Technical and Further Education Institutes: Results of the 2013 Audits

Victorian Auditor-General's Report

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Technical and Further Education Institutes: Results of the 2013 Audits

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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. Christine Fyffe MP
Speaker
Legislative Assembly
Parliament House
Melbourne

Dear Presiding Officers

Under the provisions of section 16AB of the *Audit Act 1994*, I transmit my report *Technical and Further Education Institutes: Results of the 2013 Audits*.

This report summarises the financial reports of 14 technical and further education (TAFE) institutes and the 13 entities that they control at 31 December 2013.

It informs Parliament about significant issues identified during our audits and complements the assurance provided through individual audit opinions included in the entities' annual reports.

The report highlights that many TAFEs have not effectively adapted to the changed operating environment, and consequently the financial sustainability of the sector has declined.

The report also comments on performance reporting by TAFEs, and notes that the lack of appropriate direction by the Department of Education and Early Childhood Development has resulted in inconsistent presentation of performance information that is not easily comparable across the sector. While a new strategic planning framework being introduced in 2014 provides a number of improvements, further work is required to establish a robust and high quality performance reporting framework.

Yours faithfully

John Doyle
Auditor-General

6 August 2014

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John Doyle
Auditor-General

Audit team

Tim Loughnan
Sector Director

Michael Almond
Team Leader

Matthew Graver
Audit Senior

Ryan Ackland
Alex Mulholland
Auditors

Ellen Holland and
Simone Bohan
Engagement Quality Control Reviewers

Victoria's technical and further education (TAFE) institutes deliver post-secondary vocational educational services to both domestic and international students. There have been substantial changes to the market settings in the TAFE sector over recent years, culminating in changes to the funding model that were implemented by the government in 2012. These changes are designed to increase competition for students between public and private sector vocational training providers, and further changes for the sector have been foreshadowed.

One consequence of this changed operating environment in the TAFE sector has been a net deficit of $16.2 million in 2013—a $74.8 million deterioration from the $58.6 million surplus of 2012. The main driver for this result has been a decrease of $116.3 million—15 per cent—in government operating and capital grants.

These results suggest that many TAFEs have more work to do to effectively adapt to the sector's structural changes. While a majority of TAFEs reduced their expenditure during the year, the cost reductions and increases in student fee revenue were not sufficient to offset the reductions in operating funds from government.

The decline in financial performance is reflected in a significant decline in the financial sustainability of the sector. There are immediate or short-term financial challenges at five TAFEs causing their financial sustainability risk to be rated as high. A further eight TAFEs were assessed as medium risk, which continues the pattern of deterioration over the past five years. Against the trend, Chisholm Institute's financial sustainability risk rating improved in 2013.

Nevertheless, there are some positives that can be drawn from this report. Four TAFEs reported a surplus and improved financial performance in 2013—Chisholm, Goulburn Ovens, Kangan and Sunraysia. Restructuring arrangements undertaken early by these TAFEs—such as increasing the level of courses provided through third parties, changed course offerings, staff redundancies, campus rationalisation and reducing operating costs—have set them on a financially viable pathway, and they are to be commended.

More flexible financing arrangements for the sector were approved by the government in 2013, and TAFEs are now able to incur borrowings, subject to approval by the Treasurer. TAFEs currently have very low debt levels and although they now have more opportunity to use debt as a business tool, they should do so with caution. In particular, TAFEs should consider their capacity to service and repay debt in the context of their underlying results and any liquidity issues.

Disappointingly, performance reporting across the sector remains poor. Although clear audit opinions were issued on all 19 performance reports for 2013, the TAFE sector did not have a framework that mandates a core suite of relevant and appropriate key performance indicators, nor is there sufficient guidance to entities for establishing suitable targets and analysing performance. As a result, the sector's performance reporting remained underdeveloped and inconsistent, lacked clear direction and targets, and therefore did not facilitate comparison of performance across the sector or between years. This means that Parliament and the public are unable to monitor and assess the progress of TAFEs in this new operating environment.

The Department of Education and Early Childhood Development has a key leadership role in assisting and supporting TAFEs to achieve effective performance reporting.

I note that a new performance reporting framework has been introduced for 2014 which will provide greater links between a TAFE's objectives and its key performance indicators. However, as the framework currently stands, it will not facilitate comparison of performance across the sector.

John Doyle
Auditor-General

August 2014

Audit summary

This report covers the results of the 2013 financial audits of 27 entities, comprising 14 technical and further education (TAFE) institutes and the 13 entities they control.

Historically, the results of audits of universities and TAFEs were found in one report. This year, however, for the first time the results are presented in separate reports—*Technical and Further Education Institutes: Results of the 2013 Audits* and *Universities: Results of the 2013 Audits*.

This approach recognises the significant changes over recent years in the higher education and vocational education sectors. There have been changes to the market settings in both sectors, changes to legislation for both TAFEs and universities, and increased competition between public and private sector providers and between higher education and vocational training providers—with further changes signalled in the higher education sector. This means that TAFEs and universities are operating in increasingly disparate environments and are subject to different pressures on their operations. By reporting separately, we aim to provide the reader with greater clarity about the performance of entities in both sectors.

Conclusion

The quality of financial reporting in the TAFE sector is adequate. However, performance reporting remained underdeveloped and inconsistent, lacked clear direction and did not facilitate comparability across the sector. A new performance reporting framework being introduced in 2014 provides for greater links between strategic directions and key performance indicators, however, it does not address key elements aimed at providing greater comparison of performance across the sector.

The TAFE sector generated a net deficit of $16.2 million—a decrease of $74.8 million from the $58.6 million surplus in 2012. The results were affected by decreased government funding to the TAFE sector, partially offset by an increase in student fee revenue and reduced costs. The results suggest that many TAFEs have yet to adapt sufficiently to changes to the funding model and the new contestable environment.

Quality of financial reporting

Clear audit opinions were issued on the financial reports of 27 TAFE entities. An emphasis of matter paragraph was included in the financial report of Northern Melbourne Institute of TAFE (NMIT), drawing attention to a material uncertainty in its ability to continue as a going concern.

Overall, the financial report preparation processes of TAFEs produced accurate, complete and reliable information. In areas of monthly financial reporting and security over sensitive information better practice was noted. However, further improvement is needed in relation to all other financial report preparation areas. There was no noticeable improvement in financial report preparation in 2013 compared to previous financial years. In our future reports to Parliament, we intend to name the TAFEs that do not take appropriate steps to improve their practices.

Performance reporting

Clear audit opinions were issued on the performance reports required for the 14 TAFEs, four dual-sector universities and one associated entity for 2013. The TAFE sector, however, did not have a framework that mandated relevant and appropriate key performance indicators, nor was there any guidance to entities for establishing suitable targets and analysing performance. Accordingly, the sector's performance reporting was underdeveloped and inconsistent, lacked clear direction and did not facilitate comparability across the sector.

The lack of guidance resulted in:

- entities setting some indicators in isolation, which means they cannot be used to compare their performance against that of other entities
- the use of inconsistent methods for measuring performance against like indicators, resulting in information that cannot be used to compare performance between entities
- the use of measures that focus on pure quantitative inputs or outputs rather than considering performance in the context of the entity's strategic plan, relative size, geographic factors that affect performance, or efficiencies achieved
- failure to set targets for indicators—47 per cent of audited performance statements included targets for less than half the indicators they reported
- failure to provide performance results for the prior year, removing the ability to compare performance year on year—by eight of the 19 entities.

The Department of Education and Early Childhood Development (DEECD) has recently implemented a strategic planning framework for the TAFE sector. The framework provides guidance and oversight on the development of key performance indicators linked to strategic plans and statements of corporate intent, targets, and analysing performance. While an improvement, the framework does not establish a core suite of indicators against which TAFEs are to report. Nor does it provide guidance to eliminate inconsistency in performance measurement against core indicators, setting targets at a level appropriate to each TAFE's individual circumstances and priorities, or on the development of relevant and appropriate indicators. Without these elements to enable comparison of performance across the sector and between entities, the value of performance reporting is diminished.

The challenge remains for DEECD to assist TAFEs to achieve effective performance reporting, and to put in place and demonstrate an appropriate level of oversight to mitigate the risk of misreporting in the newly competitive environment.

Financial results and sustainability

The 14 TAFEs generated a net deficit of $16.2 million, a decrease of $74.8 million from the $58.6 million surplus in 2012. The results were affected by a decrease of $116.3 million (15 per cent) in government operating and capital grants. The decrease was partially offset by an increase in student fee revenue and reduced costs.

These results suggest that many TAFEs have yet to effectively adapt to changes to the funding model announced in May 2012. The changes were designed to make vocational and education training funding more sustainable with a view to creating a sector characterised by sustainability, high quality and direct industry engagement. So far, the impact has been an increased reliance on student fee revenue in the contestable environment. While a majority of TAFEs reduced their expenditure during the year, the cost reductions and increases in student fee revenue were still not sufficient to offset reductions in the level of operating funds secured from government.

Consequently, there was a significant decline in the financial sustainability of the sector during 2013. We assessed the financial sustainability of five of the TAFEs as being high risk. This means that there are immediate or short-term financial challenges at these TAFEs that need to be addressed.

Eight TAFEs were assessed as medium risk. The remaining TAFE, Chisholm, improved its financial sustainability during the year from medium risk to low, against the trend, and this reflects the effective cost control strategies it implemented.

Against the trend, four TAFEs reported a surplus and improved financial performance in 2013. These were Chisholm, Goulburn Ovens, Kangan and Sunraysia.

NMIT reported a net operating deficit of $31.7 million, and projected substantial cash flow deficits for the next two years. NMIT has identified and commenced implementing various operational initiatives to improve its cash flows for 2014. The initiatives include reductions in staffing levels, increased student fees, changes to campus operations and various other restructuring arrangements. DEECD has also agreed to assist NMIT to secure bridging finance of $16 million to assist with its solvency and restructuring.

NMIT has been flagged as an overall high financial sustainability risk in this report. The combination of risk rating and predicted cash flows means this TAFE requires close monitoring.

Ten TAFEs had no debt at all at 30 June 2013, and the more flexible financing arrangements now open to TAFEs have increased borrowing options. Nevertheless, TAFEs should be cautious and assess their ability to repay associated financing costs, especially if operating results continue to deteriorate.

Internal controls

Controls over procurement across the TAFE sector were generally adequate. Documented policies exist and were comprehensive, and clear financial delegations had been established. Improvements can be made by documenting the key integrity activities that underpin a tender process, and by each TAFE defining high risk and complex procurement to set clear requirements for when probity plans need to be applied.

Probity issue at Box Hill Institute

During 2013, discrepancies were identified between employment entitlements agreed in 2008 between Box Hill Institute's then chief executive officer (CEO) and the board, and the employment agreement lodged with the office of the Minister for Higher Education and Skills as required under Ministerial Directions. The agreement between the CEO and the board provided additional entitlements, detailed in a formal letter of offer from the then board chair to the CEO. The additional entitlements were not standard entitlements under the state government's standard executive contract and were not provided to the minister's office for scrutiny.

