Acquittal Report: Results of the 2009–10 Audits

Victorian Auditor-General's Report

February 2011

2010-11:19

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This report consists of five parts:
Acquittal Report: Results of the 2009–10 Audits
Annex A: Portfolio Departments and Associated Entities
Annex B: Local Government
Annex C: Public Hospitals
Annex D: Water Entities

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VAGO

Victorian Auditor-General's Office

Auditing in the Public Interest

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

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

Dear Presiding Officers

Under the provisions of section 16AB of the *Audit Act 1994*, I transmit the *Acquittal Report: Results of the 2009–10 Audits.*

Yours faithfully

D D R PEARSON
Auditor-General

9 February 2011

Contents

Acquittal report

Background

Parliament rose on 7 October 2010 for the 27 November 2010 election. This significantly shortened time lines for reporting on the annual financial statement audits for the 2009–10 financial year. Accordingly, we produced interim reports on the annual financial statement audits of the portfolio departments, local government, water and public hospital sectors across July, August and September. This report acquits the final results of the 2009–10 audits of all entities with 30 June 2010 balance dates.

This report is the sixth of seven reports to be presented to Parliament covering the results of the audits. Appendix B lists those reports and time frames.

The purpose of this report is to provide the results of the audit of 445 entities with 30 June 2010 balance dates across:

- portfolio departments and associated entities
- local government
- public hospitals
- water entities.

It also analyses the quality of financial reporting and comments on financial sustainability.

Overall conclusion

Parliament can have confidence in the financial reports, standard statements and performance statements prepared for 30 June 2010.

The average time taken by portfolio departments, public hospitals and water entities to finalise their financial statements substantially improved by one to three weeks to be finished within eight weeks of balance date. Timeliness of local government financial reporting remained consistent at around 11 weeks of balance date.

Indicators of financial sustainability show that short-term challenges exist for self-funded state entities, public hospitals and water entities. There has however been improvement in the financial sustainability of councils.

Findings

Results of audits

Of the 445 entities included in this report, clear audit opinions were issued on the financial reports of 443 entities. Clear audit opinions were issued on the standard statements of all 79 local councils. Clear audit opinions were also issued on the performance statements prepared by all 15 water entities, and 77 of the 79 local councils. A clear audit opinion indicates that the financial reports and performance statements were prepared in accordance with the applicable reporting framework.

A qualified audit opinion is issued when the financial report or performance statement is materially different to the requirements of the relevant reporting framework, and therefore, is less reliable and useful as an accountability document.

The four entities and the basis for not receiving clear opinions are detailed in Figure A.

Figure A
Exceptions where clear audit opinions were not issued

Entity	Report	Exception
Alpine Shire Council	Performance statement	**No opinion issued** **Section 132** of the *Local Government Act 1989* was not complied with as the council did not prepare a performance statement because the council's 2009–10 budget did not include the prerequisite performance targets and measures.
City of Greater Dandenong	Financial report	**Qualification** The net underlying result from operations as reported in the comprehensive income statement did not accord with AASB 101 as it excluded $37.83 million of items that are part of normal council operations. This misstated the net underlying result from operations however as these items of expenditure were included in 'other non operational expenses' the council's comprehensive result was not affected.
Public Transport Ticketing Authority	Financial report	**Qualification** As a result of significant control weaknesses in the myki system it was not possible to form an opinion on the completeness and accuracy of myki revenue collections for the 2009–10 financial year.
Yarra Ranges Shire Council	Performance statement	**Qualification** The performance statement did not comply with the *Local Government Act 1989* as the reported performance targets and measures were not set in the council's original budget.

Source: Victorian Auditor-General's Office.

The financial audit framework applied in the conduct of the 2009–10 audits is set out in Appendix C.

In certain circumstances it is appropriate to draw attention to or emphasise a matter in the audit opinion that is relevant to the users of an entity's financial report but does not warrant qualification of the audit opinion. Clear audit opinions that contained an emphasis of matter were provided for 23 entities drawing attention to the uncertainty around the going concern assumptions recognising proposed legislative changes and other reforms that would:

- amalgamate the existing 12 regional waste management groups into seven
- amalgamate the Port Phillip and Westernport Catchment Management Authority with Melbourne Water and establish four natural resource and catchment management authorities to replace the remaining nine catchment management authorities
- replace the Judicial College of Victoria with a new Judicial Commission of Victoria.

Quality of financial reporting

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

To achieve efficient and cost effective financial reporting entities need to have well planned and managed financial report preparation processes. The financial reporting processes in all sectors were generally adequate.

An assessment of each portfolio department, local government, public hospital and water sector entity's financial report preparation process was made against better practice. The elements of better practice financial report preparation are provided in Appendix D.

Areas where further improvement can be achieved are:

- developing a financial report preparation plan that addresses resources, processes, milestones, oversight and quality assurance practices to be applied in preparing the financial report
- preparation and timely provision of a shell financial statement to audit so that issues with disclosure requirements can be identified early
- undertaking a materiality assessment considering qualitative and quantitative thresholds to assist with identification of potential errors
- performing rigorous quality control and assurance procedures to improve the accuracy of the draft financial report.

Where a performance report is prepared, the requirements and quality control reviews to be conducted on the performance report should be specified in the financial reporting preparation plan. Our review showed that where financial report preparation plans were prepared by water entities, they generally did not include the requirements for preparing the performance report. As a result, performance reports were not subject to the same level of internal quality assurance as financial reports.

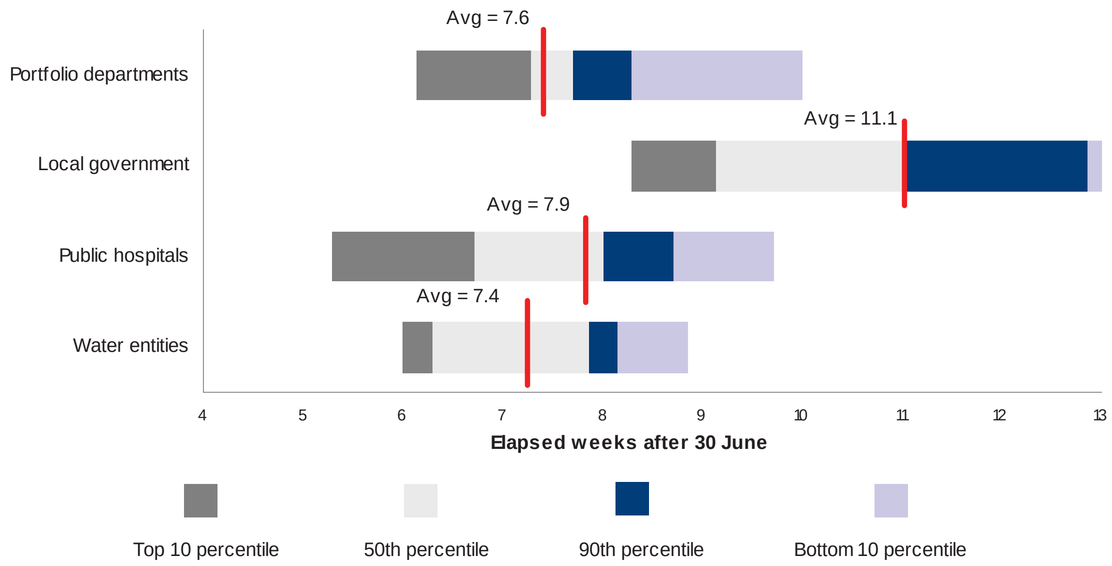
The average time taken to finalise financial statements substantially improved in 2009–10 in portfolio departments, public hospitals and water entities. This improvement has been driven in part by a requirement issued by the Premier in 2010 that entities reporting under the *Financial Management Act 1994* table annual reports in Parliament on or before 16 September 2010.

