VICTORIA

Victorian
Auditor-General

Audit summary of Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2008–09

Tabled in Parliament
24 November 2009

Audit summary

This is the third of six reports to Parliament scheduled for 2009–10 covering the results of the annual financial report audits of the Victorian state and local government sectors. This report provides the results of the audit of the Annual Financial Report (AFR) of the State of Victoria.

The key conclusion from this audit is that Parliament can have confidence in the Annual Financial Report of the State of Victoria.

Our external audit provides authoritative independent assurance that the Treasurer and the Minister for Finance, WorkCover and the Transport Accident Commission have prepared the AFR consistent with the provisions of the *Financial Management Act 1994* (FMA) and applicable accounting standards.

The AFR details the state's cost of operations, revenue, impacts of market re-measurement on the value of assets and liabilities, the value of what it owns and what it owes. In the AFR, information is provided at the:

- state level which aggregates the three sectors of government, the general government sector (GGS), the public non-financial corporations (PNFC) and the public financial corporations (PFC) to present a whole-of-government perspective, and
- GGS level separated out to provide a perspective of the operations of the budget funded sector of government.

A clear audit opinion on the 2008–09 AFR was issued on 29 September 2009 and included in Chapter four of the Financial Report that was tabled in Parliament on 14 October 2009 in line with the timing required by legislation.

However, the AFR preparation timetable was not achieved due to the late provision of certified financial data by 34 (79 per cent) material entities and lengthy considerations regarding the recognition and measurement of land under roads and the measurement of infrastructure assets at fair value.

Financial performance and position of the state

In 2008–09 the net result, including transactions and other economic flows, for the state was a deficit of $13 088.8 million (deficit of $3 165.9 million, 2007–08) largely reflecting the second year of actuarial losses by the state's defined benefit superannuation plans combined with realised and unrealised losses on financial instruments due to financial market conditions.

The net result from transactions for the state was a deficit of $62.9 million in 2008–09 (a surplus of $1 638.6 million, 2007–08) again largely reflecting the impact of the global financial crisis. The general government sector (GGS) net result from transactions was a surplus of $251.2 million in 2008–09 ($1 646.6 million, 2007–08) which exceeded the revised key financial objective of a net result from transactions of at least $100 million. The achievement of this target was primarily due to the recognition of fiscal stimulus funding from the Commonwealth and higher sales of goods and services and other revenue.

The state’s net worth for the year increased by $26 412.8 million (29 per cent) to $118 003.6 million ($91 590.8 million in 2007–08). Notwithstanding the investment losses of $4 022.2 million, revaluation of non-financial assets of $20 263.5 million and the recognition of land under roads of $18 682.5 million more than offset the losses. These factors improved the state’s net asset position.

Borrowings, provisions for insurance claims and the superannuation liability are the major obligations of the state. Total state liabilities increased during the year by $18 141.8 million (31.2 per cent) to $76 250.4 million ($58 108.6 million in 2007–08). This increase mainly reflected the impact of adverse financial market conditions, and the part funding of the State’s infrastructure program from borrowings. The state’s triple-A credit rating was re-affirmed by Standard & Poor’s in September 2009.

While the net result from transactions for the GGS is an indicator of the government’s financial performance, the financial sustainability of the state requires consideration of the state’s net result. When looking at this ‘bottom line’ and by taking into account other economic flows, the deficits in the 2007–08 and 2008–09 net results clearly demonstrate the state’s exposure to financial markets and economic conditions. These and other factors can put at risk longer-term financial sustainability and will need to be closely monitored, so that revenue and expenditure policy settings remain sustainable.

Risks to the financial performance and condition

There are a number of external factors which need to be continually monitored in managing short and long term sustainability.

External factors that could impact the state’s future financial performance and condition include:

- the performance of the national economy and the policy directions and decisions of the Commonwealth Government, which significantly influence the level of Commonwealth grants to the state
- volatility in the performance of the Australian and international financial and equity markets, significantly influencing the investment revenues in the short term and superannuation expenses of the state
- demographic trends, including the ageing population, expected to affect the level and nature of services provided by the government

- the public sector workforce pressures for wage and salary growth, and the need to maintain sustainable full time equivalent (FTE) whilst meeting increased demands on government service delivery
- the implementation of any Australian emissions trading scheme and climate change.

Quality of reporting

DTF prepares the AFR in accordance with the requirements of the FMA and applicable Australian accounting standards and interpretations. Australian Accounting Standard AASB 1049 *Whole of Government and General Government Sector Financial Reporting* has particular relevance.