Recommendations

Number	Recommendation	Page
1.	That, in line with better practice report preparation, and in order to improve the quality of reporting, technical and further education institutes: • prepare shell financial statements • improve financial compliance reviews, analytical reviews, materiality assessments and quality assurance practices • address the competency of staff involved.	11
2.	That the Department of Education and Early Childhood Development works with technical and further education institutes to develop a robust framework that specifies reporting requirements, mandates a core suite of relevant and appropriate key performance indicators, and guides entities in establishing suitable targets and effectively analysing performance.	18
3.	That technical and further education institutes improve the quality of performance statements by including comparative information and explanations of significant variances observed.	18

Recommendations – *continued*

Number	Recommendation	Page
4.	That the Department of Education and Early Childhood Development acts to mitigate the risk of misstatement of performance by technical and further education institutes by ensuring adequate scrutiny of information reported.	18
5.	That technical and further education institutes document and define high-value, high-risk and complex procurement in the context of their business so that there is clarity on when and where probity should be applied.	44
6.	That technical and further education institutes adopt a schedule for periodic review of all key financial policies to ensure they remain current.	44

Submissions and comments received

In addition to progressive engagement during the course of the audit, 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 DEECD, the Department of Treasury and Finance and each of the 14 TAFEs with a request for submissions or comments.

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 are included in Appendix F.

1 Background

1.1 Introduction

Historically the results of audits of universities and technical and further education (TAFE) institutes were presented in one report, the *Tertiary Education and Other Entities: Results of Audits* report. However, this year for the first time the results are presented in separate reports—*Technical and Further Education Institutes: Results of the 2013 Audits* and *Universities: Results of the 2013 Audits.*

This approach recognises the significant changes over recent years in the higher education and vocational education sectors. There have been changes to the market settings in both sectors, changes to legislation for both TAFEs and universities, and increased competition between public and private sector providers and between higher education and vocational training providers—with further changes signalled in the higher education sector. This means that TAFEs and universities are operating in increasingly disparate environments. The entities in each sector are subject to different pressures on their operations. By reporting separately, we aim to provide the reader with greater clarity about the performance of entities in the two sectors.

1.1.1 This report

This report covers the 2013 results of 27 entities, comprising 14 TAFEs and the 13 entities they control. It is one of a suite of Parliamentary reports on the results of 2012–13 financial audits conducted by VAGO. The full list of reports can be found in Appendix A of this report.

A breakdown of the 27 entities covered by this report is set out in Figure 1A.

Figure 1A
TAFEs and controlled entities

Entity category	2012	2013
TAFE	14	14
Entities controlled by TAFEs[(a)]	14	13
Total	**28**	**27**

(a) Entities controlled by TAFEs generally comprise subsidiary companies.
Source: Victorian Auditor-General's Office.

Details of the entities covered in this report are set out in Appendix B.

The report informs Parliament about significant issues arising from the financial audits in addition to the assurance provided through audit opinions on financial reports and performance reports included in the respective entities' annual reports.

The report comments on the quality of financial reporting and the financial sustainability of TAFEs. It also comments on the effectiveness of controls over procurement, financial policies and financial delegations across the TAFE sector.

1.2 Recent changes to the TAFE sector

Over recent years, the Department of Education and Early Childhood Development has acted to improve aspects of the accountability and oversight framework relating to the TAFE sector, in particular, by:

- reconstituting TAFE institutes in April 2013
- working to strengthen financial expertise and commercial acumen on TAFE institute boards progressively since April 2013
- removing chief executive officers (CEO) from TAFE institute boards in 2013 to clarify the relationship between governance and management, and reduce the potential for conflicts of interest, including relating to the remuneration and performance monitoring of the CEO
- making of Commercial Guidelines in April 2013 to provide accountabilities and parameters for TAFE commercial activities
- making of Strategic Planning Guidelines in April 2013 to establish a financial objective for TAFEs and set out a planning and reporting framework
- development of a performance monitoring framework to provide key stakeholders and the TAFE institutes with information on financial and non-financial performance, and benchmarking data
- introducing an annual Minister’s Statement of Expectations to TAFE institutes, which is a legislative requirement, as a mechanism for communicating additional expectations—including improved financial reporting—of government as owner, as opposed to funder.

Changes to the legislative framework and funding model, announced by the government in May 2012 became a catalyst for greater reliance by the sector on student tuition and other fees rather than on government grants.

During 2013, the government reiterated its commitment to competitive neutrality in the vocational training sector, and required TAFE institutes to demonstrate the capacity to operate commercially. In future, TAFEs will be required to maintain a specified return on non-current assets and cover their depreciation costs through their operations.

A rollout of $200 million in contestable funding over four years, referred to as the TAFE Structural Adjustment Fund, was announced in 2013, including $100 million in infrastructure funding. On 16 April 2014, it was announced that $40 million of this funding would be used to facilitate a merger between Advance and Central Gippsland TAFEs. It is intended that Federation University will then integrate the amalgamated institute into its operations from January 2016.

In a further restructuring arrangement, it was announced by the Minister for Higher Education and Skills on 23 May 2014 that $64 million of the contestable funding would be provided to support the amalgamation of Bendigo TAFE and Kangan Institute. The government has also announced $8.98 million for Sunraysia TAFE and $7.7 million for South West TAFE to undertake a number of projects to improve their financial sustainability.

1.3 Structure of this report

Figure 1B outlines the structure of this report.

Figure 1B
Report structure

Report part	Description
Part 2: Financial reporting	Reports the results of the 2013 financial audits of 14 TAFEs and the 13 entities that they control.
Part 3: Performance reporting	Comments on performance reporting in the TAFE sector, including the results of the 2013 audits of 19 performance statements.
Part 4: Financial results	Summarises and analyses the financial results of 14 TAFEs, including financial performance for 2013.
Part 5: Financial sustainability	Provides insight into the financial sustainability of 14 TAFEs, based on the trends of five financial sustainability indicators over a five-year period.
Part 6: Internal controls	Assesses the internal controls, including over procurement, financial policies and financial delegations, across the TAFE sector.

Source: Victorian Auditor-General's Office.

1.4 Audit of financial reports

An annual financial audit has two aims:

- to give an opinion consistent with section 9 of the *Audit Act 1994*, on whether the financial statements present fairly in all material respects in accordance with the Australian Accounting Standards and the *Financial Management Act 1994*
- to consider whether there has been wastage of public resources or a 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 audits is set out in Appendix C.

1.4.1 Audit of internal controls relevant to the preparation of the financial report

Internal controls are systems, policies and procedures that help an entity reliably and cost effectively meet its objectives. Sound internal controls enable the delivery of reliable, accurate and timely internal and external reporting.

Integral to the annual financial audit is an assessment of the adequacy of the internal control framework, and the governance processes, related to an entity's financial reporting. In making this assessment, consideration is given to the internal controls relevant to the entity's preparation and fair presentation of the financial report. This assessment is not used for the purpose of expressing an opinion on the effectiveness of the entity's internal controls.

An explanation of the internal control framework, and its main components, is set out in Appendix C. An entity's governing body is responsible for developing and maintaining its internal control framework.

Internal control weaknesses we identify during an audit do not usually result in a 'qualified' audit opinion because often an entity will have compensating controls in place that mitigate the risk of a material error in the financial report. A qualification is warranted only if weaknesses cause significant uncertainty about the accuracy, completeness and reliability of the financial information being reported.

Weaknesses in internal controls found during the audit of an entity are reported to its CEO and audit committee in a management letter.

Our reports to Parliament raise systemic or common weaknesses identified during our assessments of internal controls over financial reporting, across a sector.

1.5 Conduct of TAFE audits

The audits of the 14 TAFEs and 13 controlled entities were undertaken in accordance with the Australian Auditing Standards.

Pursuant to section 20(3) of the *Audit Act 1994*, unless otherwise indicated any persons named in this report are not the subject of adverse comment or opinion.

The total cost of this report was $170 000.

1.6 Audit of performance reports

Under section 8(3) of the *Audit Act 1994,* the Auditor-General is authorised to audit performance indicators of a public sector entity to determine whether they fairly represent the entity's actual performance. The Auditor-General uses this authority to audit the performance reports that are required to be prepared by the TAFE sector.

1.7 Subsequent events

1.7.1 Changes to reporting by dual-sector universities

Until 31 December 2013, four 'dual-sector' universities operated in Victoria, namely, Federation University (formerly University of Ballarat), RMIT University, Swinburne University of Technology and Victoria University. In addition to its higher education courses, a dual-sector university includes a TAFE component that delivers vocational education and training.

The *Education and Training Reform Amendment (Dual Sector Universities) Act 2013* was enacted from 1 January 2014 and removed the requirement for dual-sector universities to make separate disclosure of their TAFE activities in their financial reports, or to include audited performance statements in their annual reports.

The legislative amendment reduces the reporting workload for the four universities and eliminates difficulties associated with separately reporting their TAFE and higher education activities given that administrative support and course delivery has been largely integrated over time.

From 1 January 2014, TAFE results of the four dual-sector universities will no longer be included in the Victorian whole-of-government consolidated financial statements.

2 Financial reporting

At a glance

Background

This Part covers the results from the 2013 audits of the 14 technical and further education (TAFE) institutes and the 13 entities they control.

Conclusion

The financial reports of the 27 TAFE entities received clear audit opinions, providing Parliament with confidence in these reports. Nevertheless, some entities have not acted to take up the range of better practice reporting elements which are designed to improve the efficiency and effectiveness of their financial report preparation process. In our future reports to Parliament, we intend to name the TAFEs that do not take appropriate steps to improve their practices.

Findings

- An emphasis of matter paragraph was included in the audit opinion for Northern Melbourne Institute of TAFE, drawing attention to a material uncertainty in its ability to continue as a going concern.
- Only 22 entities completed their financial reports within the mandated time frames.

Recommendation

That, in line with better practice report preparation, and in order to improve the quality of reporting, technical and further education institutes:

- prepare shell financial statements
- improve financial compliance reviews, analytical reviews, materiality assessments and quality assurance practices
- address the competency of staff involved.

2.1 Introduction

This Part covers the results of the 2013 audits of the 14 technical and further education (TAFE) institutes and the 13 entities they control.

The quality of an entity's financial reporting can be measured in part by the timeliness and accuracy of the preparation and finalisation of its financial report, as well as against better practice criteria.

Appendix B categorises the respective reporting frameworks and the completion time lines for the 27 entities.

2.2 Audit opinions issued

Independent audit opinions add credibility to financial reports by providing reasonable assurance that the information reported is reliable and accurate. A clear audit opinion confirms that the financial statements present fairly the transactions and balances for the reporting period, in accordance with the requirements of relevant accounting standards and legislation.

Clear audit opinions were issued on the financial reports of 27 entities for the year.

Emphasis of matter paragraph

In certain circumstances an audit opinion may draw attention to, or emphasise, a matter that is relevant to the users of an entity’s financial report but does not warrant a qualification. Unqualified opinions can include an emphasis of matter (EOM) paragraph.

Northern Melbourne Institute of TAFE received an EOM opinion in 2013, which drew attention to the material uncertainty regarding its ability to continue as a going concern.

2.3 Quality of reporting

The quality of an entity's financial reporting can be measured in part by the timeliness and accuracy of the preparation and finalisation of its financial report, as well as against better practice criteria.

2.3.1 Accuracy

The frequency and size of errors in the draft financial reports submitted to audit are direct measures of the accuracy of those reports. Ideally, there should be no errors or adjustments required as a result of an audit.

Our expectation is that all entities will adjust any errors identified during an audit, other than those errors that are clearly trivial or clearly inconsequential to the financial report, as defined under the auditing standards.