The most significant improvement occurred in the water sector where corporations took an average of 7.4 weeks (10.2 weeks 2008–09) to prepare their financial statements and all financial statements were finalised four weeks earlier than in 2008–09. Portfolio departments took an average of 7.6 weeks (8.6 weeks in 2008–09) and public hospitals took an average of 7.9 weeks (10.0 weeks in 2008–09), both improvements on 2008–09.

Given the improved time frames achieved in 2009–10, portfolio departments, public hospitals and water entities should maintain this momentum of earlier reporting.

Figure B shows the average time taken to finalise financial statements in each sector.

Figure B
Average time taken to finalise financial statements



Source: Victorian Auditor-General's Office.

The timeliness of financial report preparation by local councils remained consistent from 2008–09 to 2009–10. The average time taken for a council to prepare their financial report was 11.2 weeks in 2008–09 and 11.1 weeks in 2009–10, considerably longer than the other sectors. As local councils report under the *Local Government Act 1989*, there was no imperative on councils to report earlier due to the impending state election.

Financial sustainability

To be financially sustainable, entities should have the capacity to meet current and future expenditure as it falls due. They should also be able to absorb foreseeable changes and financial risks materialising, without significantly changing their revenue and expenditure policies.

Insight into the financial sustainability of entities is obtained from analysis of four core financial sustainability indicators over a five-year period from 2005–06 to 2009–10. The four core indicators used across all sectors, excluding regional library corporations, are underlying result, liquidity, self-financing and capital replacement. These indicators reflect each entity's funding and expenditure policies, and indicate whether these policies are sustainable.

More detail on the attributes and application of the indicators is provided in Appendix E.

In addition to these four core indicators, other particular indicators are used in the financial sustainability assessments of local government, public hospitals and water entities which focus on areas of risk for each sector.

The financial sustainability indicators and assessments in this report flag departures from the norm that warrant attention. To form a definitive view of any entities financial sustainability requires a holistic analysis that moves beyond financial considerations to include the entities operations and environment.

The trends and risks in this report need to be considered in light of the funding model adopted for public sector entities. Specifically, the current funding model does not provide depreciation funding to budget dependent entities, and capital grant funding is allocated strategically across the public sector rather than progressively to each entity when capital requirements are determined. However, governing boards are accountable for financial management and performance. This situation blurs accountability for governance and performance as management and governing bodies do not have the resources and discretion to make decisions around asset maintenance and replacement which can impact operational performance.

Portfolio departments' and associated entities

Financial sustainability analysis has been performed on the 46 self-funded state entities that primarily generate their own revenue.

A summary of the five-year average financial sustainability results for each portfolio is provided in Figure C.

Figure C
2009–10 financial sustainability risk assessment by portfolio – self-funded entities

Portfolio	High	Medium	Low
Education and Early Childhood Development	–	–	1
Health	–	2	2
Innovation, Industry and Regional Development	3	2	–
Justice	1	3	3
Planning and Community Development	2	5	1
Premier and Cabinet	1	2	–
Primary Industries	–	8	2
Sustainability and Environment	–	–	3
Transport	3	–	1
Treasury and Finance	–	1	–
Total	**10**	**23**	**13**

Source: Victorian Auditor-General's Office.

Our financial sustainability assessment is that 10 of the 46 self-funded entities have an overall high-risk rating at 30 June 2010.

The portfolios of Innovation, Industry and Regional Development, and Planning and Community Development have three and two entities respectively, which have an overall high-risk rating due to large underlying deficits. These entities generally operate and maintain large state assets and record large depreciation expenses year on year. The current state funding model allocates capital funding based on strategic priorities therefore entities do not receive funding for annual depreciation expenditure.

Three entities in the Transport portfolio have an overall high-risk rating due to insufficient liquidity as a result of short-term commitments for finance lease repayments and borrowings. These financial commitments are guaranteed by government.

Our financial sustainability assessment is that 23 of the 46 self-funded entities have an overall medium-risk rating at 30 June 2010.

The entities in the Planning and Community Development, Premier and Cabinet, and Primary Industries portfolios that had an overall medium-risk rating was due to high-risk self-financing assessments. The entities in these portfolios generally operate large state assets however the revenue generated from their asset holdings is insufficient to cover expenses and renew assets.

No sustainability issues were identified in the portfolios of Education and Early Childhood Development and Sustainability and Environment.

Local government

Financial sustainability analysis has been performed on the 79 local councils and 12 regional library corporations (RLCs).

In addition to the four core sustainability indicators, two further indicators are assessed for councils:

- **indebtedness**—measures a council's ability to cover non-current liabilities from revenues they generate themselves
- **renewal gap**—comparison of the rate of spending on renewing, restoring and replacing existing assets, with depreciation.

These indicators reflect two particular risks for local councils—managing debt and maintaining assets to sustain current service levels.

The financial sustainability of RLCs is assessed using three of the four core indicators being underlying result, liquidity and capital replacement. The fourth core indicator of self-financing is not applied to RLCs as they do not generate significant amounts of own-source revenue and are reliant on member councils making annual contributions.

Figure D summaries the sustainability risk assessments for the 79 councils and the 12 RLCs.

Figure D
2009–10 financial sustainability risk assessment – local government

Category	High	Medium	Low
Councils			
Inner metropolitan	–	1	16
Outer metropolitan	–	1	13
Regional city	–	–	11
Large shire	–	–	15
Small shire	1	2	19
Total	**1**	**4**	**74**
Regional library corporations	**2**	**3**	**7**

Source: Victorian Auditor-General's Office.

Overall, there has been improvement in the financial sustainability of councils with low-risk rated councils increasing from 71 to 74, and medium-risk rated councils decreasing from eight to four. However, one council has been rated high risk, previously rated medium risk.

Buloke Shire Council is the only high-risk rated council in 2009–10. The council's liquidity ratio deteriorated in the year and will need to be closely monitored by the council.

Four councils have been assessed as medium sustainability risks due to high-risk capital replacement and or renewal gap indicators. For these councils, spending less on assets compared to depreciation may indicate asset condition is deteriorating which could affect service levels in the longer-term.

Two RLCs had high-risk ratings because of insufficient liquidity. This risk is mitigated as both RLCs have commitments to receive council contributions in the new financial year to meet the operating costs of the libraries for 2010–11.

Public hospitals

Financial sustainability assessments have been performed on the 87 public hospitals.

In addition to the four core financial sustainability indicators, the assessment of public hospitals' financial sustainability includes an indicator to assess the average number of days of unrestricted cash that is available at year end to cover operating cash outflows. Without adequate unrestricted cash reserves, public hospitals may need to restrict operations or call upon the government for additional funding.

A summary of the five-year average financial sustainability results for each public hospital category is provided in Figure E.

Figure E
2009–10 financial sustainability risk assessment – public hospitals

Category	High	Medium	Low
Public hospitals			
Metropolitan	11	7	–
Regional	8	7	–
Rural	7	35	12
Total	**26**	**49**	**12**

Source: Victorian Auditor-General's Office.

Our financial sustainability assessment shows that 26 public hospitals were considered high risk at 30 June 2010 (28 in 2008–09). This arises most commonly because they were assessed as generating insufficient cash to be able to adequately fund their operations.

