 2004 balance dates, unless otherwise indicated.

Human Services

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
Department of Human Services	1 Sep. 2005	✓	1 Sep. 2005
HEALTH			
Alexandra and District Ambulance Service	26 Sep. 2005	✓	30 Sep. 2005
Ambulance Service Victoria - Metropolitan Region	29 Aug. 2005	✓	29 Aug. 2005
Chinese Medicine Registration Board of Victoria	27 Sep. 2005	✓	27 Sep. 2005
Chiropractors Registration Board of Victoria	28 Sep. 2005	✓	28 Sep. 2005
Dental Practice Board of Victoria	21 Sep. 2005	✓	22 Sep. 2005
Health Purchasing Victoria	4 Oct. 2005	✓	4 Oct. 2005
Infertility Treatment Authority	13 Sep. 2005	✓	13 Sep. 2005
Mental Health Review Board	12 Sep. 2005	✓	19 Sep. 2005
Nurses Board of Victoria	9 Sep. 2005	✓	9 Sep. 2005
Optometrists Registration Board of Victoria	22 Sep. 2005	✓	22 Sep. 2005
Osteopaths Registration Board of Victoria	19 Sep. 2005	✓	27 Sep. 2005
Pharmacy Board of Victoria	16 Sep. 2005	✓	19 Sep. 2005
Physiotherapists Registration Board of Victoria	14 Sep. 2005	✓	19 Sep. 2005
Podiatrists Registration Board of Victoria	19 Sep. 2005	✓	27 Sep. 2005
Psychosurgery Review Board	12 Sep. 2005	✓	19 Sep. 2005
Rural Ambulance Victoria	5 Sep. 2005	✓	5 Sep. 2005
Victorian Health Promotion Foundation	31 Aug. 2005	✓	12 Sep. 2005
Victorian Institute of Forensic Mental Health	21 Sep. 2005	✓	21 Sep. 2005
CEMETERIES (a)			
Anderson's Creek Cemetery Trust	2 Sep. 2005	✓	23 Sep. 2005
Ballarat General Cemeteries Trust	15 Sep. 2005	✓	21 Sep. 2005
Bendigo Cemeteries Trust	15 Aug. 2005	✓	12 Sep. 2005
Geelong Cemeteries Trust	31 Aug. 2005	✓	14 Sep. 2005
Keilor Cemetery Trust	16 Aug. 2005	✓	16 Aug. 2005
Mildura Cemetery Trust	19 Oct. 2005	✓	19 Oct. 2005
Preston Cemetery Trust	29 Sep. 2005	✓	3 Oct. 2005
Templestowe Cemetery Trust	1 Sep. 2005	✓	9 Sep. 2005
The Cheltenham and Regional Cemeteries Trust	30 Sep. 2005	✓	13 Oct. 2005
The Trustees of the Fawkner Crematorium and Memorial Park ***Reason for qualification:*** *Value assigned to land is understated in the statement of financial position.*	31 Oct. 2005	Qualified	31 Oct. 2005
The Trustees of the Necropolis Springvale	16 Sep. 2005	✓	16 Sep. 2005
Trustees of the Lilydale Memorial Park and Cemetery	31 Aug. 2005	✓	9 Sep. 2005
Wyndham Cemeteries Trust	30 Sep. 2005	✓	30 Sep. 2005

Human Services - *continued*

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
COMMUNITY SERVICES			
Victorian Relief Committee	4 Aug. 2005	✓	5 Aug. 2005
PUBLIC HOSPITALS AND ASSOCIATED ENTITIES			
Alexandra District Hospital	9 Sep. 2005	✓	9 Sep. 2005
Alpine Health	15 Sep. 2005	✓	15 Sep. 2005
Austin Health	19 Sep. 2005	✓	19 Sep. 2005
Bairnsdale Regional Health Service	9 Sep. 2005	✓	9 Sep. 2005
Ballarat Health Services	30 Aug. 2005	✓	30 Aug. 2005
Barwon Health	2 Sep. 2005	✓	2 Sep. 2005
Bass Coast Regional Health	31 Aug. 2005	✓	31 Aug. 2005
Bass Coast Regional Health Benefit Fund Trust (b) ***Reason for qualification:*** *Non-compliance with Statements of Accounting Concepts and applicable accounting standards.*	31 Aug. 2005	Qualified	7 Sep. 2005
Bayside Health	16 Sep. 2005	✓	16 Sep. 2005
Beechworth Health Service	1 Sep. 2005	✓	1 Sep. 2005
Benalla and District Memorial Hospital	14 Sep. 2005	✓	14 Sep. 2005
Bendigo Health Care Group	8 Sep. 2005	✓	8 Sep. 2005
Boort District Hospital	12 Sep. 2005	✓	12 Sep. 2005
Calvary Health Care Bethlehem Ltd ***Reason for qualification:*** *Incorrect recognition of contribution of net assets from a predecessor entity and inability to attest to the value of certain assets and liabilities.*	6 Oct. 2005	Qualified	31 Oct. 2005
Caritas Christi Hospice Limited	16 Sep. 2005	✓	16 Sep. 2005
Casterton Memorial Hospital	24 Aug. 2005	✓	24 Aug. 2005
Cell Therapies Pty Ltd	23 Aug. 2005	✓	11 Sep. 2005
Central Gippsland Health Service	14 Sep. 2005	✓	14 Sep. 2005
Cobram District Hospital	19 Sep. 2005	✓	19 Sep. 2005
Cohuna District Hospital	21 Sep. 2005	✓	21 Sep. 2005
Colac Area Health	9 Sep. 2005	✓	9 Sep. 2005
Coleraine District Health Services (c)	31 Aug. 2005	✓	31 Aug. 2005
Communities That Care Limited	12 Sep. 2005	✓	14 Sep. 2005
Dental Health Services Victoria	25 Aug. 2005	✓	25 Aug. 2005
Djerriwarrh Health Services	14 Sep. 2005	✓	14 Sep. 2005
Dunmunkle Health Services	30 Sep. 2005	✓	17 Oct. 2005
East Grampians Health Service	11 Oct. 2005	✓	19 Oct. 2005
Eastern Health	19 Sep. 2005	✓	19 Sep. 2005
Echuca Regional Health	16 Sep. 2005	✓	16 Sep. 2005