The public is entitled to expect that any financial reports that bear the Auditor-General's opinion are accurate and of the highest possible quality. Therefore, all errors identified during an audit should be adjusted, other than those that are clearly trivial.

Material adjustments

When we detect errors in the draft financial reports they are raised with management. Material errors need to be corrected before an unqualified audit opinion can be issued.

The entity itself may also change its draft financial reports after submitting them to audit if their quality assurance procedures identify that the draft information is incorrect or incomplete.

In relation to the 2013 audits, 25 material financial balance adjustments were made compared to 18 in the prior year. The adjustments related mainly to accrual accounting items associated with the preparation of the financial report. Adjustments were also required in respect of a number of one-off transactions, including the transfer of the student management system from the Department of Education and Early Childhood Development, and accounting treatment of grant funding. The adjustments resulted in changes to the net result and/or the net asset position of entities.

In addition to the financial balance adjustments, there were two disclosure errors that required adjustment in 2013 (two in 2012). Other disclosure adjustments in 2013 related to the completeness of accounting policies and executive officer remuneration disclosures, as well as the classification of cash and short-term investments.

All material errors were adjusted prior to the completion of the financial reports.

2.3.2 Timeliness

Timely financial reporting is key to providing accountability to stakeholders, and enables informed decision-making. The later reports are produced and published after year end, the less useful they are.

The *Financial Management Act 1994* requires an entity to submit its audited annual report to its minister within 12 weeks of the end of financial year. Its annual report should be tabled in Parliament within four months of the end of financial year.

In 2013, 22 entities completed their financial reports within their mandated time frames. The remaining five entities failed to finalise their financial reports within 12 weeks of their applicable balance date, although three of these entities were only one day late. The remaining two were late due to additional work they undertook relating to going concern issues.

Appendix B sets out the dates the 2013 financial reports were finalised.

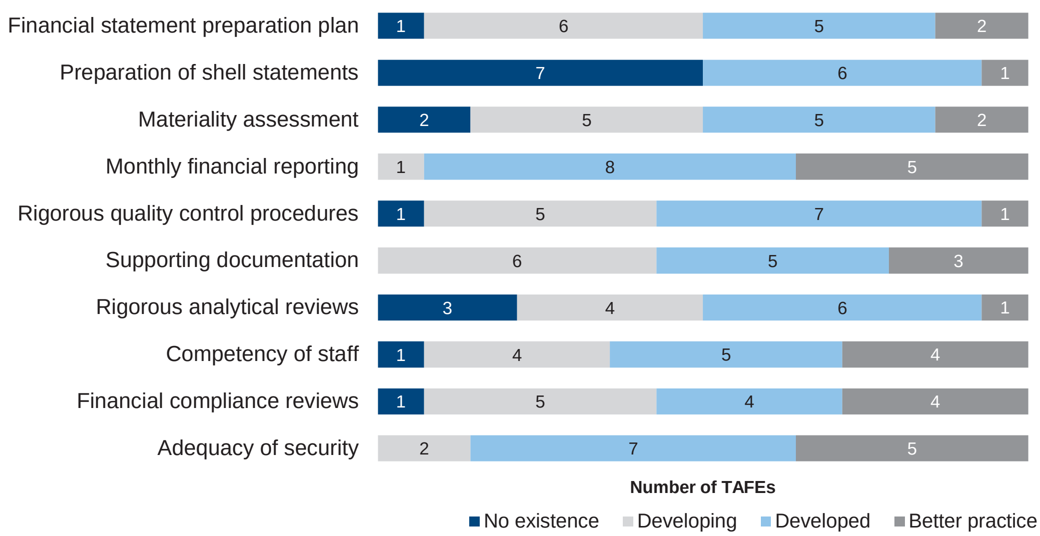
2.3.3 Better practice

An assessment of the quality of financial reporting processes of the TAFEs was conducted against better practice criteria—detailed in Appendix C—using the following scale:

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

The results are summarised in Figure 2A.

Figure 2A
Results of assessment of report preparation processes against better practice elements



Source: Victorian Auditor-General's Office.

Monthly financial reporting and security over sensitive information were assessed as the strongest areas, with a significant majority of entities' processes assessed as either 'better practice' or 'developed'. Further improvement is needed in relation to all other areas, particularly:

- preparation of shell statements
- materiality assessments
- rigorous analytical reviews
- quality assurance.

It was disappointing that there was no noticeable improvement in 2013, while some areas deteriorated in comparison to 2012.

Assessments against better practice elements have been reported over a number of years. Nevertheless, some entities have not acted to take up the range of elements which are designed to improve the efficiency and effectiveness of their financial report preparation. In our future reports to Parliament, we intend to name the TAFEs that do not take appropriate steps to improve their practices.

Recommendation

1. That, in line with better practice report preparation, and in order to improve the quality of reporting, technical and further education institutes:
   - prepare shell financial statements
   - improve financial compliance reviews, analytical reviews, materiality assessments and quality assurance practices
   - address the competency of staff involved.

3 Performance reporting

At a glance

Background

This Part covers the results of the 2013 audits of performance statements for the 14 technical and further education (TAFE) institutes, four dual-sector universities and one associated entity that are required to include an audited statement of performance in their annual report.

Conclusion

Clear audit opinions were issued on all 19 performance reports. However, the TAFE sector did not have a framework that mandated relevant and appropriate key performance indicators, nor was it provided with sufficient guidance for establishing suitable targets and analysing performance. Accordingly, the sector's performance reporting was underdeveloped and inconsistent, lacked clear direction and did not facilitate comparability across the sector. From 2014, TAFEs are to implement a strategic planning framework requiring them to set key performance indicators clearly linked to their key strategies. While an improvement, the framework does not establish a core suite of indicators against which TAFEs are to report, therefore, the value of the performance reporting is diminished.

Findings

- Forty-seven per cent of performance reports included targets for less than half of the performance indicators.
- Eight of the 19 entities did not include data to enable comparison of year on year performance.

Recommendations

- That DEECD work with TAFEs to develop a robust framework that specifies reporting requirements, mandates a core suite of relevant and appropriate key performance indicators, and guides entities in establishing suitable targets and effectively analysing performance.
- That TAFEs improve the quality of performance statements by including comparative information and explanations of significant variances observed.
- That DEECD act to mitigate the risk of misstatement of performance by TAFEs by ensuring adequate scrutiny of information reported.

3.1 Introduction

Victoria's 14 technical and further education (TAFE) institutes, the Centre for Adult Education and the TAFE components of:

- Ballarat University (known as Federation University from 1 January 2014)
- RMIT University
- Swinburne University of Technology
- Victoria University

are required to present audited performance statements in their annual reports.

The requirement to prepare performance statements was established by a November 2008 executive memorandum from the former Department of Innovation, Industry and Regional Development.

The *Audit Act 1994* empowers the Auditor-General to audit any performance indicators in the report of operations of an audited entity to determine whether they:

- are relevant to any stated objectives of the entity
- are appropriate for the assessment of the entity's actual performance
- fairly represent the entity's actual performance.

This Part comments on the results of our 2013 audits of performance reports of 19 entities, and the progress made by the sector in regards to quality performance reporting.

3.2 Audit opinions issued

Our audits of performance statements produce opinions on whether the results reported are presented fairly and whether they have been prepared in accordance with the *Financial Management Act 1994*. The opinions do not conclude on the relevance or appropriateness of the performance information reported.

Clear audit opinions were issued on all 19 performance reports audited for 2013.

3.3 Quality of reporting

Mandated performance indicators that are relevant and appropriate, with suitable targets and adequate guidance, had not been established. In the absence of such direction, performance reporting in the TAFE sector remained underdeveloped and inconsistent, lacked clear direction and did not enable comparison of performance across the sector.

In 2013, this lack of guidance resulted in:

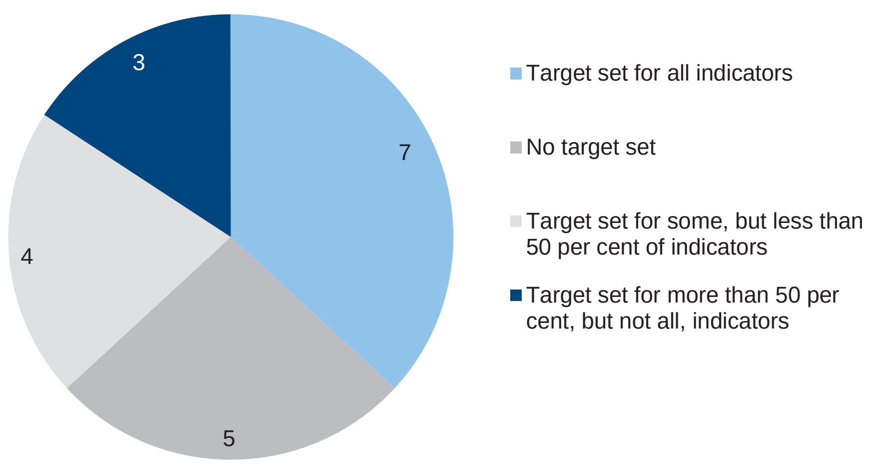
- entities setting some indicators in isolation, which means they cannot be used to compare their performance against that of other entities
- the use of inconsistent methods for measuring performance against like indicators, resulting in information that cannot be used to compare performance between entities
- the use of measures that focus on pure quantitative inputs or outputs rather than considering performance in the context of the entity's strategic plan, relative size, geographic factors that affect performance, or efficiencies achieved
- failure to set targets for indicators—47 per cent of performance statements audited included targets for less than half the indicators they reported
- failure to provide performance results for the prior year, removing the ability to compare performance year on year—for eight of the 19 entities.

3.3.1 Setting targets

While target setting was still poor in 2013, it had at least improved—in 2013 seven entities set targets for each of their performance indicators, compared with four in 2012.

Figure 3A shows the performance of entities in 2013 in relation to target setting.

Figure 3A
Target setting by TAFEs



Source: Victorian Auditor-General's Office.

However, where targets were set, there was significant variation across entities. Figure 3B shows the range of targets set across the sector for four commonly reported indicators.

Figure 3B
Range in targets set for selected indicators

Target	Working capital ratio	Student satisfaction (%)	Net operating margin (%)	Revenue per staff FTE ($)
Median	1.51	82.3	1.8	134 957
Highest	4.52	93.0	7.8	171 387
Lowest	0.19	75.0	-18.0	85 106

Note: 'FTE' refers to full-time equivalent positions.
Source: Victorian Auditor-General's Office.

Targets can legitimately vary between entities if priorities of entities differ, or if entities have different maturity levels. However, in many instances targets reflected the expected results, rather than a stretch target. To operate as drivers of performance, targets should be aspirational—neither too low as to be too easily achieved, nor too high as to be impossible to achieve.

3.3.2 Analysing performance

Performance reporting should be accompanied by commentary analysing variances from year to year and why prior year performance was exceeded or not. Such commentary provides users and the broader community with a clearer picture of the challenges faced or achievements made during the current year.

In 2013, 14 entities provided explanations of significant variances between actual and target or prior year results. However, in many cases the 'analysis' simply stated that there was a variance without explaining why.

3.4 Developments and challenges in performance reporting

Our 2013 audits show that the sector needs to improve significantly before it achieves a satisfactory standard of performance reporting.