In 2009–10, 69 public hospitals recorded a negative underlying result compared to 39 in 2008–09. This was due to higher depreciation charges in 2009–10 as a result of the revaluation of hospital buildings at the end of 2008–09.

Prudent financial management practice requires the equivalent of at least one month's operating cash outflows to be available as unrestricted cash holdings, consistent with the Department of Health funding model. On average the metropolitan and regional hospitals were not able to fund their operations for more than 22 and 27 days respectively, as at 30 June 2010.

Consistent with this outcome and our liquidity risk assessment, the Department of Health concluded that 30 public hospitals in 2009–10 (31 in 2008–09), did not comply with the going concern test in the Australian accounting standards. Those respective hospital boards were provided with a letter of comfort outlining that the department would provide adequate cash flows to enable them to meet their financial obligations up to September 2011, should this be required.

Water entities

Financial sustainability assessments have been performed on 19 water entities.

The financial sustainability assessments were conducted using the four core indicators and the following two particular indicators:

- **interest cover**—measures an entities ability to meet ongoing interest payments and ability to service debt
- **debt-to-equity**—longer-term measure that compares all current and non-current interest-bearing liabilities to equity. It complements the liquidity indicator, which is a short-term measure. A low-risk assessment indicates less reliance on debt to finance the capital structure of an organisation.

Water entities have a high reliance on debt, therefore these additional indicators focus on their ability to meet interest commitments and repay debt.

A summary of the outcomes of the sustainability assessment by water category is provided in Figure F.

Figure F
2009–10 financial sustainability risk assessment – water entities

Category	High	Medium	Low
Water entities			
Metropolitan	4	–	–
Regional urban	5	–	8
Rural	1	–	1
Total	**10**	**–**	**9**

Source: Victorian Auditor-General's Office.

Overall, our financial sustainability assessment is that 53 per cent (10 of 19) water entities have a high-risk rating. This was mainly because of underlying deficits and/or a poor liquidity position. Generally, these entities have approval to refinance their maturing debt and in recent years have refinanced the debt for a new term rather than repay the debt.

The liquidity of the sector is deteriorating with 73 per cent of water entities receiving a high-risk rating for liquidity in 2009–10 (37 per cent in 2005–06). The deterioration is due to increased debt taken on to fund large scale infrastructure projects. The four metropolitan entities have a high-risk rating due to tight liquidity. However, the four entities have a strong interest cover position, indicating an ability to service their debt as they generate profits and have positive cash flows from operating activities.

While the ability of the metropolitan and the regional urban sectors to fund new assets and/or replace existing assets using cash generated by operations has declined, the capital-replacement indicator shows an increase in the capital spend. The increased spending has predominantly been financed by new debt.

The results of the indicators should be analysed in the context of the regulatory and commercial environment in which these entities operate. Pricing arrangements are regulated by the Essential Services Commission so that water entities have a sustainable revenue stream, and all borrowings are obtained from the Treasury Corporation of Victoria, which reduces the re-financing and liquidity risks in the short term.

Recommendations

Recommendation	Page
Water entities who prepare a performance report should integrate the preparation and approval of this report into their year-end financial reporting plan and processes.	Annex D: 7
Entities should adopt the shortened annual reporting time frames achieved for the 2009–10 reporting cycle as the standard for future reporting cycles.	Annex A: 12 Annex C: 8 Annex D: 9

Structure of this report

This report provides an overview of the results from the 2009–10 financial statement audits of 445 entities with 30 June 2010 balance dates in four sector categories. The details in relation to entities within each category are reported in annexes as follows.

Report annex	Sector description
Annex A: Portfolio Departments and Associated Entities	Provides the results of the audit of the 11 portfolio departments and 198 associated entities.
Annex B: Local Government	Covers 104 entities comprising 79 local councils, 12 regional library corporations and 13 companies, trusts and joint ventures controlled by local councils.
Annex C: Public Hospitals	Covers 112 entities comprising 87 public hospitals and 25 associated entities.
Annex D: Water Entities	Covers the 20 entities comprising four metropolitan water entities, 13 regional urban water corporations, two rural water corporations and one controlled entity.

Submissions and comments received

In addition to progressive engagement during the course of audits, in accordance with section 16(3) of the *Audit Act 1994* a copy of this report, or relevant extracts from the report, was provided to all portfolio departments and named agencies with a request for submissions or comments.

The agency views have been considered in reaching our audit conclusions and are represented to the extent relevant and warranted in preparing this report. Their full section 16(3) submissions and comments, however, are included in Appendix F of this Acquittal Report and in Appendix C of each relevant annex.

Audit conduct

The cost of preparing and printing the total report including Annexes A to D, was $475 000.

Appendices index

Appendix A. Acronyms and glossary

A.1 Acronyms

AFR	Annual Financial Report of the State of Victoria
APS	Australian Public Service
AASB	Australian Accounting Standards Board
CA	*Corporations Act 2001*
DEECD	Department of Education and Early Childhood Development
DOH	Department of Health
DHS	Department of Human Services
DIIRD	Department of Innovation, Industry and Regional Development
DOJ	Department of Justice
DOT	Department of Transport
DPC	Department of Premier and Cabinet
DPCD	Department of Planning and Community Development
DPI	Department of Primary Industries
DSE	Department of Sustainability and Environment
DTF	Department of Treasury and Finance
ESTA	Emergency Services Telecommunications Authority
Fed Square	Federation Square Pty Ltd
FMA	*Financial Management Act 1994*
FMIT	First Mildura Irrigation Trust
FRD	Financial reporting direction

FTE	Full-time equivalent
GAAP	Generally accepted accounting principles
GFS	Government finance statistics
GPAC	Geelong Performing Arts Centre
GSP	Gross state product
IASB	International Accounting Standards Board
ICT	Information and communications technology
IS	Information system
IT	Information technology
LG Act	*Local Government Act 1989*
LMW	Lower Murray Urban and Rural Water Corporation
MECC	Melbourne Convention and Exhibition Centre
MOU	Memorandum of Understanding
PAEC	Public Accounts and Estimates Committee
PSC	Victorian Professional Standards Council
RLC	Regional library corporation
RTBA	Residential Tenancy Bond Authority
SLA	Service level agreement
SRO	State Revenue Office
STL	State Trustees Limited
VACT	Victorian Arts Centre Trust
VAGO	Victorian Auditor-General's Office
VFMC	Victorian Funds Management Corporation
VPS	Victorian Public Sector
VTIO	Victoria Trade and Investment Office Pty Ltd

A.2 Glossary

Accountability

Responsibility on public sector entities to achieve their objectives, with regard to reliability of financial reporting, effectiveness and efficiency of operations, compliance with applicable laws, and reporting to interested parties.

Acquisition

Acquisition, in relation to assets, means establishing control over the asset, undertaking the risks, and receiving the rights to future benefits, as would be conferred with ownership, in exchange for a cost of acquisition.

Amortisation

The systematic allocation of the depreciable amount of an intangible asset over its expected useful life.

Asset

A resource controlled by an entity as a result of past events, and from which future economic benefits are expected to flow to the entity.

Auditor's opinion

Positive written expression within a specified framework indicating the auditor's overall conclusion on the financial report based on audit evidence obtained. A clear opinion indicates that the financial report has been prepared in accordance with the requirements of the relevant legislation and Australian accounting standards.