Human Services - *continued*

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
Echuca Regional Health Foundation Limited	16 Sep. 2005	✓	16 Sep. 2005
Edenhope and District Memorial Hospital	19 Sep. 2005	✓	20 Oct. 2005
Gippsland Health Alliance (d)	19 Oct. 2005	✓	19 Oct. 2005
Gippsland Southern Health Service	31 Aug. 2005	✓	31 Aug. 2005
Goulburn Valley Health	6 Sep. 2005	✓	6 Sep. 2005
Hepburn Health Service	12 Sep. 2005	✓	12 Sep. 2005
Hesse Rural Health Service	27 Sep. 2005	✓	5 Oct. 2005
Heywood Rural Health	5 Sep. 2005	✓	7 Sep. 2005
Inglewood and Districts Health Service	16 Sep. 2005	✓	16 Sep. 2005
Kerang District Health	14 Sep. 2005	✓	14 Sep. 2005
Kilmore and District Hospital	6 Sep. 2005	✓	6 Sep. 2005
Kitaya Holdings Pty Ltd	25 Aug. 2005	✓	25 Aug. 2005
Kooweerup Regional Health Service	31 Aug. 2005	✓	31 Aug. 2005
Kyabram and District Health Services	6 Sep. 2005	✓	6 Sep. 2005
Kyneton District Health Service	6 Sep. 2005	✓	6 Sep. 2005
Latrobe Regional Hospital	8 Sep. 2005	✓	8 Sep. 2005
Lorne Community Hospital	30 Sep. 2005	✓	10 Oct. 2005
Maldon Hospital	19 Sep. 2005	✓	19 Sep. 2005
Mallee Track Health and Community Service	6 Oct. 2005	✓	6 Oct. 2005
Manangatang and District Hospital	14 Sep. 2005	✓	14 Sep. 2005
Mansfield District Hospital	3 Oct. 2005	✓	3 Oct. 2005
Maryborough District Health Service	21 Sep. 2005	✓	21 Sep. 2005
McIvor Health and Community Services	13 Sep. 2005	✓	13 Sep. 2005
Melbourne Health	30 Sep. 2005	✓	30 Sep. 2005
Mercy Public Hospitals Inc. ***Reason for qualification:*** *Failure to consolidate a "controlled" entity.*	27 Sep. 2005	Qualified	27 Sep. 2005
Moyne Health Services	16 Sep. 2005	✓	16 Sep. 2005
Moyne Health Services Inc.	2 Sep. 2005	✓	5 Sep. 2005
Mt. Alexander Hospital	21 Sep. 2005	✓	21 Sep. 2005
Nathalia District Hospital	20 Sep. 2005	✓	21 Sep. 2005
Northeast Health Wangaratta	9 Sep. 2005	✓	9 Sep. 2005
Northern Health	21 Sep. 2005	✓	21 Sep. 2005
Numurkah District Health Service	20 Sep. 2005	✓	20 Sep. 2005
O'Connell Family Centre (Grey Sisters) Inc.	27 Sep. 2005	✓	27 Sep. 2005
Omeo District Hospital (e)	9 Sep. 2005	✓	13 Sep. 2005
Orbost Regional Health	2 Sep. 2005	✓	2 Sep. 2005

Human Services - *continued*

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
Otway Health and Community Services	5 Sep. 2005	✓	12 Sep. 2005
Peninsula Health	9 Sep. 2005	✓	9 Sep. 2005
Peter MacCallum Cancer Centre	13 Sep. 2005	✓	13 Sep. 2005
Peter MacCallum Cancer Foundation	5 Sep. 2005	✓	6 Sep. 2005
Peter MacCallum Cancer Foundation Ltd	5 Sep. 2005	✓	6 Sep. 2005
Portland and District Hospital	25 Aug. 2005	✓	29 Aug. 2005
Queen Elizabeth Centre ***Reason for qualification:*** *Failure to consolidate a "controlled" entity.*	20 Aug. 2005	Qualified	20 Aug. 2005
Robinvale District Health Services	26 Sep. 2005	✓	26 Sep. 2005
Rochester and Elmore District Health Service	21 Sep. 2005	✓	21 Sep. 2005
Royal Children's Hospital (f)	30 Aug. 2005	✓	30 Aug. 2005
Royal Children's Hospital Education Institute Limited	26 Aug. 2005	✓	29 Aug. 2005
Royal Children's Hospital Foundation Limited	18 Aug. 2005	✓	18 Aug. 2005
Royal Children's Hospital Foundation Trust Funds	18 Aug. 2005	✓	18 Aug. 2005
Royal Women's Hospital (f)	1 Sep. 2005	✓	1 Sep. 2005
Royal Women's Hospital Foundation Limited	15 Sep. 2005	✓	15 Sep. 2005
Royal Women's Hospital Foundation Trust Funds ***Reason for qualification:*** *Unable to attest to the completeness of cash donations.*	15 Sep. 2005	Qualified	15 Sep. 2005
Royal Victorian Eye and Ear Hospital	19 Sep. 2005	✓	19 Sep. 2005
Rural Northwest Health	20 Oct. 2005	✓	26 Oct. 2005
Seymour District Memorial Hospital	21 Sep. 2005	✓	21 Sep. 2005
South Gippsland Hospital	13 Sep. 2005	✓	19 Sep. 2005
South West Alliance of Rural Health (d)	5 Aug. 2005	✓	19 Aug. 2005
South West Health Care	25 Aug. 2005	✓	25 Aug. 2005
Southern Health	25 Aug. 2005	✓	25 Aug. 2005
St Georges Health Service Limited	16 Sep. 2005	✓	16 Sep. 2005
St Vincent's Hospital (Melbourne) Limited ***Reason for qualification:*** *Inappropriate recognition of certain debtors.*	16 Sep. 2005	Qualified	16 Sep. 2005
Stawell Regional Health	22 Sep. 2005	✓	11 Oct. 2005
Stawell District Health Foundation	22 Sep. 2005	✓	11 Oct. 2005
Swan Hill District Hospital	19 Sep. 2005	✓	19 Sep. 2005
Tallangatta Health Service	15 Sep. 2005	✓	15 Sep. 2005
Terang and Mortlake Health Service	1 Sep. 2005	✓	1 Sep. 2005
Timboon and District Healthcare Service	5 Sep. 2005	✓	7 Sep. 2005
Tweddle Child and Family Health Service	18 Aug. 2005	✓	24 Aug. 2005

Human Services - *continued*

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
Upper Murray Health and Community Services	5 Sep. 2005	✓	5 Sep. 2005
West Gippsland Healthcare Group	25 Aug. 2005	✓	25 Aug. 2005
West Wimmera Health Service	12 Oct. 2005	✓	18 Oct. 2005
Western District Health Service (c)	31 Aug. 2005	✓	31 Aug. 2005
Western Health	5 Sep. 2005	✓	5 Sep. 2005
Wimmera Base Hospital Foundation	30 Sep. 2005	✓	13 Oct. 2005
Wimmera Health Care Group	30 Sep. 2005	✓	13 Oct. 2005
Winchelsea and District Nursing Home Society (d)	27 Sep. 2005	✓	5 Oct. 2005
Wodonga Regional Health Service	21 Sep. 2005	✓	21 Sep. 2005
Yarram and District Health Service	6 Oct. 2005	✓	6 Oct. 2005
Yarrawonga District Health Service	20 Sep. 2005	✓	20 Sep. 2005
Yea and District Memorial Hospital	20 Sep. 2005	✓	21 Sep. 2005
COMPLETED AUDITS – WITH OTHER BALANCE DATES			
Communities That Care Limited (1 July 2003 to 30 June 2004)	12 Oct. 2004	✓	20 Oct. 2004
Royal Children's Hospital Education Institute Limited (1 July 2003 to 30 June 2004)	27 Oct. 2004	✓	29 Oct. 2004
INCOMPLETE AUDITS – AS AT 31 OCTOBER 2005			
Beaufort and Skipton Health Service	*Audited financial statements yet to be finalised.*		
East Wimmera Health Service	*Audited financial statements yet to be finalised.*		
HumeNET Limited (g) (31 October 2003 to 30 June 2004)	*Audited financial statements yet to be finalised.*		
HumeNET Limited (1 July 2004 to 30 June 2005)	*Audited financial statements yet to be finalised.*		
The Trustees of the Altona Memorial Park (a)	*Audited financial statements yet to be finalised.*		