On 17 April 2013, the Minister for Higher Education and Skills approved Strategic Planning Guidelines that require TAFEs to develop a strategic plan and include key performance indicators clearly linked to their key strategies. It acknowledged that the measures may vary across TAFEs based on the strategic goals set by their governing boards. Accordingly, TAFEs developed strategic plans in 2013 in consultation with the Department of Education and Early Childhood Development (DEECD). The plans are to be implemented in 2014.

The framework provides guidance and oversight on the development of key performance indicators (KPI) linked to strategic plans and statements of corporate intent, suitable targets, and analysing performance.

While an improvement, the framework does not establish a core suite of indicators against which TAFEs are to report. Further, it does not provide guidance to eliminate inconsistency in performance measurement against core indicators, setting targets at a level appropriate to each TAFE's individual circumstances and priorities, or on the development of relevant and appropriate indicators.

The Victorian TAFE sector is diverse and ranges from organisations with revenues of $20 million to $170 million, from rural institutes to metropolitan institutes, and from niche providers to full service providers. It is entirely appropriate for a TAFE to develop a range of KPIs specific to its own circumstances, including size, geographic factors that affect performance and specific priorities.

Nevertheless, VAGO considers that TAFEs should also be required to report against a core suite of KPIs that are comparable across the sector and between TAFEs regardless of the size, geographic factors and specific priorities of individual TAFEs. This would enable comparison of operating and financial performance of TAFEs on some level despite their differences. Without the ability to compare performance across the sector and between entities, the value of performance reporting is diminished.

DEECD should work with TAFEs to develop a robust framework that specifies appropriate reporting requirements. This framework should enable entities to establish and report on suitable targets in a manner which facilitates comparison of performance across the sector.

3.4.1 Potential impact of performance reporting due to competition

Unlike other public sector entities subject to performance reporting, TAFEs operate in direct competition with each other and private sector operators. In addition, as government funding to the sector has reduced, TAFEs have become increasingly reliant on other revenue streams—principally student fees—to ensure their sustainability. In this context, attracting students has become even more critical.

Increased competition increases the risk that performance will be misrepresented in order to seek an advantage in the market. With the development of performance reporting, potential students, the public and other report users can use these reports to compare performance and guide decision-making.

To mitigate the risk of misstatement of performance and to ensure the quality and consistency of performance information reported by TAFEs, DEECD will need to establish and demonstrate an appropriate level of oversight.

3.5 Future audit approach

In our report *Tertiary Education and Other Entities: Results of the 2012 Audits*, we announced our intention to expand our audit of performance indicators for the TAFE sector in future periods. In our 2014 audit report, we intend to continue to express an opinion on the fair presentation of performance indicators and compliance with requirements, but provide entities with comments on the relevance and appropriateness of performance indicators through management letters.

From 2015, our audit opinion will also address the relevance and appropriateness of the indicators and whether they fairly present performance. Where these standards are not met, a qualified audit opinion may be issued on performance statements.

This approach will require the support of DEECD to achieve more transparent and meaningful reporting on TAFE performance to the community. Without this guidance, performance information will continue to be arbitrarily reported and results will be incomparable across the sector.

Recommendations

2. That the Department of Education and Early Childhood Development works with technical and further education institutes to develop a robust framework that specifies reporting requirements, mandates a core suite of relevant and appropriate key performance indicators, and guides entities in establishing suitable targets and effectively analysing performance.
3. That technical and further education institutes improve the quality of performance statements by including comparative information and explanations of significant variances observed.
4. That the Department of Education and Early Childhood Development acts to mitigate the risk of misstatement of performance by technical and further education institutes by ensuring adequate scrutiny of information reported.

4 Financial results

At a glance

Background

This Part analyses the financial results of the 14 technical and further education (TAFE) institutes for the year ended 31 December 2013.

Conclusion

The 14 TAFEs generated a net deficit of $16.2 million, a decrease of $74.8 million from the $58.6 million surplus in 2012. Ten TAFEs reported a reduced financial result in 2013, with seven of these reporting an operating deficit in 2013 compared with four in 2012. The results were affected by a decrease of $116.3 million—15 per cent—in government operating and capital grants. This was partially offset by a reduction in costs and an increase in student fee revenue.

These results suggest that many TAFEs have yet to effectively adapt to changes to the funding model announced in May 2012, designed to make vocational and employment training funding arrangements more sustainable. The changes have increased the sector's reliance on other revenue streams, such as student fee revenue, in the contestable environment.

Findings

- A majority of TAFEs reduced their expenditure during the year. However, these reductions and increases in student fee revenue were not sufficient to offset the reductions in operating grants from government.
- Against the trend, four TAFES reported a surplus and improved financial performance in 2013—Chisholm, Goulburn Ovens, Kangan and Sunraysia.
- Northern Melbourne Institute of TAFE (NMIT) recognised a net operating deficit of $31.7 million. NMIT projected substantial cash-flow deficits for the next two years. As a result, NMIT is implementing operational initiatives to improve its cash flows for 2014, and the Department of Education and Early Childhood Development has agreed to support NMIT in securing bridging finance of $16 million to assist with solvency and restructuring arrangements.
- Capital expenditure by the sector has declined over the past three years and the financial position of TAFEs has deteriorated.
- Total debt for the sector remains low compared to equity.

4.1 Introduction

Accrual-based financial statements enable assessment of whether entities are generating sufficient surpluses from operations to maintain services, fund asset maintenance and retire debt. The ability to generate surpluses is subject to the regulatory environment in which entities operate, and their ability to minimise costs and maximise revenue.

4.2 Financial results

4.2.1 Financial performance

The 14 technical and further education (TAFE) institutes generated a collective deficit of $16.2 million in 2013. This was a decrease of $74.8 million from the collective surplus of $58.6 million in 2012. Ten TAFEs reported a reduced financial result in 2013, with seven reporting an operating deficit in 2013—compared with four in 2012.

The lower results largely reflected a 15 per cent—$102.9 million—decrease in state government operating grants during 2013.

These results suggest that many TAFEs have yet to effectively adapt to changes to the funding model, announced in May 2012. The changes were designed to make vocational and employment training funding arrangements more sustainable, with a view to creating a sector characterised by sustainability, high quality and direct industry engagement. To date, the impact has been an increase in the sector's reliance on other funding streams, including student fee revenue, in the new more contestable environment.

Figure 4A shows that while a majority of TAFEs reduced their expenditure during 2013, the cost reductions and increases in student fee revenue were not sufficient to offset the reductions in operating grants secured from government.

Figure 4A
Net surplus/deficit by TAFE and changes in funding sources from 2012 to 2013

TAFE Institute	Surplus/deficit 2013 ($'000)	Surplus/deficit 2012 ($'000)	Movement between years ($'000)	Increase/(decrease) 2013 Govt operating grants ($'000)	Increase/(decrease) 2013 Student revenue ($'000)	Increase/(decrease) 2013 Expenses ($'000)
Advance	-9 058	-874	(8 184)	(4 882)	900	24
Bendigo	120	257	(137)	(7 767)	1 308	(7 993)
Box Hill	-2 819	8 355	(11 174)	(24 996)	(478)	(16 831)
Central Gippsland	-4 718	5 939	(10 657)	(10 587)	(20)	(4 281)
Chisholm	30 667	3 538	27 129	(17 991)	5 335	(23 927)
Gordon	589	13 129	(12 540)	(22 187)	96	(12 469)
Goulburn Ovens	13 083	11 493	1 590	40 703	1 887	40 827
Holmesglen	-9 194	4 622	(13 816)	(11 543)	1 152	300
Kangan	4 026	-1 197	5 223	(5 139)	(4 549)	(9 606)
Northern Melbourne	-31 690	5 107	(36 797)	(28 652)	1 973	(3 273)
South West	-4 364	-653	(3 711)	(2 337)	914	(34)
Sunraysia	1 975	81	1 894	11 487	2 252	11 550
William Angliss	-5 423	-1 081	(4 342)	(9 106)	3 289	(2 941)
Wodonga	568	9 798	(9 230)	(2 057)	96	9 205
Total	**-16 238**	**58 514**	**(74 752)**	**(95 054)**	**14 155**	**(19 449)**

Note: Government operating grants include Commonwealth and state funding.
Note: Figures in blue indicate a deficit. Figures in brackets indicate a decrease.
Source: Victorian Auditor-General's Office.

Northern Melbourne Institute of TAFE (NMIT) recognised a net operating deficit of $31.7 million and negative cash outflows from operating activities of $23.3 million in its 2013 financial report. This was predominantly driven by a $28.7 million—or 41 per cent—decrease in contestable government operating grants for TAFE students. NMIT has projected further cash flow deficits for the next two years. As a result, NMIT is implementing operational initiatives to improve its cash flows for 2014, and the Department of Education and Early Childhood Development has agreed to support NMIT in securing bridging finance of $16 million to assist with the entity's solvency and restructuring arrangements.

Another two TAFEs failed to achieve significant cost savings and consequently their operating results deteriorated. Advance and Holmesglen reported increases in expenses, while South West achieved a marginal reduction in costs only.

This suggests that these TAFEs, along with NMIT, have not responded sufficiently to the changed funding and operating conditions.

In 2013, Wodonga amalgamated with Driver Education Centre of Australia, leading to increased costs for the period.

Four TAFEs went against the downward trend and improved their financial performance in 2013. These TAFEs—Chisholm, Goulburn Ovens, Kangan and Sunraysia—are to be commended on their response to the changed operating environment. Restructuring arrangements undertaken by these TAFEs included:

- Goulburn Ovens and Sunraysia increased the number of courses provided by third parties rather than by their own employees. This service provision model enabled them to secure increases of $40.4 million and $11.3 million in government grants, respectively, to cover the costs of the third party providers.
- Chisholm and Kangan embarked early on a program of staff redundancies in 2012 in order to reduce expenditure to address announced funding cuts.
- Kangan substantially reduced its operating costs.

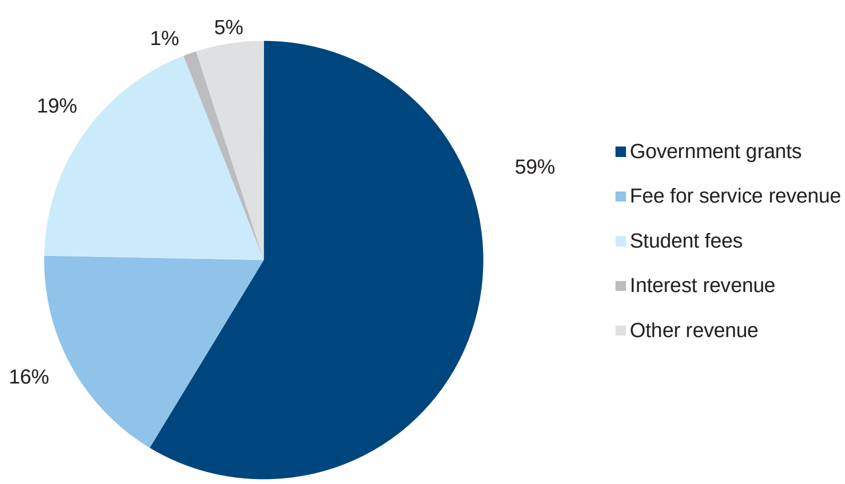
Revenue

TAFEs generate their revenue from government grants, student fee revenue, investment revenue and various fees and charges.

In 2013, TAFEs collectively generated revenue of $1.08 billion, $89.4 million less than in 2012. The decrease was mainly due to a net reduction of $95.0 million in government operating grants—that is, a $102.9 million reduction in state operating grants offset by a $7.8 million increase in Commonwealth operating grants.