Audit Act 1994

The *Audit Act 1994* establishes the operating powers and responsibilities of the Auditor-General. This includes the operations of his office—the Victorian Auditor-General's Office (VAGO) as well as the nature and scope of audits conducted by VAGO. The Act also addresses the relationship of the Auditor-General with the Public Accounts and Estimates Committee as the representative body of Parliament and the Auditor-General's accountability to Parliament for discharge of the position's responsibilities.

Capital expenditure

Amount capitalised to the balance sheet for contributions by a public sector entity to major assets owned by the entity, including expenditure on:

- capital renewal of existing assets that returns the service potential or the life of the asset to that which it had originally
- capital expansion which extends an existing asset at the same standard to a new group of users.

Clear audit opinion

An unqualified audit opinion is provided when the financial statements present fairly the transactions and balances for the reporting period in accordance with the relevant legislative framework.

Corporations Act 2001

The *Corporations Act 2001* is an act of the Commonwealth of Australia that sets out the laws dealing with business entities in Australia at federal and interstate levels. It focuses primarily on companies, although it also covers some laws relating to other entities such as partnerships and managed investment schemes.

Depreciation

The systematic allocation of the depreciable amount of an asset over its expected useful life.

Emphasis of matter

An auditor's report can include an emphasis of matter paragraph that draws attention to a disclosure or item in the financial report. The addition of an emphasis of matter does not affect the auditor's opinion.

Entity

Is a body whether corporate or unincorporated that has a public function to exercise on behalf of the state, or is wholly owned by the state, including: departments, statutory authorities, statutory corporations and government business enterprises.

Expense

Outflows or other depletions of economic benefits in the form of incurrence of liabilities or depletion of assets of the entity, other than those relating to contributions by owners, that results in a decrease in equity during the reporting period.

Financial Management Act 1994

The *Financial Management Act 1994* was developed to improve financial administration and accountability and provide for annual reporting to Parliament by all Victorian public sector agencies.

Financial sustainability

An entity's ability to manage financial resources so it can meet spending commitments, both at present and into the future.

Financial reporting direction

Financial reports are prepared in accordance with Australian Accounting Standards and Interpretations as issued by the Australian Accounting Standards Board (AASB). Where an AASB standard provides accounting treatment options, the Minister for

Finance issues financial reporting directions to ensure consistent application of accounting treatment across the Victorian public sector in compliance with that particular standard.

Financial year

The 12-month period from 1 July to 30 June each year.

Internal control

A process affected by an entity's structure, work and authority flows, people and management information systems, designed to assist the entity accomplish specific goals and objectives. Internal control is a means by which an entity's resources are directed, monitored and measured. It plays an important role in preventing and detecting fraud and protecting the entity's resources.

Investment

The expenditure of funds intended to result in medium- to long-term service and/or financial benefits arising from the development and/or use of infrastructure or assets by either the public or private sectors.

Liability

A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

Materiality

Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial report. Materiality depends on the size or nature of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.

Qualified opinion in the auditor's report

The types of qualified opinions in an auditor's report and the basis for issuing these opinions is as follows:

- A 'qualified opinion' is expressed when the auditor concludes that an unqualified opinion cannot be expressed due to a disagreement with management, a conflict between applicable financial reporting frameworks or a scope limitation; however the effect is not so material and pervasive as to require an adverse opinion or a disclaimer of opinion. The qualified opinion is expressed as being 'except for' the effects of the matter to which the qualification relates.

- A 'disclaimer of opinion' is expressed when a limitation of scope of the auditor's work exists and the possible effect of the limitation on scope is so material and pervasive that the auditor has not been able to obtain sufficient appropriate audit evidence and accordingly is unable to express an opinion on the financial statements.
- An 'adverse opinion' is expressed when the effect of a disagreement with management or a conflict between applicable financial reporting frameworks is so material or pervasive to the financial statements that the auditor concludes that a qualification is not adequate to disclose the misleading or incomplete nature of the financial statements.
- An 'emphasis of matter' is expressed in certain circumstances to draw attention to, or emphasise, a matter that is included in the note to the financial statements that is relevant to the users of the auditor's report but is not of such nature that is affects the auditor's opinion (i.e. the auditor's opinion remains unmodified). The circumstances in which an emphasis of matter is used are specified and include:
  - when a significant uncertainty exists, the resolution of which depends upon future events and which may materially affect the financial statements
  - when information in a document containing the audited financial statements is materially inconsistent with the financial statements
  - when financial statements and the auditor's report have been issued and a fact is discovered that leads to revised financial statements and a new auditor's report being prepared.

Revenue

Inflows or other enhancements or savings in outflows of service potential, or future economic benefits in the form of increases in assets or reductions in liabilities of the entity, other than those relating to contributions by owners which results in an increase in equity during the reporting period.

Risk

The chance of a negative impact on the objectives, outputs or outcomes of the entity.

Standard statements

Prepared by local councils, standard statements mirror the three general purpose financial statements with additional columns showing the original approved budget and a variance. A supporting narrative statement explains material variances between actual and budgeted results.

Appendix B.

VAGO reports on results of audits

Figure B1
VAGO reports on results of audits

Report	Description
Portfolio Departments: Interim Results of the 2009–10 Audits (2010–11:1 tabled 28 July 2010	Reported on the interim results of audits of the 11 portfolio departments. It examined the effectiveness of internal controls for IT systems; for identifying, declaring and managing conflicts of interest; and for procurement. It also commented on financial reporting developments.
Local Government: Interim Results of the 2009–10 Audits (2010–11:3 tabled 11 August 2010)	Reported on the interim results of audits of 79 local councils, 13 agencies they control and 12 regional library corporations. It examined the effectiveness of internal controls supporting the preparation of the financial reports, controls over conflicts of interest and IT change management.
Water Entities: Interim Results of the 2009–10 Audits (2010–11:4 tabled 11 August 2010)	Reported on the interim results of audits of 19 water entities. It examined the effectiveness of internal control supporting the preparation of the financial reports and aspects of how they manage capital projects and creditors.
Public Hospitals: Interim Results of the 2009–10 Audits (2010–11:5 tabled 1 September 2010)	Reported on the interim results of audits of approximately 110 agencies in the sector. It examined the effectiveness of internal control supporting the preparation of the financial reports and aspects of how they manage leave and creditors.
Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2009–10 (2010–11:16 tabled 7 October 2010)	Provided the result of the audit of the state's annual financial report. It examined the quality and timeliness of financial reporting, explained significant financial results for the state and made observations on the status and financial implications of the more significant projects and developments.
Acquittal Report: Results of the 2009–10 Audits (this report)	Provides the results of the annual financial statement audits of 445 agencies across the portfolio departments and associated entities, and the local government, public hospital and water sectors. The report comments on the quality of financial reporting and financial sustainability.

Figure B1
VAGO reports on results of audits – *continued*

Report	Description
Tertiary Education and Other Entities: Results of the 2010 Audits	The report will provide the results of the annual financial statement audits of approximately 110 entities that end their financial year other than on 30 June 2010. It will examine timeliness of their financial and performance reporting, the effectiveness of their internal control, their financial sustainability and aspects of how they manage creditors, employee costs and student fee revenue. *Scheduled to be tabled in Parliament in May 2011.*

Source: Victorian Auditor-General's Office.

Appendix C.
Financial audit framework

An annual financial audit has two aims:

- to give an opinion consistent with section 9 of the *Audit Act 1994*, about whether financial reports are fairly stated
- to consider whether there has been any wastage of public resources or any lack of probity or financial prudence in the management or application of public resources, consistent with section 3A(2) of the *Audit Act 1994*.