(a) Financial statements cover an 18-month period, 1 January 2004 to 30 June 2005.

(b) Wonthaggi and District Benefit Fund Trust changed its name on 23 September 2004 to Bass Coast Regional Health Benefit Fund Trust.

(c) On 1 July 2005, Western District Health Service and Coleraine District Health Service were amalgamated to form the Western District Health Service.

(d) Agencies controlled by the state or another public sector agency, which came within the Auditor-General's audit mandate in 2004-05 pursuant to recent amendments to the *Audit Act 1994*.

(e) The Omeo District Hospital changed its name on 1 July 2005 to Omeo District Health.

(f) The Royal Children's Hospital and the Royal Women's Hospital were established on 1 July 2004, following the disaggregation of Women's and Children's Health.

(g) Commenced operation on 31 October 2003.

Infrastructure

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
Department of Infrastructure	18 Aug. 2005	✓	18 Aug. 2005
ENERGY INDUSTRIES (a)			
Network Tariff Rebate Trust Fund	15 Aug. 2005	✓	5 Sep. 2005
Special Power Payment Trust	15 Aug. 2005	✓	5 Sep. 2005
Victoria Energy Networks Corporation	15 Aug. 2005	✓	16 Aug. 2005
TRANSPORT AND MAJOR PROJECTS			
Melbourne Port Corporation	25 Aug. 2005	✓	25 Aug. 2005
Port of Hastings Corporation	23 Sep. 2005	✓	23 Sep. 2005
Public Transport Ticketing Body	2 Sep. 2005	✓	2 Sep. 2005
Roads Corporation	17 Aug. 2005	✓	23 Aug. 2005
Rolling Stock Holdings (Victoria) P/L	23 Aug. 2005	✓	24 Aug. 2005
Rolling Stock (Victoria – VL) P/L	23 Aug. 2005	✓	24 Aug. 2005
Rolling Stock (VL – 1) P/L	23 Aug. 2005	✓	24 Aug. 2005
Rolling Stock (VL – 2) P/L	23 Aug. 2005	✓	24 Aug. 2005
Rolling Stock (VL – 3) P/L	23 Aug. 2005	✓	24 Aug. 2005
Southern and Eastern Integrated Transport Authority	16 Aug. 2005	✓	16 Aug. 2005
Spencer Street Station Authority	21 Sep. 2005	✓	21 Sep. 2005
Victorian Railway Heritage Operations Pty Limited (b)	19 Aug. 2005	✓	19 Aug. 2005
Victorian Rail Services Pty Ltd (c)	6 Sep. 2005	✓	6 Sep. 2005
Victorian Rail Track	23 Aug. 2005	✓	24 Aug. 2005
Victorian Regional Channels Authority	30 Aug. 2005	✓	2 Sep. 2005
V/Line Passenger Corporation	19 Aug. 2005	✓	19 Aug. 2005
V/Line Passenger Pty Ltd	19 Aug. 2005	✓	19 Aug. 2005
COMPLETED AUDITS – WITH OTHER BALANCE DATES			
Victorian Rail Services Pty Ltd (1 July 2003 to 30 June 2004)	6 Sep. 2005	✓	6 Sep. 2005
INCOMPLETE AUDITS – AS AT 31 OCTOBER 2005			
Victorian Urban Development Authority	*Audited financial statements yet to be finalised.*		

(a) The Office of Chief Electrical Inspector and Office of Gas Safety have not been included in the appendix because their balance date was extended to 9 August 2005 by the Minister for Finance under the *Financial Management Act 1994*. These entities ceased operations at that date and a new entity was created to perform their functions.

(b) Commenced operation on 7 July 2004.

(c) Ceased operation on 30 June 2005.

Innovation, Industry and Regional Development

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
Department of Innovation, Industry and Regional Development	22 Aug. 2005	✓	23 Aug. 2005
INNOVATION, STATE AND REGIONAL DEVELOPMENT			
Fed Square Pty Ltd (a)	21 Sep. 2005	✓	21 Sep. 2005
Prince Henry's Institute of Medical Research	22 Sep. 2005	✓	22 Sep. 2005
TOURISM			
Australian Grand Prix Corporation	30 Aug. 2005	✓	30 Aug. 2005
Emerald Tourist Railway Board	25 Aug. 2005	✓	30 Aug. 2005
Melbourne Convention and Exhibition Trust	26 Aug. 2005	✓	6 Sep. 2005
Tourism Victoria	22 Sep. 2005	✓	22 Sep. 2005
Victoria Trade and Investment Office Pty Ltd	22 Sep. 2005	✓	22 Sep. 2005
INCOMPLETE AUDITS – AS AT 31 OCTOBER 2005			
VCPO Limited (b)	*Audited financial statements yet to be finalised.*		

(a) Federation Square Management Pty Ltd changed its name on 1 July 2004 to Fed Square Pty Ltd.

(b) The Overseas Projects Corporation of Victoria Ltd changed its name on 14 January 2005 to VCPO Limited.