Despite the net decrease, government grants remained the largest component of operating revenue for TAFEs, representing 59 per cent of total revenue in 2013 (65 per cent in 2012), as shown in Figure 4B.

Figure 4B
Revenue composition, 2013



Source: Victorian Auditor-General's Office.

TAFEs also received reduced state capital grants ($14.5 million) and Commonwealth capital grants ($6.7 million) during 2013. When added to the reductions in operating grants, this resulted in an overall decrease in government grants of $116.3 million for the year.

Trends in student fee revenue

Recent policy changes were designed to increase competition between private and public sector training providers. As a result, it is important that TAFEs proactively target students and adjust their marketing activities and course design to attract enrolments in the domestic and international student markets.

Over the past five years, revenue from student fees has increased by 14.2 per cent, mainly driven by domestic student fee revenue. Total student fee revenue increased by 7.8 per cent to $195.3 million in 2013.

International students

International student fee revenue has fluctuated year on year, but overall has decreased by 26.4 per cent over the five-year period. However, this revenue stream continued to be important to TAFEs. In 2013 it generated $92.2 million ($105.5 million in 2012), or 47.2 per cent of total student fee revenue for the year. Student fees from offshore operations comprised $33.7 million, or 36.6 per cent of international student fee revenue ($40.7 million in 2012).

Although they represent only around 5 per cent of total student numbers, international students generate substantially higher revenue per student than do domestic students, and are an important factor in the ongoing viability of individual TAFEs and the sector.

New international student enrolments increased to 7 400 in 2013 (6 500 in 2012).

Domestic students

Between 2009 and 2013, total fees from domestic students increased by 125.2 per cent. The increase was due to increased TAFE fees for some courses, partially offset by a decrease in domestic student numbers.

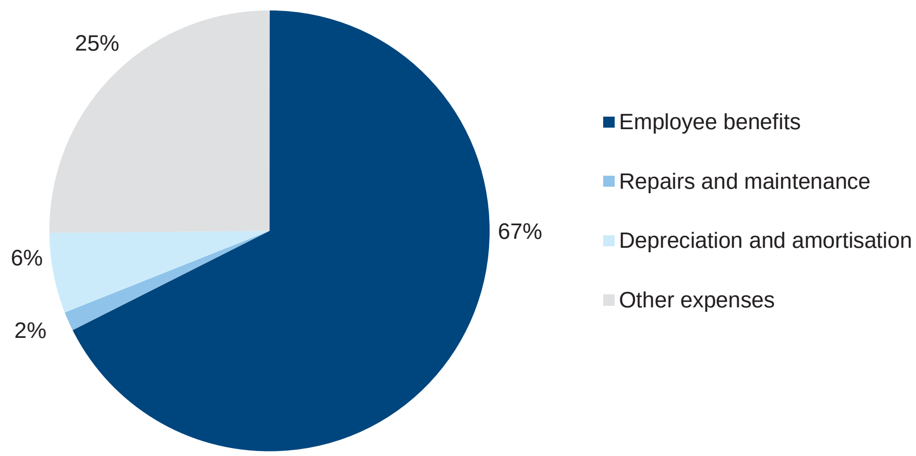
New enrolments for domestic students decreased in 2013 to 196 500 (208 400 in 2012).

Expenses

In 2013, the 14 TAFEs collectively incurred operating expenses of $1.1 billion, a decrease of $19.4 million or 1.8 per cent from 2012. Although the decline in TAFE spending was much less than the decline in revenue during the year, the full effect of reduced employee numbers should impact on costs over the next two years.

Figure 4C shows the composition of TAFE expenditure for 2013.

Figure 4C
Expenditure composition, 2013



Source: Victorian Auditor-General's Office.

Employee-related costs remained the most significant expenditure item, representing 67 per cent of total expenses in 2013 (67 per cent in 2012). Expenditure composition for the TAFE sector was consistent with 2012.

4.3 Financial position

TAFEs carried land and buildings representing 76.8 per cent of their total assets on their balance sheets at 31 December 2013. However, their revenue base is not tied to the value of their assets and most of their assets cannot be readily sold to obtain funds.

The financial objective for an entity should be to maintain and improve its asset base and related service provision, while managing its levels of debt. Capital expenditure has declined over the past three years, and an increase in government loans provided in 2013 indicates that the financial position of TAFEs is deteriorating. However, total debt for the sector remains low compared to equity.

4.3.1 Assets

The total value of TAFE assets increased by $38.2 million to $2.43 billion at 31 December 2013, mainly as a result of:

- a $73.9 million increase in intangible assets due to the transfer of the student management system asset from the state government to the TAFE sector upon its completion, offset by
- a $33.9 million decrease in property, plant and equipment that was mainly due to the annual depreciation charge.

Valuations of land and buildings during 2013 resulted in asset write-downs at the following TAFEs:

- **Advance**—an impairment to capital works in progress of $2.0 million due to significant doubt over whether the project will proceed
- **NMIT**—a revaluation decrement to buildings of $14.3 million due to revaluation of certain buildings held for sale to market value, rather than carried at depreciated replacement cost
- **Sunraysia**—a revaluation decrement of $12.2 million to land, due to a decrease in the assessed valuation since the last revaluation in 2009.

4.3.2 Liabilities

At 31 December 2013, TAFEs had total liabilities of $238.9 million. Debt increased by $16.4 million in 2013 to 7 per cent of total TAFE liabilities (less than 1 per cent in 2012). The increase was due to loans made to Central Gippsland, Gordon, Kangan, South West and William Angliss Institute. Ten TAFEs had no debt at all at 30 June 2013. However, total debt for those entities, and the sector as a whole, remained low compared to equity. Nevertheless, TAFEs should be cautious and assess their ability to repay associated financing costs, especially if operating results continue to deteriorate.

An increase of $18 million in payables was partially offset by a $9.3 million decrease in employee benefit provisions. The decrease was due to staff reductions resulting from structured redundancy programs across the sector.

Provisions (42.8 per cent) and payables (46.0 per cent) continued to be the major components of total TAFE liabilities.

5 Financial sustainability

At a glance

Background

To be financially sustainable, entities need to be able to meet current and future expenditure as it falls due. They also need to absorb foreseeable changes and risks, and adapt their revenue and expenditure policies to address changes in their operating environment. This Part provides an insight into the financial sustainability of technical and further education (TAFE) institutes based on an analysis of the trends in their key financial indicators over the past five years.

Conclusion

The sector's financial sustainability deteriorated in 2013, continuing a pattern of deterioration over the past five years. TAFEs are finding it difficult to generate surpluses and to replace assets from operating activities. As at 31 December 2013, 10 TAFEs had no debt at all, and the more flexible financing arrangements now open to them have increased borrowing options. Nevertheless, TAFEs should be cautious and assess their ability to repay associated financing costs, especially if operating results continue to deteriorate.

Findings

- The financial sustainability of five TAFEs was assessed as high risk due to significant operating deficits. A further eight were assessed as having a medium financial sustainability risk due to poor self-financing and capital replacement indicators.
- Chisholm Institute's risk rating improved against the trend, reflecting the effective cost control strategies it implemented.
- Northern Melbourne Institute of TAFE (NMIT) has an overall high financial sustainability risk. Based on historical data, its liquidity risk is low. Future projections showed cash flow deficits over the next two years. As a result, NMIT is implementing operational initiatives to improve its cash flows for 2014. To assist with the projected cash shortfall and necessary restructuring arrangements, the Department of Education and Early Childhood Development agreed to support NMIT in securing bridging finance of $16 million.

5.1 Introduction

To be financially sustainable, entities need to be able to meet their current and future expenditure as it falls due. They also need to absorb foreseeable changes and risks, and adapt their revenue and expenditure policies to address changes in their operating environment.

This Part examines the financial sustainability of the 14 technical and further education (TAFE) institutes through analysis of five financial sustainability indicators over a five-year period. Appendix D describes the sustainability indicators and risk assessment criteria used in this report.

To form a definitive view of any entity's financial sustainability, a holistic analysis that moves beyond financial indicators would be required, including an assessment of the entity's operations and the regulatory environment in which the entity operates. These additional considerations are not examined in this report.

5.2 Financial sustainability risk assessment

5.2.1 Overall assessment

Overall the financial sustainability risk assessment for the TAFE sector deteriorated in 2013.

Figure 5A shows that the number of TAFEs with a high financial sustainability risk increased from none in 2012 to six in 2013.

Figure 5A
Two-year financial sustainability risk assessment

Entity	2013	2012
Advance	High	Medium
Bendigo	Medium	Medium
Box Hill	Medium	Medium
Central Gippsland	High	Low
Chisholm	Low	Medium
Gordon	Medium	Low
Goulburn Ovens	Medium	Medium
Holmesglen	Medium	Low
Kangan	Medium	Medium
Northern Melbourne	High	Medium
South West	High	Medium
Sunraysia	Medium	Medium
William Angliss	High	Medium
Wodonga	Medium	Low
Total	**14**	**14**

Source: Victorian Auditor-General's Office.

Five TAFEs were assessed as having a high risk to their financial sustainability due to significant operating deficits. A further eight TAFEs were assessed as medium risk due to their poor self-financing and capital replacement indicators.

Only Chisholm Institute was assessed as having a low risk to its financial sustainability. The improvement in its risk rating in 2013 was due to the substantial changes made to its staffing and operating arrangements over the past two years, the cost savings from which were realised in 2013.

5.2.2 Summary of trends in risk assessments over the five-year period

To further understand the results, we analysed data for the five indicators from the previous five years. The relevant data, and the basis for calculating the indicators, is reproduced in Appendix D.

The five-year data shows that TAFEs are finding it increasingly difficult to generate surpluses and replace assets from operations. On the positive side, debt levels remain low and more flexible financing arrangements were approved for the sector during 2013. This provides opportunities for TAFEs. However, they need to carefully assess their ability to repay associated financing costs should their operating results continue to deteriorate.

When the risk assessments for each of the five sustainability indicators are analysed for the sector they show that over the five years to 2013:

- **Underlying result**—the number of TAFEs in the medium- and high-risk categories has risen significantly. The decline commenced in 2011, following a deterioration in student numbers, and fell at a greater rate in 2013.
- **Liquidity**—all TAFEs had low liquidity risk over the five-year period.
- **Self-financing**—the number of TAFEs in the high-risk category has increased from five to 11, showing a steady deterioration over the past three years.
- **Capital replacement**—the position has deteriorated significantly from 2011 onwards. Eleven of the 14 TAFEs (79 per cent) now have a risk assessment of medium or high. This means that their ability to fund asset replacement using funds generated from operating activities is restricted, and as a consequence, the condition of TAFE assets may start to deteriorate.
- **Debt-to-equity**—all TAFEs have had low debt-to-equity risk over the five-year period.

Impact of changes in legislation and funding model on sustainability

Changes to the legislative framework and funding model, announced in May 2012, became a catalyst for greater reliance by the sector on student tuition and other fees rather than on government grants. The changes have had a significant impact on TAFEs, specifically:

- From 1 January 2013 the full impact of the previously announced changes to the funding model came into effect and most TAFEs took action to alleviate expected revenue shortfalls. As a result, the cost to students undertaking some vocational education and training courses increased, contributing to a decline in student participation. New student commencements were down in 2013 compared to 2012, while total student numbers also declined. TAFEs also reacted by reducing or changing course offerings.
- The sector also focused on reducing costs through staff redundancies. The full impact of action taken to reduce employee numbers should be realised over the next two years.
- Four TAFEs closed campuses between 2012 and 2013.
- Government capital funding declined by 36 per cent, and most TAFEs reduced 'non-essential' capital expenditure, resulting in substantially reduced capital expenditure across the sector in 2013.