The quality of the AFR depends upon the accuracy of financial data submitted to DTF by public sector entities and DTF's quality assurance processes in preparing the consolidated accounts.

A direct measure of accuracy is the incidence and magnitude of the errors in the financial data submissions and the draft financial reports requiring adjustments.

In 2008–09 errors in the financial data submissions of 31 material entities (28 in 2008) were detected, indicating deficiencies in quality assurance processes of both reporting entities and DTF.

Material error was also identified in the draft disclosure notes to the AFR for commitments and contingencies. Initially the amounts disclosed in the AFR did not agree to the audited balances included in the individual entities financial reports. All these material errors were corrected in the AFR before issue of the clear audit opinion.

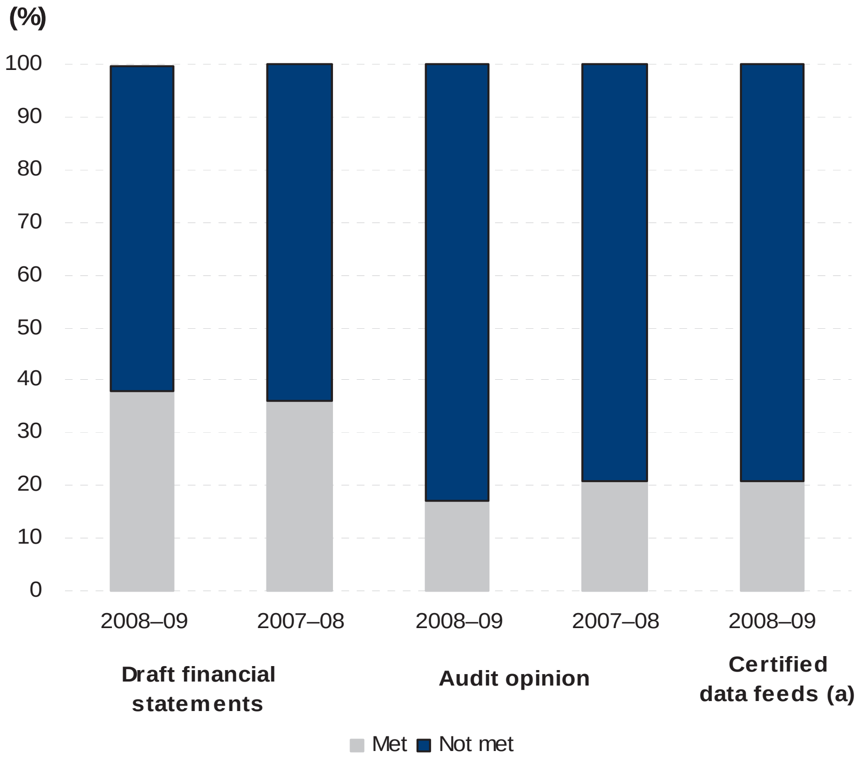
Timeliness of reporting

The timely preparation and audit of the AFR depends on the consolidated entities meeting the established AFR preparation timetable and the early identification and resolution of significant accounting, recognition, measurement, presentation and disclosure matters. The individual financial operations of these material entities are significant in the reporting of the consolidated finances of the state and collectively comprise more than 90 per cent of the state's assets, liabilities, revenue and expenditure.

Responding to last year's audit recommendation, DTF released the AFR timetable in February 2009. This timetable included earlier reporting milestone dates than the FMA legislative time frames to enable the AFR 15 October tabling date to be met.

Notwithstanding the earlier consultations and issue of the AFR timetable, fewer material entities met the time lines as summarised below.

Figure A
Timeliness of reporting for material entities 2008–09 and 2007–08



Note: (a) Comparative data not available for certified data feeds.
Source: Victorian Auditor-General's Office.

This situation highlights the ongoing need to improve processes and to better focus efforts to deliver reliable financial reports within the established time frames.

Current issues

It is important for the AFR and consolidated entities to apply consistent accounting policies so the utility and comparability of financial reports can be optimised.