Justice

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
Department of Justice	17 Aug. 2005	✓	31 Aug. 2005
ATTORNEY-GENERAL			
Equal Opportunity Commission	22 Sep. 2005	✓	22 Sep. 2005
Judicial College of Victoria	14 Oct. 2005	✓	17 Oct. 2005
Legal Practice Board	20 Sep. 2005	✓	22 Sep. 2005
Legal Practitioners Liability Committee	16 Sep. 2005	✓	22 Sep. 2005
Office of Public Prosecutions	28 Sep. 2005	✓	28 Sep. 2005
Office of the Legal Ombudsman	23 Sep. 2005	✓	27 Sep. 2005
Office of the Public Advocate	22 Sep. 2005	✓	22 Sep. 2005
Office of the Victorian Privacy Commissioner	22 Sep. 2005	✓	22 Sep. 2005
Senior Master of the Supreme Court	22 Aug. 2005	✓	5 Sep. 2005
Sentencing Advisory Council (a)	7 Oct. 2005	✓	17 Oct. 2005
Victoria Legal Aid	17 Aug. 2005	✓	29 Aug. 2005
Victorian Electoral Commission	30 Aug. 2005	✓	31 Aug. 2005
Victorian Institute of Forensic Medicine	9 Sep. 2005	✓	19 Sep. 2005
Victorian Law Reform Commission	14 Sep. 2005	✓	16 Sep. 2005
CONSUMER AFFAIRS			
Domestic Building (HIH) Indemnity Fund	20 Sep. 2005	✓	22 Sep. 2005
Residential Tenancies Bond Authority	13 Sep. 2005	✓	16 Sep. 2005
GAMING AND RACING			
Footy Consortium Pty Ltd (b)	19 Sep. 2005	✓	22 Sep. 2005
Greyhound Racing Victoria	15 Sep. 2005	✓	16 Sep. 2005
Harness Racing Victoria	9 Sep. 2005	✓	19 Sep. 2005
Tattersall's Club Keno Pty Ltd (b)	19 Sep. 2005	✓	22 Sep. 2005
Tattersall's Gaming Pty Ltd (b)	12 Sep. 2005	✓	22 Sep. 2005
Tattersall's Sweeps Pty Ltd (b)	19 Sep. 2005	✓	22 Sep. 2005
Victorian Commission for Gaming Regulation	30 Aug. 2005	✓	9 Sep. 2005
POLICE AND EMERGENCY SERVICES			
Australasian Police Multicultural Advisory Bureau	9 Sep. 2005	✓	22 Sep. 2005
Country Fire Authority	24 Oct. 2005	✓	24 Oct. 2005
Emergency Communications Victoria (c)	31 Aug. 2005	✓	7 Sep. 2005
Metropolitan Fire and Emergency Services Board	19 Sep. 2005	✓	22 Sep. 2005
National Institute of Forensic Science	22 Sep. 2005	✓	12 Oct. 2005
Office of the Chief Commissioner of Police	17 Aug. 2005	✓	5 Sep. 2005
Gambling Research Panel (d) (1 July 2004 to 22 Dec. 2004)	12 Oct. 2005	✓	17 Oct. 2005

(a) Commenced operation on 1 July 2004.

(b) Final accounts were prepared for the year ended 30 June 2005.

(c) The *Emergency Services Telecommunications Authority Act 2004* established the Emergency Services Telecommunications Authority on 1 July 2005, which replaced Emergency Communications Victoria.

(d) Ceased operation on 22 December 2004.

Sustainability and Environment

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
Department of Sustainability and Environment	29 Sep. 2005	✓	29 Sep. 2005
PLANNING			
Architects' Registration Board of Victoria	13 Sep. 2005	✓	29 Sep. 2005
Building Commission	12 Aug. 2005	✓	16 Aug. 2005
Heritage Council	6 Oct. 2005	✓	6 Oct. 2005
Plumbing Industry Commission	14 Sep. 2005	✓	14 Sep. 2005
Surveyors Registration Board of Victoria (a)	6 Sep. 2005	✓	15 Sep. 2005
ENVIRONMENT AND WATER			
Alpine Resort Co-ordinating Council	4 Oct. 2005	✓	5 Oct. 2005
Barwon Regional Waste Management Group	12 Sep. 2005	✓	19 Sep. 2005
Barwon Region Water Authority	10 Aug. 2005	✓ (b)	16 Aug. 2005
Calder Regional Waste Management Group	29 Sep. 2005	✓	29 Sep. 2005
Central Gippsland Region Water Authority	27 Sep. 2005	✓ (b)	27 Sep. 2005
Central Highlands Region Water Authority	27 Sep. 2005	✓ (b)	27 Sep. 2005
Central Murray Regional Waste Management Group	25 Aug. 2005	✓	26 Aug. 2005
City West Water Ltd (c)	23 Aug. 2005	✓	23 Aug. 2005
Coliban Region Water Authority	22 Sep. 2005	✓ (b)	3 Oct. 2005
Corangamite Catchment Management Authority	9 Sep. 2005	✓	9 Sep. 2005
Desert Fringe Regional Waste Management Group	20 Sep. 2005	✓	22 Sep. 2005
Eastern Regional Waste Management Group	9 Sep. 2005	✓	9 Sep. 2005
East Gippsland Catchment Management Authority	19 Sep. 2005	✓	19 Sep. 2005
East Gippsland Region Water Authority	31 Aug. 2005	✓ (b)	31 Aug. 2005
Eco Recycle Victoria	15 Sep. 2005	✓	15 Sep. 2005
Environment Protection Authority	9 Sep. 2005	✓	9 Sep. 2005
First Mildura Irrigation Trust	13 Sep. 2005	✓	13 Sep. 2005
Gippsland and Southern Rural Water Authority	12 Sep. 2005	✓	12 Sep. 2005
Gippsland Regional Waste Management Group	13 Sep. 2005	✓	20 Sep. 2005
Glenelg Region Water Authority (d)	25 Aug. 2005	✓ (b)	25 Aug. 2005
Glenelg-Hopkins Catchment Management Authority	1 Sep. 2005	✓	1 Sep. 2005
Goulburn Broken Catchment Management Authority	2 Sep. 2005	✓	2 Sep. 2005
Goulburn-Murray Rural Water Authority	11 Aug. 2005	✓	17 Aug. 2005
Goulburn Valley Region Water Authority	7 Sep. 2005	✓ (b)	7 Sep. 2005
Goulburn Valley Regional Waste Management Group	7 Sep. 2005	✓	7 Sep. 2005