The financial audit framework applied in the conduct of the 2009–10 audits is set out in the Figure C1.

Figure C1
Financial audit framework

Planning

Planning is not a discrete phase of a financial audit, rather it continues throughout the engagement. However, initial audit planning is conducted at two levels:

- At a high or entity level, planning involves obtaining an understanding of the entity and its environment, including its internal controls. The auditor identifies and assesses: the key risks facing the entity; the entity's risk mitigation strategies; any significant recent developments; and the entity's governance and management control framework.
- At a low or financial reports line item level, planning involves the identification, documentation and initial assessment of processes and controls over management, accounting and information technology systems.

The output from the initial audit planning process is a detailed audit plan and a client strategy document, which outlines the proposed approach to the audit. This strategy document is issued to the client after initial audit planning and includes an estimate of the audit fee.

Conduct

The conduct phase involves the performance of audit procedures aimed at testing whether or not financial statement balances and transactions are free of material error. There are two types of tests undertaken during this phase:

- Tests of controls, which determine whether controls identified during planning were effective throughout the period of the audit and can be relied upon to reduce the risk of material error.
- Substantive tests, which involve: detailed examination of balances and underlying transactions; assessment of the reasonableness of balances using analytical procedures; and a review of the presentation and disclosure in the financial reports, for compliance with the applicable reporting framework.

The output from this phase is a final (and possibly an interim) management letter which details significant findings along with value-adding recommendations on improving controls and processes. These documents are issued to the client after any interim audit work and during the reporting phase.

Reporting

The reporting phase involves the formal presentation and discussion of audit findings with the client management, and/or the audit committee. The key outputs from this process are:

- A signed audit opinion, which is presented in the client's annual report alongside the certified financial reports.
- A report to Parliament on significant issues arising from audits either for the individual entity or for the sector as a whole.

Source: Victorian Auditor-General's Office.

Appendix D.
Better practice—financial report preparation

Figure D1
Selected better practice—financial report preparation

Key area	Better practice
Financial report preparation plan	A plan should be established which outlines the processes, resources required, milestones, oversight, and quality assurance practices required in preparing the financial report.
Preparation of shell statements	The preparation and timely provision of a shell financial report to audit allows for early identification of amendments, minimising the need for significant disclosure changes at year-end.
Materiality assessment	An assessment of materiality, including quantitative and qualitative thresholds, should be established at the planning phase in consultation with the audit committee. Materiality assists the preparers in assessing potential errors in the financial report.
Monthly financial reporting	Full accrual monthly reporting should be adopted to assist in preparing the annual financial report. This allows for the year-end process to be an extension of the month-end process.
Rigorous quality control and assurance procedures	A review of the supporting documentation, data and the financial report itself should be undertaken by an appropriately experienced and independent officer prior to providing to audit.
Supporting documentation	Documentation should be of a high standard, support and validate the financial report, and provide a management trail.
Rigorous analytical reviews	Rigorous and objective analytical review procedures should be undertaken during the financial report preparation process to help to improve the accuracy of the financial report.
Reviews of controls/self assessment	Quality control and assurance processes should be sufficiently robust to provide assurance to the audit committee as to the accuracy and completeness of the financial report.
Competency of staff	Preparers of the financial report should have a good understanding and experience in applying relevant accounting standards and legislation. In addition they require project management and interpersonal skills.
Financial compliance reviews	Periodic compliance reviews should be undertaken to identify areas of non-compliance or changes to legislation that impact the financial report.
Adequate security	Sensitive information should be protected and safeguarded throughout the process to prevent inappropriate public disclosure.

Source: Victorian Auditor-General's Office and Australian National Audit Office Better Practice Guide *Preparation of Financial Statements June 2009*.

Assessment of each entity's performance against better practice was based on the following criteria:

- **no existence**—function not conducted by the entity
- **developing**—partially encompassed in the entity's financial reporting preparation processes
- **developed**—entity has implemented the process, however it is not fully effective or efficient
- **better practice**—entity has implemented processes which are effective and efficient.

The ranking in each area reflects our assessment of the adoption, efficiency and effectiveness of each better practice.

Appendix E.

Financial sustainability indicators and criteria

Figure E1
Four core indicators of financial sustainability

Indicator	Formula	Description
Underlying result (%)	Adjusted net result/ underlying revenue	A positive result indicates a surplus, and the larger the percentage the stronger the result. A negative result indicates a deficit. Operating deficits cannot be sustained in the long term. Net result and total underlying revenue is obtained from the comprehensive operating statement and is adjusted to take into account large one-off (non-recurring) transactions.
Liquidity	Current assets/ current liabilities	This measures the entity's ability to pay existing liabilities in the next 12 months. A ratio of one or more means that there are more cash and liquid assets than short-term liabilities. Current liabilities have been adjusted to exclude those liabilities not expected to be settled within the next 12 months including employee provisions and prepaid funerals.
Self-financing (%)	Net operating cash flows/ underlying revenue	Measures the ability to replace assets using cash generated by operations. The higher the percentage the more effectively this can be done. Net operating cash flows are obtained from the cash flow statement.
Capital replacement	Cash outflows for property plants and equipment/ depreciation	Comparison of the rate of spending on infrastructure, property, plant and equipment and intangibles with depreciation. This is a long-term indicator, as capital expenditure can be deferred in the short term if there are insufficient funds available from operations, and borrowing is not an option. Cash outflows for property, plant, equipment, infrastructure and intangibles are taken from the cash flow statement. Depreciation and amortisation is taken from the comprehensive operating statement.

Source: Victorian Auditor-General's Office.

Figure E2
Additional sector specific indicators

Indicator	Formula	Description
Local government		
Indebtedness (%)	Non-current liabilities/ Own-sourced revenue	Comparison of non-current liabilities (mainly comprised of borrowings) to own-sourced revenue. The higher the percentage, the less able councils are to cover non-current liabilities from the revenues they generate themselves. Own-sourced revenue is used (rather than total revenue) because it does not include capital grants, which are usually tied to specific projects.
Renewal gap	Renewal and upgrade expenditure/ Depreciation	Comparison of the rate of spending on existing infrastructure, property, plant and equipment through renewing, restoring and replacing existing assets with depreciation. Ratios higher than 1:1 indicate that spending on existing assets is greater than the depreciation rate. Similar to capital replacement, this is a long-term indicator, as capital expenditure can be deferred in the short term if there are insufficient funds available from operations, and borrowing is not an option.
Public hospitals		
Average number of days cash available	Cash balance at year-end/ (operating cash outflow/365)	Measures how many days of operating cash outflows can be funded by the cash balance at year-end. Cash and cash equivalents balance is obtained from the balance sheet and excludes monies held in trust and restricted funds. Operating cash outflows are obtained from the cash flow statement.
Water entities		
Interest coverage	Net operating cash flows before net interest and tax payments/net interest payments	This measures the entity's ability to meet ongoing interest payments and therefore service debt. Net operating cash flows and net interest and tax payments are obtained from the cash flow statement.
Debt-to-equity (%)	Debt/equity	This is a longer-term measure that compares all current and non-current interest-bearing liabilities to equity. It complements the liquidity ratio, which is a short-term measure. A low ratio indicates less reliance on debt to finance the capital structure of an organisation.

Source: Victorian Auditor-General's Office.