Cost savings for the sector as a whole, however, were limited and inconsistent.

During 2013, the government reiterated its commitment to competitive neutrality in the vocational training sector, and required TAFE institutes to demonstrate the capacity to operate commercially. In future, TAFEs will be required to maintain a specified return on non-current assets and cover their depreciation costs through their operations.

A rollout of $200 million in contestable funding over four years, referred to as the TAFE Structural Adjustment Fund, was announced in 2013, including $100 million in infrastructure funding. On 16 April 2014 it was announced that $40 million of this funding would be used to facilitate a merger between Advance and Central Gippsland TAFEs. It is intended that Federation University will then integrate the amalgamated institute into its operations from January 2016.

In a further restructuring arrangement, it was announced by the Minister for Higher Education and Skills on 23 May 2014 that $64 million of the contestable funding would be provided to support the amalgamation of Bendigo TAFE and Kangan Institute. The government has also announced $8.98 million for Sunraysia TAFE and $7.7 million for South West TAFE to undertake a number of projects to improve their financial sustainability.

5.3 Five-year trend analysis

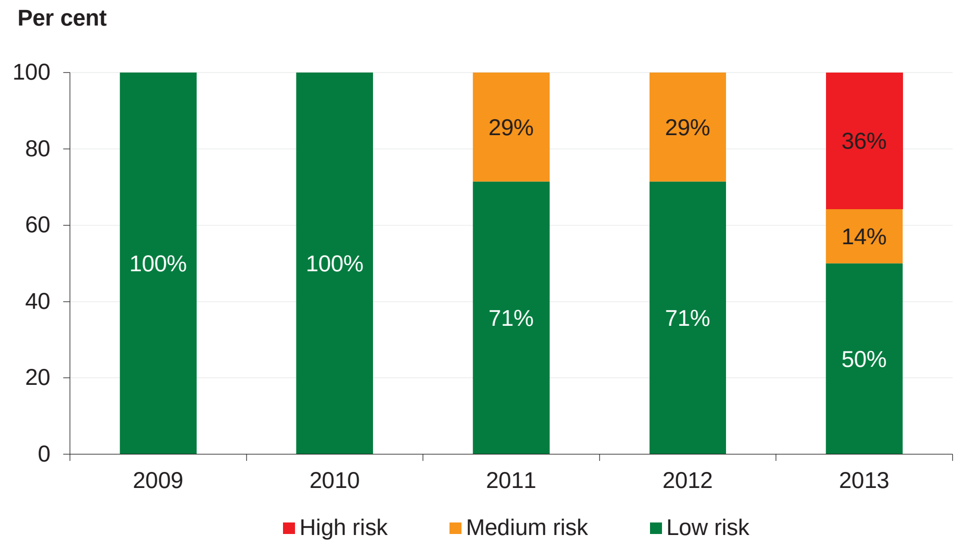
This section provides analysis and commentary on each indicator's trend for the past five years.

5.3.1 Underlying result

The average underlying result for TAFEs has declined over the five-year period, with 12 of the 14 TAFEs recording a lower result in 2013 than in 2009. The decline highlights the difficulties faced by the sector during a period of reduced enrolments following changes to the funding model.

Figure 5B shows a sharp deterioration in the underlying result indicator, with the number of TAFEs moving into either the high- or medium-risk category substantially increasing in 2013.

Figure 5B
Underlying result risk assessment



Source: Victorian Auditor-General's Office.

Seven of 14 TAFEs generated an operating deficit in 2013 (four in 2012), with only three TAFEs reporting an improved underlying result. The deteriorating position indicates that cost savings are not being realised at the same rate as revenue is declining.

Advance TAFE was assessed as high risk in 2013, with an underlying result of negative 50.9 per cent. This means that the operating deficit was half of total revenue in 2013, indicating that this TAFE is in dire financial trouble.

Funding will be provided through the TAFE Structural Adjustment Fund to support Advance TAFE and its amalgamation with Central Gippsland and eventually, Federation University.

5.3.2 Liquidity

The liquidity indicator is a measure of whether an entity has sufficient cash to meet its liabilities when they become due. All 14 TAFEs were assessed as having low risk for the liquidity indicator. Across the sector, however, performance against this measure has declined over the five-year period for 11 of 14 TAFEs, mainly due to a reduction in cash holdings and the overall level of trade creditors increasing by $55.6 million (106 per cent) since 2009.

While Northern Melbourne Institute of TAFE (NMIT) was assessed as having low liquidity risk, this rating is based on historical information. NMIT's future projections indicated cash flow deficits for the next two years, meaning that budgeted expenses were expected to be substantially more than expected revenue.

NMIT has identified and commenced the implementation of various operational initiatives to improve its cash flows for 2014. These initiatives include a reduction in staffing levels, increased student fees, ceasing operations at the Greensborough campus, the finalisation of partnering and access arrangements with La Trobe University and Swinburne University respectively, and various other restructuring arrangements.

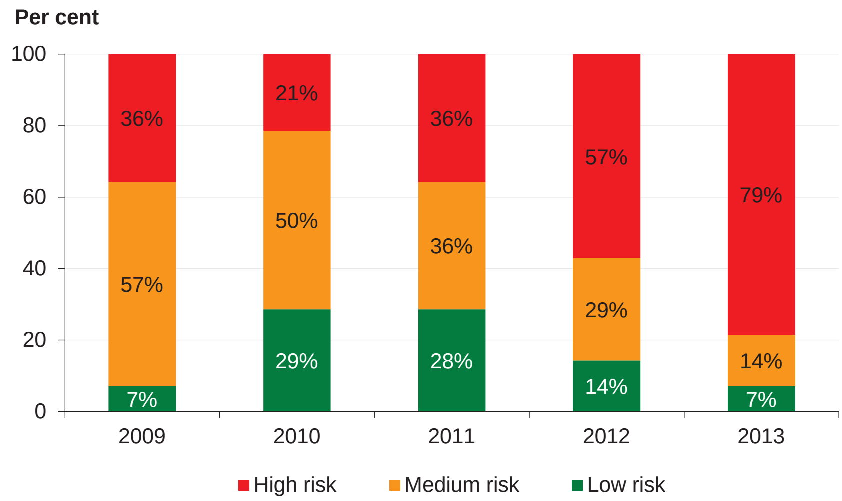
To assist with its solvency and restructuring arrangements, the Department of Education and Early Childhood Development (DEECD) has agreed to support NMIT in securing bridging finance of $16 million.

Notwithstanding DEECD's support for NMIT, our audit opinion on its 2013 financial statements contained an emphasis of matter paragraph. This highlighted the risk that NMIT may be unable to meet expenditure commitments when they fall due, thereby putting at risk its continuation as a going concern.

5.3.3 Self-financing

Figure 5C shows the weakening of self-financing indicator results for the TAFE sector over the past five years. TAFE self-financing results have deteriorated since 2009, particularly over the past three years. The average result for the sector decreased from 10.6 per cent in 2012 to negative 0.8 per cent in 2013.

Figure 5C
Self-financing risk assessment



Source: Victorian Auditor-General's Office.

The majority of TAFEs (11 of 14) now have a self-financing risk of high, with just one TAFE in the low-risk category. This indicates that where TAFEs have not responded sufficiently to policy changes, and where they require net capital investment in the short term, they are finding it increasingly difficult to generate sufficient cash to fund asset replacement from their operating activities.

5.3.4 Debt-to-equity

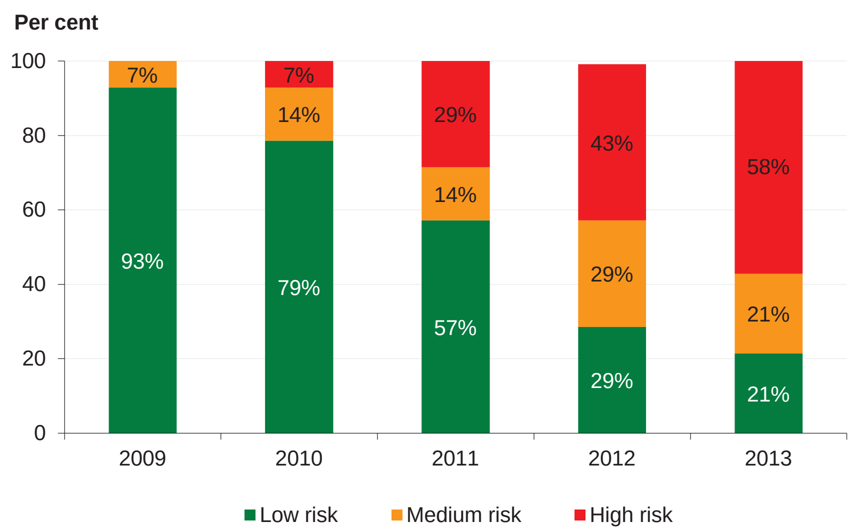
All TAFEs were in the low-risk category for the debt-to-equity ratio for the past five years. Historically, TAFEs have been unable to incur debt. However, more flexible financing arrangements for the sector were approved by the government in 2013 and TAFEs are now able to incur borrowings, subject to approval by the Treasurer.

As at 31 December 2013, 10 TAFEs had no debt at all and more flexible financing arrangements now open to TAFEs provide opportunities. Nevertheless, TAFEs should be cautious and assess their ability to repay associated financing costs, especially if operating results continue to deteriorate.

5.3.5 Capital replacement

Figure 5D shows that over the five-year period there has been a substantial decline in the ability of TAFEs to fund asset renewals, specifically highlighting a significant increase in the number of entities in the high-risk category.

Figure 5D
Capital replacement risk assessment



Source: Victorian Auditor-General's Office.

In 2013, government capital funding to the TAFE sector decreased by 36 per cent to $37.9 million. The decline in the capital replacement results highlights the dependence of TAFEs on government funding for their capital programs. Nevertheless, TAFEs are now able to fund capital expenditure from their cash reserves, by borrowing, or by the disposal of surplus assets. The data illustrate that spending on capital works is not sufficient to maintain and upgrade existing infrastructure and equipment.

Eleven of the 14 TAFEs (79 per cent) are now in either the medium- or high-risk category for this indicator. If greater investment does not occur, assets will deteriorate at a greater rate than they are replaced or renewed. This presents a risk to the long-term financial sustainability of TAFEs as their buildings and other infrastructure assets progressively become less functional.

Capital grants have historically been strategically allocated across the sector, with funds for asset replacement not provided until the government considered replacement to be appropriate.

Under the government's competitive neutrality policy, all vocational training providers receive funding based on student contact hours and not for specific types of expenditure such as the depreciation of their assets.

TAFEs are faced with a new commercial and autonomous operating environment in which state government capital funding will be allocated on a contestable basis. In light of this, TAFEs will need to take advantage of any announced contestable capital funding that becomes available, more flexible financing arrangements and cash reserves in order to fund asset replacement.

6 Internal controls

At a glance

Background

This Part presents the results of our review of the procurement practices and financial policies and delegations in the technical and further education (TAFE) sector.