Sustainability and Environment - *continued*

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2004 BALANCE DATES			
Grampians Regional Waste Management Group	20 Sep. 2005	✓	22 Sep. 2005
Grampians Wimmera Mallee Water Authority (e)	21 Sep. 2005	✓ (b)	21 Sep. 2005
Highlands Regional Waste Management Group	30 Sep. 2005	✓	30 Sep. 2005
Lower Murray Urban and Rural Water Authority (e)	3 Oct. 2005	✓ (b)	3 Oct. 2005
Mallee Catchment Management Authority	4 Oct. 2005	✓	4 Oct. 2005
Melbourne Water Corporation	19 Aug. 2005	✓	19 Aug. 2005
Mildura Regional Waste Management Group	13 Sep. 2005	✓	14 Sep. 2005
Mornington Peninsula Regional Waste Management Group	23 Aug. 2005	✓	23 Aug. 2005
North Central Catchment Management Authority	7 Sep. 2005	✓	7 Sep. 2005
North East Catchment Management Authority	23 Sep. 2005	✓	23 Sep. 2005
North East Water	23 Sep. 2005	✓ (b)	23 Sep. 2005
North East Regional Waste Management Group	3 Oct. 2005	✓	3 Oct. 2005
Northern Regional Waste Management Group	6 Oct. 2005	✓	6 Oct. 2005
Parks Victoria	12 Aug. 2005	✓	16 Aug. 2005
Phillip Island Nature Park Board of Management	5 Oct. 2005	✓	5 Oct. 2005
Portland Coast Region Water Authority (d)	22 Sep. 2005	✓ (b)	22 Sep. 2005
Port Phillip and Westernport Catchment Management Authority	22 Sep. 2005	✓	22 Sep. 2005
Royal Botanic Gardens Board	12 Sep. 2005	✓	14 Sep. 2005
Smart Water Fund	7 Oct. 2005	✓	7 Oct. 2005
South East Water Limited (c)	29 Aug. 2005	✓	29 Aug. 2005
South Eastern Regional Waste Management Group	6 Sep. 2005	✓	6 Sep. 2005
South Gippsland Region Water Authority	28 Sep. 2005	✓ (b)	28 Sep. 2005
South West Water Authority (d)	8 Sep. 2005	✓ (b)	8 Sep. 2005
South Western Regional Waste Management Group	8 Sep. 2005	✓	19 Sep. 2005
Sustainable Energy Authority Victoria	19 Sep. 2005	✓	19 Sep. 2005
Trust for Nature (Victoria)	12 Sep. 2005	✓	12 Sep. 2005
Victorian Plantations Corporation (c)	28 Sep. 2005	✓	28 Sep. 2005
VicForests (f)	7 Oct. 2005	✓	7 Oct. 2005
West Gippsland Catchment Management Authority	20 Sep. 2005	✓	20 Sep. 2005
Western Region Water Authority	17 Aug. 2005	✓ (b)	17 Aug. 2005
Western Regional Waste Management Group	15 Sep. 2005	✓	15 Sep. 2005
Westernport Region Water Authority	10 Oct. 2005	✓ (b)	10 Oct. 2005
Wimmera Catchment Management Authority	21 Sep. 2005	✓	21 Sep. 2005

Sustainability and Environment *- continued*

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
Yarra Bend Park Trust	21 Sep. 2005	✓	21 Sep. 2005
Yarra Valley Water Limited (c)	24 Aug. 2005	✓	24 Aug. 2005
Zoological Parks and Gardens Board	1 Sep. 2005	✓	1 Sep. 2005
COMPLETED AUDITS – WITH OTHER BALANCE DATES			
ENVIRONMENT AND WATER			
Central Highlands Region Timber Pty Ltd (g) (1 July 2004 to 29 Aug. 2004)	27 Sep. 2005	✓	27 Sep. 2005
Falls Creek Alpine Resort Management Board (1 Nov. 2003 to 31 Oct. 2004)	1 Aug. 2005	✓	4 Aug. 2005
Mount Baw Baw Alpine Resort Management Board (1 Nov. 2003 to 31 Oct. 2004)	24 July 2005	✓	4 Aug. 2005
Mount Buller Alpine Resort Management Board (1 Nov. 2003 to 31 Oct. 2004)	16 July 2005	✓	4 Aug. 2005
Mount Hotham Alpine Resort Management Board (1 Nov. 2003 to 31 Oct. 2004)	14 Sep. 2005	✓	14 Sep. 2005
Mount Stirling Alpine Resort Management Board (1 Nov. 2003 to 31 Oct. 2004)	16 July 2005	✓	4 Aug. 2005
INCOMPLETE AUDITS – AS AT 31 OCTOBER 2005			
Commissioner for Environmental Sustainability	*Audited financial statements yet to be finalised.*		

(a) The *Surveying Act 2004* established the Surveyors Registration Board of Victoria on 17 June 2004, which replaced the Surveyors Board of Victoria.

(b) For regional water authorities, audit opinions were issued on the authorities' financial statements and statement of performance. For some of these authorities, the dates of the performance statements and audit opinions may differ from the financial statements dates.

(c) The Treasurer of Victoria holds the shareholdings in these companies.

(d) On 1 July 2005, South West Water Authority, Glenelg Region Water Authority and Portland Coast Region Water Authority amalgamated to form Wannon Region Water Authority.

(e) Commenced operation on 1 July 2004.

(f) Commenced operation on 1 August 2004.

(g) Ceased operation on 29 August 2004.

Primary Industries

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
Department of Primary Industries	26 Aug. 2005	✓	26 Aug. 2005
AGRICULTURE			
Agriculture Victoria Services Pty Ltd	12 Sep. 2005	✓	12 Sep. 2005
Dairy Food Safety Victoria	24 Aug. 2005	✓	24 Aug. 2005
Melbourne Market Authority	9 Sep. 2005	✓	9 Sep. 2005
Murray Valley Citrus Marketing Board	12 Sep. 2005	✓	12 Sep. 2005
Murray Valley Wine Grape Industry Development Committee	1 Sep. 2005	✓	1 Sep. 2005
Phytogene Pty Ltd	16 Sep. 2005	✓	16 Sep. 2005
PrimeSafe	12 Aug. 2005	✓	12 Aug. 2005
Veterinary Practitioners Registration Board	7 Sep. 2005	✓	7 Sep. 2005
Victorian Strawberry Industry Development Committee	28 Sep. 2005	✓	29 Sep. 2005
COMPLETED AUDITS – WITH OTHER BALANCE DATES			
Northern Victorian Fresh Tomato Industry Development Committee (1 July 2003 to 30 June 2004)	7 Apr. 2005	✓	22 Apr. 2005
INCOMPLETE AUDITS – AS AT 31 OCTOBER 2005			
Greater Victoria Wine Grape Industry Development (1 July 2004 to 30 Sep. 2004)	*Audited financial statements yet to be finalised.*		
Northern Victorian Fresh Tomato Industry Development Committee (1 July 2004 to 30 June 2005)	*Audited financial statements yet to be finalised.*		

Premier and Cabinet

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
Department of Premier and Cabinet	16 Aug. 2005	✓	17 Aug. 2005
ARTS			
Australian Centre for the Moving Image	20 Oct. 2005	✓	20 Oct. 2005
Council of Trustees of the National Gallery of Victoria	5 Sep. 2005	✓	15 Sep. 2005
Film Victoria	21 Sep. 2005	✓	22 Sep. 2005
Geelong Performing Arts Centre Trust	23 Sep. 2005	✓	23 Sep. 2005
Library Board of Victoria	18 Aug. 2005	✓	15 Sep. 2005
Museums Board of Victoria	2 Sep. 2005	✓	19 Sep. 2005
State Library of Victoria Foundation	18 Aug. 2005	✓	15 Sep. 2005
Victorian Arts Centre Trust	20 Sep. 2005	✓	22 Sep. 2005
PREMIER			
Office of the Ombudsman (a)	22 Sep. 2005	✓	22 Sep. 2005
State Services Authority (b)	23 Sep. 2005	✓	23 Sep. 2005
COMPLETED AUDITS – WITH OTHER BALANCE DATES			
Office of Public Employment (b) (1 July 2004 to 4 April 2005)	22 Sep. 2005	✓	22 Sep. 2005

(a) The Office of the Ombudsman prepared a composite financial report that includes the financial operations of the Office of Police Integrity, which was established in November 2004.