Financial sustainability risk assessment

The financial sustainability of entities has been assessed using the risk assessment criteria outlined in Figure E3.

Figure E3
Financial sustainability indicators—risk assessment criteria

	Core indicators				Sector specific indicators				
Risk	**Underlying result (%)**	**Liquidity**	**Self-financing (%)**	**Capital replacement**	**Indebtedness (%)**	**Renewal gap**	**Average number of days cash held**	**Interest coverage**	**Debt-to-equity (%)**
High	**Negative 10% or less**	**Equal to or less than 1.0**	**Less than 10%**	**Equal to or less than 1.0**	**More than 60%**	**Equal to or less than 0.5**	**Equal to or less than 15 days**	**Equal to or less than 1.0**	**More than 60%**
	Insufficient revenue is being generated to fund operations and asset renewal.	Insufficient current assets to cover liabilities.	Insufficient cash from operations to fund new assets and asset renewal.	Spending on capital works has not kept pace with consumption of assets.	Potentially long-term concern over ability to repay debt levels from own-source revenue.	Spending on existing assets has not kept pace with consumption of these assets.	Insufficient cash is held to fund operations.	Insufficient interest cover to meet ongoing interest payments.	Long-term concern with ability to repay debt.
Medium	**Negative 10% to zero**	**1.0–1.5**	**10–20%**	**1.0–1.5**	**40–60%**	**0.5–1.0**	**15–30 days**	**1.0–2.0**	**40–60%**
	A risk of long-term run down to cash reserves and inability to fund asset renewals.	Need for caution with cash flow, as issues could arise with meeting obligations as they fall due.	May not be generating sufficient cash from operations to fund new assets.	May indicate spending on asset renewal is insufficient.	Some concern over the ability to repay debt from own-source revenue.	May indicate insufficient spending on renewal of existing assets.	May indicate insufficient cash is available to fund operations.	May not be able to service debt as interest payments fall due.	May indicate concern over the ability to repay debt.
Low	**More than zero**	**More than 1.5**	**20% or more**	**More than 1.5**	**40% or less**	**More than 1.0**	**More than 30 days**	**More than 2.0**	**40% or less**
	Generating surpluses consistently.	No immediate issues with repaying short-term liabilities as they fall due.	Generating enough cash from operations to fund assets.	Low risk of insufficient spending on asset renewal.	No concern over the ability to repay debt from own-source revenue.	Low risk of insufficient spending on asset base.	Low risk of insufficient cash available to fund operations.	Low risk of debt servicing issues.	Low risk of not repaying debt from own-source revenue.

Source: Victorian Auditor-General's Office.

The risk assessment of the liquidity indicator at public hospitals is based on criteria that differs to that set out above. The Department of Health considers a public hospital as a liquidity concern if the indicator is below 0.7, and a medium risk if between 0.7 and 1.0. There are no liquidity concerns if the indicator is above one.

The overall financial sustainability risk assessment is calculated using the ratings determined for each indicator outlined in Figure E4.

Figure E4
Overall financial sustainability risk assessment

● (red)	High risk of short-term and immediate sustainability concerns indicated either: • **red** underlying result indicator • **red** liquidity indicator • **red** average number of days cash available indicator (public hospitals) • **red** interest coverage indicator (water).
● (orange)	Medium risk of longer-term sustainability concerns indicated by either: • **red** self-financing indicator • **red** self-financing indicator and red indebtedness indicator (local government) • **red** capital replacement indicator • **red** renewal gap indicator (local government) • **red** debt-to-equity indicator (water).
● (green)	Low risk of financial sustainability concerns—there are no high-risk indicators.
▲	An increasing indicator that is an improving trend.
■	No substantial trend.
▼	A decreasing indicator that is a deteriorating trend.

Source: Victorian Auditor-General's Office.

Appendix F.

Audit Act 1994 section 16—submissions and comments

Introduction

In accordance with section 16(3) of the *Audit Act 1994* a copy of this report, or relevant extracts from the report, was provided to portfolio departments and named agencies with a request for submissions or comments.

The submissions and comments provided for publication are not subject to audit nor the evidentiary standards required to reach an audit conclusion. Responsibility for the accuracy, fairness and balance of those comments rests solely with the agency head.

Contents

Submissions and comments received

RESPONSE provided by the Secretary of the Department of Health

Department of Health

Secretary

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Melbourne Victoria 3001
DX 210311
www.health.vic.gov.au
Telephone: 1300 253 942
Facsimile: 1300 253 964

e2150738

Mr D D R Pearson
Auditor-General
Level 24, 35 Collins Street
MELBOURNE VIC 3000

Dear Mr Pearson 17/01

Thank you for your letter of 14 December 2010 inviting me to comment on the forthcoming *Acquittal Report: Results of the 2009-10 Audits*.

I can confirm that I am satisfied with the fairness and accuracy of the report, although the draft report blacks out the summary information of the five year average financial sustainability results for each public hospital category in Figure E (page 9), so I am unable to form a view as to the table contents and what looks to be further commentary below that table.

There is also a factual error in the number of hospitals receiving letters of comfort in 2009-10, which should be amended from 22 to 31, copies of which will be provided to your office.

I would like to include a succinct response to your findings and recommendation which is included as Attachment 1.

I would like to thank your staff for the manner in which the audit has been conducted.

Yours sincerely

FRAN THORN
Secretary

Encl. Attachment 1

State Government Victoria

RESPONSE provided by the Secretary of the Department of Health – continued

Attachment 1

RESPONSE provided by the Secretary, Department of Health

I believe the report generally provides a balanced analysis of the issues of public hospital financial sustainability.

While 26 public hospitals were assessed as high risk at 30 June 2010, the report acknowledges that this arises most commonly because hospitals were assessed as generating insufficient cash to be able to adequately fund their operations. The department continues to pay grants twice each month and closely monitor hospital financial performance.

The audit makes some observations in regard to better practice in the preparation of financial reports where there is always room for improvement particularly in the areas identified.

Recommendation

Entities should adopt the shortened annual reporting time frames achieved for the 2009-10 reporting cycle as the standard for future reporting cycles.

Recommendation 1

Agree in principle.

A statewide approach to an earlier reporting cycle is agreed in principle. As acknowledged in the report, the earlier timeframe was a result of the timing of the 2010 State election and this challenging timeframe should be revisited as part of a whole of government assessment of the related risks and benefits.

RESPONSE provided by the Secretary of the Department of Planning and Community Development

Department of Planning and Community Development

1 Spring Street
Melbourne Victoria 3000
GPO Box 2392
Melbourne Victoria 3001
Telephone: (03) 9208 3333
Facsimile: (03) 9208 3680

Ref: CSEC002377

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

Dear Mr Pearson 14/01

AUDIT ACT 1994, S16(3) - PROPOSED AUDIT REPORT - ACQUITTAL REPORT: RESULTS OF THE 2009-10 AUDITS

Thank you for your letter dated 14 December 2010 seeking the Department of Planning and Community Development's (DPCD) comments for inclusion in the proposed audit report, *Acquittal Report: Results of the 2009-10 Audits.*

DPCD comments on the report are enclosed.

Please contact [redacted] should you require any further information.