Conclusion

Overall we found that documented policies and clear financial delegations had been established across the TAFE sector. Controls over procurement were generally adequate, but improvements could still be made in documenting the key integrity activities that underpin a tender process.

Findings

- Documentation evidencing the integrity of the tender process can be improved at TAFEs, with more clarity around probity requirements and the completion of conflicts of interest declarations. At one TAFE, Chisholm, a probity auditor was not appointed, acting on advice from the Higher Education and Skills Group, even though the contract was in excess of $10 million.
- During 2013, discrepancies were identified between the employment agreement lodged with the office of the Minister for Higher Education and Skills and the actual employment entitlements of the Box Hill Institute's chief executive officer agreed in 2008. A number of additional entitlements were not included in the agreement lodged with the minister's office for scrutiny. The additional entitlements were not standard under the state government standard executive contract.

Recommendations

That technical and further education institutes:

- document and define high-value, high-risk and complex procurement in the context of their business.
- adopt a schedule for periodic review of all key financial policies.

6.1 Introduction

Comprehensive internal controls help entities reliably and cost-effectively meet their objectives. Reliable internal controls are a prerequisite for the delivery of reliable, accurate and timely external and internal financial reports.

In our annual audits we focus on the internal controls relating to financial reporting and assess whether entities have managed the risk that the financial statements may not be complete and accurate. Poor internal controls diminish management's ability to achieve their entity's objectives and comply with relevant legislation. They also increase the risk of fraud and error.

The governing body of each technical and further education (TAFE) institute is responsible for developing and maintaining internal controls that enable:

- preparation of accurate financial reports and other supporting information
- timely and reliable external and internal reporting
- appropriate safeguarding of assets
- the prevention and detection of errors and irregularities.

The *Education and Training Reform Act 2006* and the *Financial Management Act 1994* (FMA) require management of TAFE institutes to implement effective internal control structures.

In this Part we report on aspects of internal controls in the state's 14 TAFEs covering procurement, and financial policies and delegations.

6.2 Procurement

The TAFE sector spent $275 million on the procurement of goods and services and had capital expenditure of $79 million in 2013. Poor procurement practices give rise to the risk of:

- the procurement process being unfair or not transparent
- inadequate supplier competition resulting in reduced value for money
- suppliers and TAFEs facing unnecessary transaction costs
- TAFEs purchasing inferior goods, services or assets that do not meet their operating objectives.

TAFEs are required to implement and maintain an effective internal control framework for procurement. The internal control framework should ensure that procurement satisfies an entity’s business needs, is suitably authorised, is in line with policies and procedures, and is consistent with the principles of value for money, open and fair competition, accountability, risk management, probity and transparency.

6.2.1 Procurement management framework

The key elements of an effective procurement management framework are detailed in Figure 6A. The framework draws upon the:

- Victorian Auditor-General's Office *Public Sector Procurement: Turning Principles into Practice* guidelines
- Standing Directions of the Minister for Finance under the FMA
- Victorian Government Purchasing Board policies.

Figure 6A
Key elements of an effective procurement framework

Key area	Better practice criteria
Procurement policies	Procurement and tendering policies exist and: • outline procurement objectives • comply with applicable government guidelines • clearly specify where to procure each type of goods and services • set out rules and requirements for purchases made using corporate cards • specify the requirement to avoid any actual or perceived bias • specify arrangements for obtaining quotations • detail when an open tender, selective tender or quotation is required • outline when an exemption from public and selective tendering is permitted • specify reporting frequencies and accountabilities • specify probity requirements for high-value or high-risk procurements. Policy approved by the board.
Management practices	Probity plan developed for all high-value, high-risk or complex procurements. Conflicts of interest—actual or perceived—identified and managed. Evaluation plan clearly documented and specifies panel member responsibilities. Probity auditor required for complex procurement or procurements over $10 million. Tender evaluation criteria established and submissions evaluated. Documented evidence of tender evaluations maintained. Post-tender evaluations conducted. Long-term contracts periodically assessed for value for money. Comprehensive and regular reporting to executive and board.
Governance and oversight	Compliance with procurement policy and government requirements monitored. Procurement risks included in the entity's risk register and managed. Board authorisation and oversight of probity plans for all high-value, high-risk or complex procurement. Monitoring of procurement performance and the results of significant tenders. Internal audit periodically engaged to review procurement activities. Policies reviewed periodically and changes approved by the board.

Source: Victorian Auditor-General's Office.

The above elements were considered in our assessment of the procurement function at each of the 14 TAFEs.

Controls over procurement across the TAFE sector were generally adequate. Policies were well established and comprehensive, and periodic review of procurement arrangements occurs. Improvements can be made by documenting the key integrity activities that underpin a tender process.

6.2.2 Policies

All TAFEs had detailed policies and procedures relating to procurement that complied with government policies and guidelines and generally included:

- an objective
- preferred suppliers
- arrangements for purchases on corporate cards
- probity provisions and the requirement to avoid any actual or perceived bias
- open tender, selective tender, limited tender and quotation requirements
- arrangements for obtaining quotations.

Procurement and tendering policies at all but two TAFEs were current and approved by the governing body—or management where approval had been delegated.

6.2.3 Management practices

Management oversight of procurement activities could be improved in the TAFE sector.

Better practice involves the preparation of probity plans for procurement with a value in excess of $10 million. Not all TAFEs undertake procurement of this size. However, a monetary threshold is not the only factor to consider when deciding if probity auditors should be engaged. Complex or high-risk procurement should also be subject to independent review to give comfort over purchasing propriety. We identified that in 29 per cent of TAFEs there was no requirement for probity plans to be in place for high-risk, complex or high-value procurement.

Where tenders are conducted, each of the 14 TAFEs require tender evaluation criteria to be set, provide guidance material for evaluators and require staff involved in the tender process to declare any conflicts of interest. Almost half of the TAFEs (43 per cent) did not require post-tender evaluations to be done, thereby missing the opportunity to identify areas for improvement.

Management monitoring over procurement is sound, with most TAFEs periodically assessing long-term purchasing arrangements, and reports on tendering and procurement provided to both senior management and boards.

6.2.4 Governance and oversight

The governing board is responsible for an entity's overall procurement framework, including risk identification, monitoring and oversight. The board typically reviews and signs off on key decisions made by management, particularly in relation to procurement activities with high risk, complexity or value.

The entity's audit committee may be used to review an entity's compliance with regulatory requirements and established policies and procedures, and to provide assurance on the integrity of the tender process.

Oversight of procurement at board and senior management level was generally sound, with procurement policies routinely approved, compliance monitored and results of significant tender outcomes reported.

During the past three years the procurement policies, procedures and internal controls had been subject to internal audit scrutiny at 79 per cent of TAFEs.

6.2.5 Procurement testing

To confirm the operating effectiveness of procurement controls we selected one contract from 11 of the TAFEs that had entered into a contract worth more than $200 000 during the financial year. The total value of contracts tested was $29.2 million.

We found that good practice was applied in procurement plans, tender evaluation plans and contractor performance management in the 11 tender processes reviewed. Specifically, a procurement plan had been developed for each tender and included:

- clear specifications
- a business case
- internal organisational requirements
- tender assessment criteria
- performance measures by which the successful application would be assessed.

The tender evaluation plans that we reviewed were generally comprehensive, detailing the tenders received, the assessment process, criteria, scoring and a rationale for selecting the preferred tender.

Contractor performance was also being monitored where required post completion of the 11 tender processes reviewed.

We observed that documentation evidencing the integrity of the tender process can be improved. Probity plans should be required when TAFEs undertake high-value, high-risk or complex procurement. TAFEs should consider and document what constitutes high-risk and complex procurement for them individually based on their organisational expertise, experience and risk appetite. Defining high-risk and complex procurement would set clear requirements for when probity plans need to be applied.

Chisholm Institute conducted a tender process in 2013 to award a $17.3 million contract for the construction of the Berwick Trade Careers Centre. The institute, acting on advice provided by the Higher Education and Skills Group, employed a contractor to manage the delivery of the project and make decisions on scope, cost, expenditure and fulfilment of the approved project brief and user needs. Based on this advice, a probity auditor was not appointed, even though the contract was in excess of $10 million. Appointment of a probity auditor enables scrutiny of the process and assessment of compliance with all legal and statutory requirements.

The integrity of a procurement process is underpinned by the independence and impartiality of all members of the tender assessment panel. A conflict of interest declaration provides evidence that no conflict of interest exists, either real or perceived. Or if a conflict is declared, it is transparent and can be managed so as not to adversely impact the tender process. We observed a need for TAFEs to reinforce the requirement for conflict of interest declarations to be prepared by all members of a tender panel in all procurement processes.

A formal post-tender evaluation had not been completed for all 11 tender processes reviewed, although a limited number were undertaken on an ad hoc basis. TAFEs could be missing opportunities to identify lessons learnt and improve tender processes and procedures where post-tender evaluations are not conducted.

6.3 Financial policies and delegations

Financial policies and delegations set the framework for the internal control environment. Without these, the risk of unauthorised and inappropriate transactions increases.

TAFEs are required by the FMA to establish effective financial policies and delegations. These policies should cover core financial activities, including revenue and debtor management, expenditure and creditor management, asset management, and payroll. A register of financial delegations is required to be established that sets out which staff are authorised to incur expenditure on behalf of the entity, and to what amount.

6.3.1 Financial policies and delegations framework

The key elements of an effective financial policies and delegations framework are detailed in Figure 6B. The framework draws upon the Standing Directions of the Minister for Finance under the FMA.

Figure 6B
Key elements of an effective financial policies and delegations framework

Component	Key elements
Policy	**Financial policies** Financial policies are established for key financial operations, including: • revenue and debtor management • expenditure and creditor management • asset management • payroll management. Policies are comprehensive and address core aspects of financial management procedures. Relevant legislation, applicable government guidelines and other government policy requirements addressed. Policies include requirements for periodic review and approval by the board. **Financial delegations** Clear financial delegations given to specific positions. Register of financial delegations established and includes: • positions holding financial authority for each transaction type • delegation limits for each transaction or authorisation type • alternate delegated signatories to cover staff absences • staff names holding positions • specimen signatures for authorised position holders. Arrangements for updating the register of financial delegations upon substantial change in duties or position. Financial delegations approved by the board.
Management practices	Quality assurance mechanisms established for monitoring policy compliance. Induction training on financial policies provided for new staff as appropriate. Register of financial delegations centrally maintained and periodically reviewed. Financial policies periodically reviewed.
Governance and oversight	Risks associated with financial policies and delegation arrangements included in the entity's risk register and managed. Internal audit periodically engaged to review compliance with financial policies and delegation requirements. Financial policies periodically reviewed and changes approved by the board. Updates to the register of financial delegations approved by the board.

Source: Victorian Auditor-General's Office.

We assessed the financial policies and delegation frameworks of the 14 TAFEs against the above elements. Overall we found that documented policies exist across the TAFE sector and clear financial delegations had been established.

6.3.2 Policies

TAFE institutes had documented policies and or procedures for the key financial activities defined in the FMA—revenue and debtor management, expenditure and creditor management, asset management and payroll activities.

The policies were observed to accord with the requirements of the FMA. However, the currency of policies is an issue that needs to be addressed. We observed that only six of the 14 TAFE institutes had reviewed and updated all key financial policies in the past three years. There were some significant time lapses since policies had been last updated, including:

- one TAFE, whose revenue and debtor management policy had been in place since 2000
- one TAFE, whose asset management policy was last approved in August 2008.