(b) The *Public Administration Act 2004* established the State Services Authority in April 2005, merging the previous Office of Public Employment into the State Services Authority.

Treasury and Finance

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
Department of Treasury and Finance	22 Sep. 2005	✓	22 Sep. 2005
FINANCE			
Emergency Services Superannuation Scheme	19 Aug. 2005	✓	19 Aug. 2005
Essential Services Commission	28 Sep. 2005	✓	30 Sep. 2005
Government Superannuation Office	17 Aug. 2005	✓	22 Aug. 2005
Parliamentary Contributory Superannuation Fund	7 Sep. 2005	✓	7 Sep. 2005
State Superannuation Fund	17 Aug. 2005	✓	22 Aug. 2005
Vicfleet Pty Ltd	21 Sep. 2005	✓	22 Sep. 2005
Victorian Managed Insurance Authority	18 Aug. 2005	✓	22 Aug. 2005
TREASURER			
Gascor EPL Pty Ltd (a)	11 Sep. 2005	✓	13 Sep. 2005
Gascor Holdings No. 1 Pty Ltd (a)	11 Sep. 2005	✓	13 Sep. 2005
Gascor Holdings No. 2 Pty Ltd (a)	11 Sep. 2005	✓	13 Sep. 2005
Gascor Holdings No. 3 Pty Ltd (a)	11 Sep. 2005	✓	13 Sep. 2005
Gascor IEPL Pty Ltd (a)	11 Sep. 2005	✓	13 Sep. 2005
Gascor KEPL Pty Ltd (a)	11 Sep. 2005	✓	13 Sep. 2005
Gascor MAPL Pty Ltd (a)	11 Sep. 2005	✓	13 Sep. 2005
Gascor MGPL Pty Ltd (a)	11 Sep. 2005	✓	13 Sep. 2005
Gascor SAPL Pty Ltd (a)	11 Sep. 2005	✓	13 Sep. 2005
Gascor SNPL Pty Ltd (a)	11 Sep. 2005	✓	13 Sep. 2005
Gascor (T No.1) Pty Ltd (a)	11 Sep. 2005	✓	13 Sep. 2005
Gascor (TH) Pty Ltd (a)	11 Sep. 2005	✓	13 Sep. 2005
Gascor WAPL Pty Ltd (a)	11 Sep. 2005	✓	13 Sep. 2005
Gascor WPL Pty Ltd (a)	11 Sep. 2005	✓	13 Sep. 2005
Industry Supervision Fund	23 Sep. 2005	✓	23 Sep. 2005
Rural Finance Corporation	16 Aug. 2005	✓	16 Aug. 2005
State Electricity Commission of Victoria	29 Aug. 2005	✓	29 Aug. 2005
State Trustees Limited	29 Aug. 2005	✓	29 Aug. 2005
Common Fund No. 1 (b)	29 Aug. 2005	✓	29 Aug. 2005
Common Fund No. 2 (b)	29 Aug. 2005	✓	29 Aug. 2005
Equity Common Fund (b)	29 Aug. 2005	✓	29 Aug. 2005
Fixed Interest Common Fund (b)	29 Aug. 2005	✓	29 Aug. 2005
Property Common Fund (b)	29 Aug. 2005	✓	29 Aug. 2005
Charitable Common Fund (b)	29 Aug. 2005	✓	29 Aug. 2005
Premium Cash Fund (b)	29 Aug. 2005	✓	29 Aug. 2005

Treasury and Finance *- continued*

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
Premium Cash Plus Fund (b)	29 Aug. 2005	✓	29 Aug. 2005
Premium Diversified Fund (b)	29 Aug. 2005	✓	29 Aug. 2005
Premium Equity Fund (b)	29 Aug. 2005	✓	29 Aug. 2005
Premium Fixed Interest Fund (b)	29 Aug. 2005	✓	29 Aug. 2005
Premium International Fund (b)	29 Aug. 2005	✓	29 Aug. 2005
Premium Property Fund (b)	29 Aug. 2005	✓	29 Aug. 2005
STL Financial Services Limited	29 Aug. 2005	✓	29 Aug. 2005
Treasury Corporation of Victoria (c)	2 Sep. 2005	✓	2 Sep. 2005
Victorian Funds Management Corporation	25 Aug. 2005	✓	5 Sep. 2005
VFM Australian Equities Trust (d)	25 Aug. 2005	✓	5 Sep. 2005
VFM Australian Fixed Interest Trust (d)	25 Aug. 2005	✓	5 Sep. 2005
VFM Emerging Markets Trust (d)	25 Aug. 2005	✓	5 Sep. 2005
VFM Global Bond Trust (d)	25 Aug. 2005	✓	5 Sep. 2005
VFM Global Small Companies Trust (d)	25 Aug. 2005	✓	5 Sep. 2005
VFM Hedged International Equities Trust (d)	25 Aug. 2005	✓	5 Sep. 2005
VFM Income Trust (d)	25 Aug. 2005	✓	5 Sep. 2005
VFM Indexed Bonds Trust (d)	25 Aug. 2005	✓	5 Sep. 2005
VFM International Equities Trust (d)	25 Aug. 2005	✓	5 Sep. 2005
VFM Short Term Money Market Trust (d)	25 Aug. 2005	✓	5 Sep. 2005
WORKCOVER			
Accident Compensation Conciliation Service	30 Aug. 2005	✓	5 Sep. 2005
Transport Accident Commission	19 Aug. 2005	✓	19 Aug. 2005
TAC Law Pty Ltd	29 Aug. 2005	✓	29 Aug. 2005
Victorian Trauma Foundation	17 Aug. 2005	✓	19 Aug. 2005
Victorian Trauma Foundation Pty Ltd	17 Aug. 2005	✓	19 Aug. 2005
Victorian WorkCover Authority	23 Aug. 2005	✓	23 Aug. 2005

Treasury and Finance - *continued*

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – WITH OTHER BALANCE DATES			
Paragon Warehouse Trust No.1 (e) (1 July 2004 to 2 June 2005)	17 Sep. 2004	✓	17 Sep. 2004
Paragon Warehouse Trust No. 2 (e) (1 July 2004 to 2 June 2005)	17 Sep. 2004	✓	17 Sep. 2004
INCOMPLETE AUDITS – AS AT 31 OCTOBER 2005			
South Eastern Medical Complex Limited	*Audited financial statements yet to be finalised.*		

(a) "Shell companies" of previous gas industry entities.

(b) State Trustees Limited is the trustee and manager of these funds. For 2004-05, aggregate financial statements were prepared covering all these funds.