Yours sincerely

Yehudi Blacher
SECRETARY

Victoria
The Place To Be

RESPONSE provided by the Secretary of the Department of Planning and Community Development – continued

<u>**Attachment 1**</u>

DPCD comments on proposed audit report – acquittal report: results of the 2009-10 audits

Financial sustainability measures	In relation to the financial sustainability measures, DPCD would like to reiterate its concerns from previous years about use of the measures, particularly for the States Sports Centres Trust and Queen Victoria Women's Centre Trust. The current measures do not adequately take into account the government funding model currently used by both trusts. This issue was raised with the Auditor-General in response to the 2007-08 and 2008-09 audit reports (refer Attachment 2). In 2009-10, the net surplus for the States Sports Centre and Queen Victoria Women's Centre Trusts were $62,000 and $10,000 respectively.
Financial sustainability calculation of averages	DPCD has concerns regarding the calculation of averages for the five-year financial sustainability rating. The current calculation does not take into account the relative differences in modes of operation of the Department's entities. The report should also note that some of the entities have only been with DPCD since 2008. This issue was raised with the Auditor-General in response to the 2008-09 audit (refer Attachment 2).
Local councils	The Department has no concern in regard to the accuracy and fairness of the Report as they pertain to the results of the financial audits of local government for 2009-10. DPCD notes the Auditor-Generals report on the overall improvement in the financial sustainability of councils.

RESPONSE provided by the Secretary of the Department of Planning and Community Development – continued

Attachment 2:

DPCD comments on proposed audit report – acquittal report: results of the 2008-09 audits

RESPONSE provided by the Secretary, Department of Planning and Community Development

The report offers a valuable assessment of the Department of Planning and Community Development (DPCD) and its associated entities. While DPCD is generally in agreement with the overall proposed report, there is one specific area that we would like to bring to your attention.

As with the previous year, the Department continues to have concerns regarding the use of financial sustainability measures particularly for the State Sport Centre Trust (SSC) and the Queen Victoria Women's Centre Trust (QVWC). Any analysis about the financial performance and sustainability of the SSC and QVWC should be considered in light of their current business models which are as follows:

- *Under the SSC model any large new capital projects or substantial refurbishments are funded from government appropriations. These have included the $50 million redevelopment of the Melbourne Sports and Aquatic Centre in Albert Park. The redevelopment, which included the construction of an Olympic sized outdoor pool and hydrotherapy pool, have been used to host major international events such as the Commonwealth Games in 2006 and FINA World Championships in 2007.*
- *The QVWC model is underpinned by the former Queen Victoria Memorial Hospital heritage building which was gifted to the Trust in 1994.*

Based on the business model of both Trusts, a more suitable measure of sustainability and financial performance is the operating result excluding depreciation. It is appropriate to exclude depreciation in this circumstance as the Trusts are generally not required to fund significant capital expenditures.

For the SSC, the average net result over the four years from 2005–06 to 2008–09 with depreciation excluded was an average surplus of $331,000. This equates to an underlying result of 2.75 per cent (compared to -41.94 per cent cited in your report). For the QVWC, the average net result over the four years from 2005–06 to 2008–09 with depreciation excluded was an average surplus of $75,000. This equates to an underlying result of 8.24 per cent (compared to -34.28 per cent cited in your report).

I would also like to draw your attention to the calculation used to derive the Portfolio average which is also on page 59 of the report. This calculation is based on a simple average of DPCD entities. This method of calculation does not reflect the relative differences of magnitude of the various operating positions of the entities listed. Therefore, it would be more appropriate to calculate a weighted portfolio average, which would give a better, more robust indication of the total overall financial sustainability of the Department's portfolio entities.

Victorian Auditor-General's Report *Portfolio Departments and Associated Entities: Results of the 2008–09 Audits* xv

RESPONSE provided by the CEO of the City of Wodonga

14 January 2011

CITY OF WODONGA
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Enquiries: Trevor Ierino
Reference: A10.0014 OUT

D.D.R. (Des) Pearson
Auditor General
Level 24,
35 Collins Street
Melbourne VIC 3000

Dear Mr Pearson,

Re: 2009/10 Financial Performance of Councils

Thank you for the opportunity to provide comment on your report on the financial performance of Councils for the 2009/10 financial year.

You have provided us with extracts of data and commentary from your proposed report which we have reviewed and wish to comment on.

Whilst we agree with the accuracy of the data with respect to the City of Wodonga, we believe in order to provide a more complete and conclusive understanding of Council's future financial sustainability, the following points should be taken into account by readers of the report:-

1. Council's investment at LOGIC was always with a long term view of some 20-25 years. LOGIC has been a success story for Wodonga with regard to actual land sales themselves, but more importantly, the jobs and economic activity generated by the additional investment by the purchasers of land. Land sales to date have exceeded the "most likely case" envisaged in the original business plan. To date at more than 500 direct jobs and many indirect jobs on an ongoing basis have been created, more than $130 million worth of development has occurred, generating an annual rate receipt of $490,000.

2. Logic is conservatively valued in the balance sheet as at 30 June 2010 at $27.2m under the historical cost convention in accordance with accounting standards. The City of Wodonga is confident, however, that its market value is far greater, and that eventual sales at Logic will be well in excess of the current book value. This has been confirmed by confidential independent land valuations commissioned by the City of Wodonga.

3. Council has land holdings that council has identified as surplus to its needs. These assets are in the process of being divested, with land valued in the order of $9 million being put to the market in the very near future.

4. Wodonga City Council's Strategic Resource Plan (SRP) does not rely upon the realisation of LOGIC or any other land sale proceeds which are currently in the process of eventuating. A copy of the SRP can be found under Documents and Publications at www.wodonga.vic.gov.au.

CITY OF WODONGA VIC

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RESPONSE provided by the CEO of the City of Wodonga – continued

5. Council's Strategic Resource Plan provides for a long term prudent financial management platform to ensure the City of Wodonga's key strategic activities are able to be achieved. Also, emphasis on the implementation of a strong asset management ethos will see the knowledge of the City's investment gap strengthened. By linking asset management to the City's strategic financial direction this will provide further information to assist in improving the long term sustainability of the City.

6. City of Wodonga has communicated a clear and concise financial strategy to its community. It is our strong and clear view that the City's finances are sustainable and that the strategies that have already been put in place will ensure that rates growth will not be compromised, whilst delivering the services, assets, and events expected by the Wodonga community.

The Council believes consideration of the above points provides for Council's outstanding debt to be extinguished in its entirety with a significantly amount remaining for cash reserves in the longer term. We trust that the above explanation provides clarification to readers of the report to the financial sustainability indicators developed by your office.

Yours sincerely

Gavin Cator
Chief Executive Officer

RESPONSE provided by the CEO of the Yarra Plenty Regional Library

Yarra Plenty Regional Library

Monday 20 December 2010

Mr D D R Pearson
Auditor-General
Victorian Auditor General's Office
Level 24, 35 Collins Street
Melbourne 3000

Dear Mr Pearson

Acquittal Report: Results of the 2009 – 10 Audits

Please find attached comments from Yarra Plenty Regional Library for inclusion in the report to be tabled in Parliament in February 2011.

Yours sincerely

Christine Mackenzie
CEO

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RESPONSE provided by the CEO of the Yarra Plenty Regional Library – continued

Comments for inclusion in the Acquittal Report: Results of the 2009 – 10 Audits

From Yarra Plenty Regional Library (YPRL)

Despite correspondence and meetings with VAGO discussing the high risk rating for the Library Service, there has been no movement by VAGO to amend the rating of "high risk" assigned to YPRL.