The 2008–09 AFR is the first to be prepared in accordance with AASB 1049, this resulted in:

- water, rail and port infrastructure assets being measured at fair value resulting in a $15 300 million increment being reported in the AFR. However, the majority of water, rail and port entities record infrastructure assets at cost in their individual entity financial reports. This is in accordance with accounting standards and FRD 121 *Infrastructure Assets (Water/Rail)*. However, FRD 121 also requires the entities concerned to move to recording the applicable assets at fair value in their individual entity financial reports to commence either in 2009–10 or 2010–11 years.
- the recognition of $18 682.5 million of land under roads in the AFR. However, Vic Roads did not recognise land under roads in their financial report in accordance with options available in AASB 1051 *Land Under Roads* to not recognise land under roads acquired prior to 1 July 2008.

There will continue to be a variance between valuations in the AFR and the financial reports of the water and rail entities until these entities are required to implement fair valuation of infrastructure assets in their financial reports.

Assuming current revenue levels, this change in accounting policy would result in higher depreciation charges, lower net results and affect the tax related balances for these entities. These inconsistencies at 30 June 2009 highlight the need for a concerted effort to treat like transactions and events consistently to achieve optimal utility and comparability.

Significant developments

Victorian Bushfire Appeal Trust Fund

The Victorian Bushfire Appeal Trust Fund, up to 25 October 2009 had received $382 million, an increase of $9.1 million since 30 June 2009 with payments of $78.2 million being distributed to individuals and communities since 30 June. The $169.1 million ($238.2 million at 30 June 2009) balance of the fund is to be utilised to make further distributions to individuals and communities.

Post-balance date events

Victorian Desalination Plant

Construction, operation and maintenance of the Victorian Desalination Plant is to be delivered by Aquasure via a public private partnership model for the state government. Construction commenced in October 2009 with estimated construction costs of $3 500 million to be borne by Aquasure. The future financial implications of this project are not yet quantifiable because final negotiations and syndication had not been completed at 30 September 2009. The state government has provided a Treasurer's Guarantee over a portion of the plant debt, as a lender of last resort in the case that the syndication process is not successful.

Rail franchise

Operation and maintenance contracts for Melbourne's passenger train and tram networks for the eight years ending November 2017 were completed in August 2009. The train contract with United Group Limited for Metro Trains Melbourne is expected to cost the state an average of $474 million per year and the tram contract with Keolis Downer EDI an average of $97 million per year.

Other developments

Channel Deepening Project

This project is scheduled for completion by 31 December 2009 and is expected to come in ahead of schedule and under the original budget.

Food Bowl Modernisation Project

Project works have recently commenced with estimated costs for the project of $2 004.5 million. $168.1 million of this project had been spent at 30 June 2009.

Northern Sewerage Project

This project commenced in August 2007 and is on schedule for completion in mid 2012. The $650 million estimated costs for this project are to be funded by Melbourne Water Corporation and Yarra Valley Water Limited.

Myki

Myki is now operating in town buses in Ballarat, Bendigo, Geelong, Seymour, Warragul and the Latrobe Valley. It is expected that Melbourne operations will begin in late 2009. Total capital costs are forecast at $454 million, with $261.4 million of capital costs incurred at 30 June 2009. Operating costs to 30 June 2009 were $201.6 million with committed operating costs totalling $367.4 million projected over ten years commencing in 2009–10. Further capital and operating costs of $393.6 million are also forecast however these have not been contracted for at 30 June 2009.

New Melbourne Convention Centre

The new Melbourne Convention Centre was officially opened on 5 June 2009. A private sector consortium is to operate the Melbourne Exhibition and Convention Centre (MECC) for a period of 25 years which commenced on 31 March 2009. The state's total estimated costs for the MECC is $1 734 million.

Melbourne Central City Studios

The state paid $6 million for Melbourne Central City Studios in November 2008. The net assets of the studios were subsequently written down to $0.5 million and the studios continue to have a high financial viability risk.

Commonwealth Games Athlete's Village

The state's estimated cost for the Commonwealth Games Athletes Village has increased from the 2006 reported cost of $41 million to $59.1 million due to lower than expected forecast revenue. This is a result of reducing the number of apartments to be built from 650 to 632. The estimated average return for each apartment has also been reduced from $70 000 to $45 500.

Recommendations

Number	Recommendation	Page
1.	DTF should, in consultation with material entities: • develop improved processes, to achieve the required time frames, and • improve their quality assurance processes.	17
2.	Public sector entities should more rigorously align their financial reporting timetable, including audit committee and board meeting dates, to the AFR timetable.	17
3.	DTF should lead the adoption of consistent recognition and measurement policies across the Victorian public sector.	17

General

The total cost of preparing and printing this report was $160 000.