(c) On 9 August 2004, pursuant to section 44A(1) of the *Financial Management Act 1994* (FMA), the Minister for Finance directed the Treasury Corporation of Victoria to prepare, in addition to the existing reporting requirements under Part 7 of the FMA, audited concise financial statements for every financial year until otherwise directed.

(d) For 2004-05, aggregate financial statements were prepared for these trusts and funds.

(e) Ceased operation on 2 June 2005.

Victorian Communities (excluding local government)

Entity	Financial statements signed	Clear opinion issued	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
Department for Victorian Communities	29 Aug. 2005	✓	29 Aug. 2005
COMMONWEALTH GAMES, AND SPORT AND RECREATION			
2007 World Swimming Championships Corporation (a)	8 Sep. 2005	✓	8 Sep. 2005
Melbourne 2006 Commonwealth Games Corporation	12 Aug. 2005	✓	24 Aug. 2005
Melbourne and Olympic Parks Trust ***Reason for qualification:*** *Incorrect recognition of an expense and an associated liability.*	10 Aug. 2005	Qualified	19 Aug. 2005
State Sport Centres Trust	22 Sep. 2005	✓	22 Sep. 2005
Victorian Institute of Sport Ltd	20 Sep. 2005	✓	22 Sep. 2005
Victorian Institute of Sport Trust	20 Sep. 2005	✓	22 Sep. 2005
MULTICULTURAL AFFAIRS			
VITS Languagelink	21 Sep. 2005	✓	22 Sep. 2005
VETERAN'S AFFAIRS			
Shrine of Remembrance Trustees	29 Sep. 2005	✓	30 Sep. 2005
WOMEN'S AFFAIRS			
Queen Victoria Women's Centre Trust	21 Sep. 2005	✓	22 Sep. 2005

(a) Commenced operation on 16 February 2005.

Local government

Entity	Financial statements signed	Clear opinion issued		Auditor-General's report signed
		Financial statements (a)	Performance statement	
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES				
MUNICIPAL COUNCILS AND ASSOCIATED COMPANIES				
Alpine Shire Council	20 Sep. 2005	✓	✓	27 Sep. 2005
Ararat Rural City Council	31 Aug. 2005	✓	✓	12 Sep. 2005
Ballarat City Council	14 Sep. 2005	✓	✓	16 Sep. 2005
Banyule City Council	12 Sep. 2005	✓	✓	13 Sep. 2005
Bass Coast Shire Council	21 Sep. 2005	✓	✓	26 Sep. 2005
Baw Baw Shire Council	13 Sep. 2005	✓	✓	22 Sep. 2005
Bayside City Council	19 Sep. 2005	✓	✓	20 Sep. 2005
Benalla Rural City Council	21 Sep. 2005	✓	✓	27 Sep. 2005
Boroondara City Council	13 Sep. 2005	✓	✓	15 Sep. 2005
Borough of Queenscliffe	6 Sep. 2005	✓	✓	14 Sep. 2005
Brimbank City Council	20 Sep. 2005	✓	✓	20 Sep. 2005
Buloke Shire Council	29 Sep. 2005	✓	✓	29 Sep. 2005
Campaspe Shire Council	20 Sep. 2005	✓	✓	21 Sep. 2005
Cardinia Shire Council	12 Sep. 2005	✓	✓	16 Sep. 2005
Casey City Council	13 Sep. 2005	✓	✓	15 Sep. 2005
Central Goldfields Shire Council	1 Sep. 2005	✓	✓	15 Sep. 2005
City Library Joint Venture	12 Oct. 2005	✓	n.a.	20 Oct. 2005
CityWide Service Solutions Pty Ltd	9 Aug. 2005	✓	n.a.	15 Aug. 2005
Colac-Otway Shire Council	23 Sep. 2005	✓	✓	23 Sep. 2005
Corangamite Shire Council	6 Sep. 2005	✓	✓	12 Sep. 2005
Darebin City Council	16 Sep. 2005	✓	✓	19 Sep. 2005
East Gippsland Shire Council	19 Sep. 2005	✓	✓	22 Sep. 2005
Frankston City Council	21 Sep. 2005	✓	✓	23 Sep. 2005
Gannawarra Shire Council ***Reason for qualification:*** *Asset revaluations not undertaken with sufficient regularity to ensure the reported asset values did not materially differ from their fair values.* *Budget for 2004-05 submitted to the minister did not incorporate key strategic activities and related performance measures.*	28 Oct. 2005	Qualified	Qualified	31 Oct. 2005
Glen Eira City Council	20 Sep. 2005	✓	✓	26 Sep. 2005
Glenelg Shire Council	23 Aug. 2005	✓	✓	19 Sep. 2005
Golden Plains Shire Council	15 Sep. 2005	✓	✓	19 Sep. 2005
Greater Bendigo City Council	14 Sep. 2005	✓	✓	23 Sep. 2005

Local government *- continued*

Entity	Financial statements signed	Clear opinion issued		Auditor-General's report signed
		Financial statements (a)	Performance statement	
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES				
Greater Dandenong City Council	12 Sep. 2005	✓	✓	19 Sep. 2005
Greater Geelong City Council	13 Sep. 2005	✓	✓	22 Sep. 2005
Greater Shepparton City Council	20 Sep. 2005	✓	✓	21 Sep. 2005
Hepburn Shire Council	19 Sep. 2005	✓	✓	20 Sep. 2005
Hindmarsh Shire Council	21 Sep. 2005	✓	✓	22 Sep. 2005
Hobsons Bay City Council	13 Sep. 2005	✓	✓	16 Sep. 2005
Horsham Rural City Council	20 Sep. 2005	✓	✓	22 Sep. 2005
Hume City Council	8 Sep. 2005	✓	✓	15 Sep. 2005
Indigo Shire Council	6 Sep. 2005	✓	✓	13 Sep. 2005
Kingston City Council	22 Sep. 2005	✓	✓	23 Sep. 2005
Knox City Council	26 Sep. 2005	✓	✓	27 Sep. 2005
Latrobe City Council	20 Sep. 2005	✓	✓	22 Sep. 2005
Loddon Shire Council	8 Sep. 2005	✓	✓	15 Sep. 2005
Macedon Ranges Shire Council	28 Sep. 2005	✓	✓	28 Sep. 2005
Manningham City Council	20 Sep. 2005	✓	✓	21 Sep. 2005
Mansfield Shire Council	21 Sep. 2005	✓	✓	27 Sep. 2005
Maribyrnong City Council	13 Sep. 2005	✓	✓	13 Sep. 2005
Maroondah City Council	5 Sep. 2005	✓	✓	12 Sep. 2005
Melbourne City Council	23 Aug. 2005	✓	✓	29 Aug. 2005
Melbourne Wholesale Fish Market Pty Ltd	16 Aug. 2005	✓	n.a.	19 Aug. 2005
Melton Shire Council ***Reason for qualification:*** *Budget for 2004-05 submitted to the minister did not incorporate key strategic activities and related performance measures.*	14 Sep. 2005	✓	Qualified	15 Sep. 2005
Mildura Rural City Council	23 Sep. 2005	✓	✓	28 Sep. 2005
Mitchell Shire Council	21 Sep. 2005	✓	✓	22 Sep. 2005
Moira Shire Council ***Reason for qualification:*** *Asset revaluations not undertaken with sufficient regularity to ensure the reported asset values did not materially differ from their fair values.*	27 Sep. 2005	Qualified	✓	29 Sep. 2005
Monash City Council	22 Sep. 2005	✓	✓	27 Sep. 2005
Moonee Valley City Council	6 Sep. 2005	✓	✓	6 Sep. 2005
Moorabool Shire Council	21 Sep. 2005	✓	✓	22 Sep. 2005
Moreland City Council	12 Sep. 2005	✓	✓	12 Sep. 2005