The following information is presented in light of this assessment:

1. YPRL's 2009/10 General Purpose Financial Report and Standard Statements were unqualified by VAGO who advised that the 'financial report presents fairly in all material aspects in accordance with applicable accounting standards and the financial reporting requirements of the Local Government Act 1989.' As YPRL received an unqualified opinion, it can be implied VAGO believes that YPRL can meet their commitments as they fall due.

2. VAGO's 2009/10 Closing Report and Management Letter did not include any reference to YPRL being at a high financial sustainability risk.

3. YPRL's 'underlying deficit' was discussed at length at the YPRL Audit Committee Meeting on 9 September 2010. The Director responsible for Local Government from VAGO was in attendance at that meeting when the Board Members indicated their dissatisfaction with the accounting treatment (in accordance with the Australian Accounting Standards) of $1.187 million Council Contribution Income that was paid in June 2009 but related to the 2009/10 financial year. The Accounting Standards treatment does not allow these funds to be shown as 'income received in advance' in the year they are received, thereby distorting the financial results for the particular years - in this case the 2008/09 income was overstated by this $1.187 million and the 2009/10 income understated by this amount. This resulted in the 2009/10 underlying result being a deficit of $881,000 - if the correct yearly income could have been shown the result would have been an underlying surplus of $306,000.

4. The Board's 2009/10 General Purpose Financial Report explained this in Note 2(b) with the 2009/10 Standard Statements referred to this situation on note 1(b).

5. The Board's Liquidity ratio is adversely affected by the majority of its Long Service Liability being treated as a current liability - $857,000 of the total liability of $913,000 is treated as current. The adjusted liquidity ratio (refer Note 26 (b) of the 2009/10 General Purpose Financial Report) is 1.73. This adjusted ratio is a much more reliable liquidity measure. It should be noted that the Board's Long Service Leave liability is fully 'cash backed' in a separate bank account in full compliance with the Local Government Long Service Leave regulations. This must be considered when assessing financial sustainability.

6. The Board has confidence that in the unlikely event that it is required to liquidate it has sufficient assets, both cash and non cash, to cover all liabilities.

7. YPRL has the full support of its three Member Councils – Whittlesea, Nillumbik and Banyule. The following statement has been made by these three Councils:

RESPONSE provided by the CEO of the Yarra Plenty Regional Library – continued

"The Councils accept that Yarra Plenty Regional Library was incorporated under Section 196 of the Victorian Local Government Act 1989 and is dependent on funding from Member Councils for its continued existence and ability to carry out its normal activities. The Yarra Plenty Regional Library Service has the full financial support of its three Member Councils as part of the Library's Agreement which reduces any viability risk to nil".

8. The three Member Councils of YPRL are not high risk. This must be taken into account when evaluating the sustainability of YPRL.

To determine the financial sustainability of YPRL based on the timing of cash contributions from Member Councils and the Long Service Leave delineation between 'current and non-current' cannot be construed as any form of financial sustainability analysis. YPRL operates on an annual cash based operational and capital budget, with the majority of funding from Member Councils. The Board's 2010/11 Budget provides for the following funding contributions:

Member Councils – 77.5%

Government Grants – 16.2%

Library Fees – 6.3%

YPRL refutes VAGO's methodology to determine its financial sustainability. This methodology is obviously flawed. The criteria that VAGO applies to Victorian Councils to measure financial sustainability should not apply to Regional Library Corporations.

CMackenzie

Christine Mackenzie

CEO

Auditor-General's acquittal response to the CEO of the Yarra Plenty Regional Library

VAGO

Victorian Auditor-General's Office

17 January 2011 File No. 26471/01

Christine Mackenzie
CEO
Yarra Plenty Regional Library
Bag 65
Bundoora VIC 3083

Dear Ms Mackenzie

Acquittal Report: Results of the 2009-10 audits

I refer to your letter of 20 December 2010 providing comments on the above report.

You assert in your response that, as the Yarra Plenty Regional Library Corporation (YPRL) received an unqualified audit opinion, it can be implied that the Victorian Auditor General's Office believes that YPRL can meet their commitments as they fall due. You infer that the unqualified audit opinion contradicts the financial sustainability analysis in the report. This is not correct.

The financial sustainability of the YPRL is assessed during each financial audit as required by Australian auditing standards. In that assessment, the financial support and commitment of member councils is relied on when forming a view on the YPRL's ability to meet its financial obligations when they fall due. Without the commitment of financial support from member councils, the 2009-10 financial statements of the YPRL would have been qualified. The fact that your member councils provide commitments of financial support confirms the financial sustainability risk assessment made in our report.

In your response you state the view that the methodology applied to calculate the financial sustainability for libraries is obviously flawed. In particular you identify concerns with the calculation of the financial sustainability indicators for underlying deficit and liquidity. I disagree with your conclusion.

The 2009-10 financial statements of the YPRL were prepared in accordance with Australian accounting standards and reported a comprehensive result of a deficit of $881,273. You certified that these financial statements presented fairly the financial balances and transactions for the year ended 30 June 2010. Our financial sustainability analysis is performed using your financial statements. If the YPRL and member councils are dissatisfied with the requirements of Australian accounting standards, these concerns should be raised with the Australian Accounting Standards Board.

Level 24, 35 Collins Street, Melbourne Vic. 3000
Telephone 61 3 8601 7000 Facsimile 61 3 8601 7010 Email comments@audit.vic.gov.au Website www.audit.vic.gov.au

Auditing in the Public Interest

Auditor-General's acquittal response to the CEO of the Yarra Plenty Regional Library – continued

VAGO

Victorian Auditor-General's Office

The YPRL has a current long service leave liability of $835,921. As required by the *Local Government Act 1989*, an asset of $810,000 in cash has been set aside to cover the liability. In calculating the liquidity ratio these two amounts offset each other and have no effect. It would be misleading to omit the current long service leave liability and not the corresponding asset when calculating liquidity.

Yours sincerely

D D R Pearson
Auditor-General

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Auditing in the Public Interest

Auditor-General’s reports

Reports tabled during 2010–11

Report title	Date tabled
Portfolio Departments: Interim Results of the 2009–10 Audits (2010–11:1)	July 2010
Taking Action on Problem Gambling (2010–11:2)	July 2010
Local Government: Interim Results of the 2009–10 Audits (2010–11:3)	August 2010
Water Entities: Interim Results of the 2009–10 Audits (2010–11:4)	August 2010
Public Hospitals: Interim Results of the 2009–10 Audits (2010–11:5)	September 2010
Business Continuity Management in Local Government (2010–11:6)	September 2010
Sustainable Farm Families Program (2010–11:7)	September 2010
Delivery of NURSE-ON-CALL (2010–11:8)	September 2010
Management of Prison Accommodation Using Public Private Partnerships (2010–11:9)	September 2010
Soil Health Management (2010–11:10)	October 2010
Sustainable Management of Victoria's Groundwater Resources (2010–11:11)	October 2010
The Department of Human Services’ Role in Emergency Recovery (2010–11:12)	October 2010
Access to Ambulance Services (2010–11:13)	October 2010
Management of the Freight Network (2010–11:14)	October 2010
Security of Infrastructure Control Systems for Water and Transport (2010–11:15)	October 2010
Auditor-General’s Report on the Annual Financial Report of the State of Victoria, 2009–10 (2010–11:16)	October 2010
Restricting Environmental Flows during Water Shortages (2010–11:17)	October 2010
Victorian Registration and Qualifications Authority (2010–11:18)	October 2010

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VAGO

Victorian Auditor-General's Office

Auditing in the Public Interest

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- Victorian Auditor-General's Office
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