Local government - *continued*

Entity	Financial statements signed	Clear opinion issued		Auditor-General's report signed
		Financial statements (a)	Performance statement	
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES				
Mornington Peninsula Shire Council	19 Sep. 2005	✓	✓	22 Sep. 2005
Mount Alexander Shire Council	16 Sep. 2005	✓	✓	22 Sep. 2005
Moyne Shire Council	13 Sep. 2005	✓	✓	15 Sep. 2005
Murrundindi Shire Council	6 Sep. 2005	✓	✓	12 Sep. 2005
Nillumbik Shire Council	21 Sep. 2005	✓	✓	22 Sep. 2005
Northern Grampians Shire Council	29 Sep. 2005	✓	✓	29 Sep. 2005
Port Phillip City Council	19 Sep. 2005	✓	✓	19 Sep. 2005
Prahran Market Pty Ltd	20 Sep. 2005	✓	n.a.	29 Sep. 2005
Pyrenees Shire Council	23 Sep. 2005	✓	✓	28 Sep. 2005
Queen Victoria Market Pty Ltd	16 Aug. 2005	✓	n.a.	19 Aug. 2005
Regent Management Company Pty Ltd	30 Sep. 2005	✓	n.a.	17 Oct. 2005
South Gippsland Shire Council	7 Sep. 2005	✓	✓	19 Sep. 2005
Southern Grampians Shire Council	14 Sep. 2005	✓	✓	19 Sep. 2005
Stonnington City Council	19 Sep. 2005	✓	✓	20 Sep. 2005
Strathbogie Shire Council	15 Sep. 2005	✓	✓	23 Sep. 2005
Streetsahead Cleaning Services	16 Sep. 2005	✓	n.a.	22 Sep. 2005
Surf Coast Shire Council	13 Sep. 2005	✓	✓	16 Sep. 2005
Sustainable Melbourne Trust Fund	18 Oct. 2005	✓	n.a.	20 Oct. 2005
Swan Hill Rural City Council	13 Sep. 2005	✓	✓	19 Sep. 2005
Towong Shire Council	5 Sep. 2005	✓	✓	20 Sep. 2005
Wangaratta Rural City Council	12 Sep. 2005	✓	✓	26 Sep. 2005
Warrnambool City Council	7 Sep. 2005	✓	✓	12 Sep. 2005
Wellington Shire Council	7 Sep. 2005	✓	✓	14 Sep. 2005
West Wimmera Shire Council	21 Sep. 2005	✓	✓	22 Sep. 2005
Whitehorse City Council	25 Aug. 2005	✓	✓	1 Sep. 2005
Whittlesea City Council	13 Sep. 2005	✓	✓	20 Sep. 2005
Wimmera Development Association ***Reason for qualification:*** *Inappropriate disclosure of non-reciprocal grants.*	21 Sep. 2005	Qualified	n.a.	23 Sep. 2005
Wodonga Rural City Council	26 Sep. 2005	✓	✓	28 Sep. 2005
Wyndham City Council	14 Sep. 2005	✓	✓	15 Sep. 2005
Yarra City Council	21 Sep. 2005	✓	✓	22 Sep. 2005
Yarra Ranges Shire Council	23 Aug. 2005	✓	✓	30 Aug. 2005
Yarriambiack Shire Council	8 Sep. 2005	✓	✓	16 Sep. 2005

Local government *- continued*

Entity	Financial statements signed	Clear opinion issued (a)	Auditor-General's report signed
COMPLETED AUDITS – 30 JUNE 2005 BALANCE DATES			
REGIONAL LIBRARY CORPORATIONS			
Casey - Cardinia Regional Library Corporation	5 Sep. 2005	✓	15 Sep. 2005
Central Highlands Regional Library Corporation	19 Sep. 2005	✓	22 Sep. 2005
Corangamite Regional Library Corporation	19 Sep. 2005	✓	29 Sep. 2005
Eastern Regional Library Corporation	27 Sep. 2005	✓	28 Sep. 2005
Geelong Regional Library Corporation	5 Sep. 2005	✓	19 Sep. 2005
Glenelg Regional Library Corporation	22 Sep. 2005	✓	28 Sep. 2005
Goulburn Valley Regional Library Corporation	22 Sep. 2005	✓	23 Sep. 2005
High Country Regional Library Corporation	16 Sep. 2005	✓	19 Sep. 2005
North Central Goldfields Regional Library Corporation (b) ***Reason for qualification:*** *Budget for 2004-05 submitted to the minister did not include standard statements.*	26 Aug. 2005	Qualified	4 Oct. 2005
West Gippsland Regional Library Corporation	13 Sep. 2005	✓	13 Sep. 2005
Whitehorse Manningham Regional Library Corporation	1 Sep. 2005	✓	19 Sep. 2005
Wimmera Regional Library Corporation	20 Sep. 2005	✓	22 Sep. 2005
Yarra Melbourne Regional Library Corporation	26 Sep. 2005	✓	27 Sep. 2005
Yarra Plenty Regional Library Corporation	28 Sep. 2005	✓	30 Sep. 2005

(a) In the case of municipal councils and regional library corporations, audit opinions refer to the financial and standard statements prepared by these entities.

(b) Qualification of standard statements only with a clear audit opinion issued on the financial statements.

n.a. Not applicable, as agencies were not required by legislation to produce a performance statement.

Auditor-General's Reports

2005

Report title	Date issued
Regulating operational rail safety (2005:1)	February 2005
Managing patient safety in public hospitals (2005:2)	March 2005
Management of occupational health and safety in local government (2005:3)	April 2005
Results of special reviews and other investigations (2005:4)	May 2005
Results of financial statement audits for agencies with other than 30 June 2004 balance dates, and other audits (2005:5)	May 2005
Our children are our future: Improving outcomes for children and young people in Out of Home Care (2005:6)	June 2005
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