Policies that are out of date may not reflect current best practice control activities, thereby increasing the risk that transactions processed may not be complete, accurate or valid.

Documented controls over payroll activities can be improved. There is a divergence of practice in TAFE institutes adopting either payroll policies or payroll procedures or a combination of both. This in itself is not an issue, as long as all key risk and control areas are addressed in some way. However we identified consistent shortcomings in internal controls relating to:

- segregation of duties between key payroll functions
- review of any manual adjustments made by payroll staff
- managing excessive leave balances.

These represent an opportunity for TAFEs to improve internal controls and documentation in relation to payroll.

6.3.3 Financial delegations

Nearly all TAFE institutes have a register of financial delegations that lists all staff and positions holding financial authority, along with delegation limits for specific transaction/authorisation types. One TAFE is currently working to develop such a register.

For the register to be effective it needs to remain current. In all TAFEs we observed that there were mechanisms in place to deal with staff absences or changes in positions. Further, with one exception, all TAFEs that had a register had updated it within the past 12 months. Box Hill has not updated its register since 2011.

6.3.4 Management practices

Monitoring of policy compliance was undertaken by management at each of the 14 TAFEs. This generally involved follow up of internal audit recommendations, spot checks and periodic management-initiated reviews.

Management at all TAFEs had developed detailed work instructions for their financial management functions. These documents incorporated aspects of the overarching policy in a logical, structured approach for day-to-day use. Where policies did not exist, these work instructions were substituted as the principal guidance document for staff.

All TAFEs maintained their register of financial delegations centrally, to ensure version control and that changes were only made in accordance with the instrument of delegation. Eleven TAFEs demonstrated better practice by establishing information technology (IT) security controls that set financial delegation limits in their electronic payment systems.

Appropriate measures were in place at all TAFEs to deal with any conflicts of interest or where a delegate would benefit from the exercise of their financial delegation.

6.3.5 Governance and oversight

Oversight and monitoring of policy compliance and financial delegation registers is generally conducted at the management level.

Internal audit had been engaged at 86 per cent of TAFEs to review compliance with financial policies within the past three years. This indicates that TAFE boards recognise the importance of gaining assurance over the operating effectiveness of financial policy frameworks and delegation controls.

6.4 Probity issue at Box Hill Institute

6.4.1 Provision of generous employment entitlements and noncompliance with Ministerial Directions

Ministerial Directions to TAFEs regarding the employment of executive staff require a copy of the employment agreement between a TAFE and its chief executive officer (CEO) to be provided to the Minister for Higher Education and Skills. This requirement aims to promote transparency and provide the opportunity for the arrangements to be scrutinised.

In 2008, Box Hill employed a new CEO under a five-year employment agreement. The employment agreement was lodged with the minister’s office, as required. In November 2012, the board resolved to enter into a new employment agreement with the CEO. Responsibility for finalising the CEO’s new agreement was delegated to the chair appointed to the Box Hill board in 2013.

The chair’s subsequent enquiries into the CEO’s employment agreement revealed significant discrepancies between the entitlements in the employment agreement lodged with the minister's office, and those agreed in 2008 between the CEO and the board. The agreement between the CEO and the board provided additional entitlements, detailed in a formal letter of offer from the then board chair to the CEO. The letter of offer was signed by the chair of the board, in December 2008.

The additional agreed entitlements included:

- additional four weeks of paid leave of absence per annum after two years of service
- one fully paid overseas trip per year for self-directed professional development
- access to purchasing Box Hill-supplied home office equipment at market value after five years of service
- in the event of the CEO's retirement, retention of his motor vehicle as a retirement gift
- access to Box Hill's IT systems and networks for a further five years beyond the contract term and subject to the institute's network policy.

Though agreed, additional entitlements were not standard under the state government standard executive contract. They were not provided to the minister's office, and were, therefore, unable to be scrutinised.

Once identified, the CEO's additional entitlements were brought to the attention of the board in July 2013. A new employment agreement to be effective from 8 December 2013 was signed by the board in mid-2013 and forwarded to the minister’s office. The new agreement excluded the entitlements specified in the 2008 letter of offer.

Box Hill has advised that all senior executive contracts have been amended to reflect only standard state government terms and conditions.

Recommendations

That technical and further education institutes:

5. document and define high-value, high-risk and complex procurement in the context of their business so that there is clarity on when and where probity should be applied.
6. adopt a schedule for periodic review of all key financial policies to ensure they remain current.

Appendix A. VAGO reports on the results of financial audits

Figure A1
VAGO reports on the results of the 2012–13 financial audits

Report	Description
Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2012–13	This report provides the result of the audit of the state's annual financial report. It addresses the quality and timing of financial reporting, explains significant financial results for the state and financial implications of significant projects and developments that occurred during 2012–13. *Tabled in Parliament in November 2013.*
Portfolio Departments and Associated Entities: Results of the 2012–13 Audits	The report provides the results of the audits of approximately 208 entities. The report addresses their financial reporting, financial sustainability and reporting development, the use of contractors and temporary staff, and management of business continuity and information technology disaster recovery planning. *Tabled in Parliament in November 2013.*
Public Hospitals: Results of the 2012–13 Audits	The report provides the results of the audits of 112 entities in the public hospital sector. It addresses their financial performance, financial sustainability, and management of private patient fees and risk. *Tabled in Parliament in November 2013.*
Local Government: Results of the 2012–13 Audits	The report provides the results of the audits of 102 entities in the local government sector. The report addresses their financial and performance reporting, financial sustainability, aspects of how they manage rate revenue, and the operation of audit committees. *Tabled in Parliament in December 2013.*
Water Entities: Results of the 2012–13 Audits	This report provides the results of the audits of 20 entities in the water sector. The report addresses their financial and performance reporting, financial sustainability, and comments on internal controls relating to information technology security and change management, procurement and treasury management. *Tabled in Parliament in December 2013.*
Universities: Results of the 2013 Audits	This report presents the results of audits of 64 entities in the university sector. The report addresses their financial reporting, financial sustainability and internal controls relating to procurement, financial policies and financial delegations. *Tabled in Parliament in May 2014*
Technical and Further Education Institutes: Results of the 2013 Audits This report	This report presents the results of audits of 27 entities in the TAFE sector. The report addresses their financial reporting, financial sustainability and internal controls relating to procurement, financial policies and financial delegations. *Tabled in Parliament in August 2014*

Source: Victorian Auditor-General's Office.

Appendix B.
Completed audit listing

TAFEs and associated entities

Entity	Audit type		Financial statements		Timeliness of financial statements completion		
	FMA	Non-FMA	Clear opinion	Opinion date	Up to 12 weeks	12 to 18 weeks	More than 18 weeks
TAFE INSTITUTES							
Advance TAFE	✓		✓	30-Apr-14		✓	
Bendigo Regional Institute of TAFE	✓		✓	18-Mar-14	✓		
Box Hill Institute of TAFE	✓		✓	28-Feb-14	✓		
Box Hill Enterprises Ltd		✓	✓	28-Feb-14	✓		
Centre for Adult Education	✓		✓	28-Feb-14	✓		
Central Gippsland Institute of TAFE	✓		✓	20-Mar-14	✓		
Chisholm Institute of TAFE	✓		✓	27-Feb-14	✓		
Caroline Chisholm Education Foundation	✓		✓	27-Feb-14	✓		
Gordon Institute of Technical and Further Education	✓		✓	18-Mar-14	✓		
GOTEC Limited		✓	✓	18-Mar-14	✓		
Goulburn Ovens Institute of TAFE	✓		✓	18-Mar-14	✓		
Holmesglen Institute	✓		✓	12-Mar-14	✓		
Holmesglen Foundation	✓		✓	04-Mar-14	✓		
Holmesglen International Training Services Pty Ltd		✓	✓	17-Mar-14	✓		
Kangan Institute	✓		✓	20-Mar-14	✓		
John Batman Consultancy & Training Pty Ltd		✓	✓	20-Mar-14	✓		
Northern Melbourne Institute of TAFE	✓		✓	15-May-14			✓
South West Institute of TAFE	✓		✓	26-Mar-14		✓	
Sunraysia Institute of TAFE	✓		✓	26-Mar-14		✓	
TAFE Kids Incorporated		✓	✓	26-Mar-14		✓	

Entity	Audit type		Financial statements		Timeliness of financial statements completion		
	FMA	Non-FMA	Clear opinion	Opinion date	Up to 12 weeks	12 to 18 weeks	More than 18 weeks
William Angliss Institute of TAFE	✓		✓	28-Feb-14	✓		
Angliss Consulting Pty Ltd		✓	✓	28-Feb-14	✓		
Angliss Multimedia Pty Ltd		✓	✓	28-Feb-14	✓		
Angliss Solutions Pty Ltd		✓	✓	28-Feb-14	✓		
William Angliss Institute Foundation	✓		✓	28-Feb-14	✓		
William Angliss Pty Ltd		✓	✓	28-Feb-14	✓		
Wodonga Institute of TAFE	✓		✓	12-Mar-14	✓		
2013 Total	**18**	**9**			**22**	**4**	**1**
		27					**27**
2012 Total	**18**	**10**			**93**	**2**	**0**
		28					**95**

Note: 'FMA' refers to the *Financial Management Act 1994*.

Appendix C.

Financial audit frameworks

The financial audit framework applied in the conduct of the 2013 audits covered by this report is set out in 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 report 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 report 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:

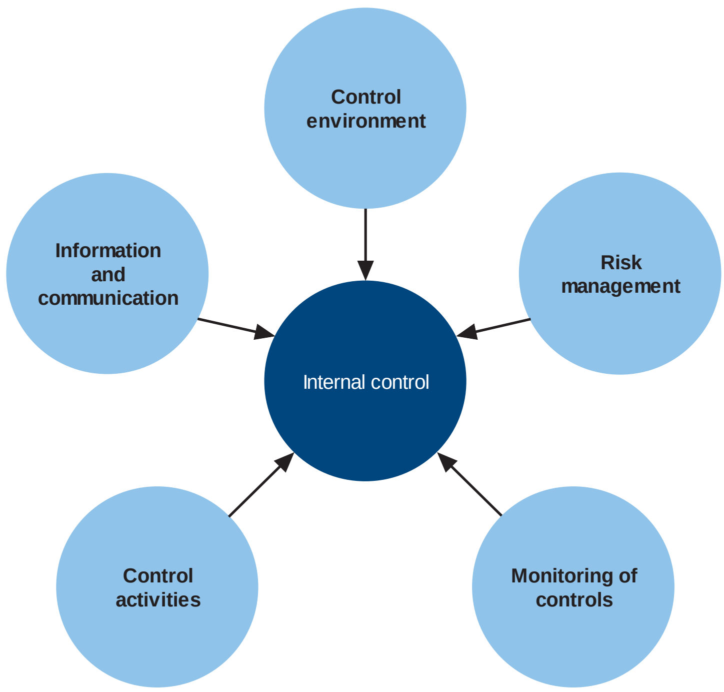
- A signed audit opinion, which is presented in the client's annual report alongside the certified financial report.
- A report to Parliament on significant issues arising from audits either for the individual entity or for the sector as a whole.

Source: Victorian Auditor-General's Office.

Internal control framework

Figure C2 identifies the main components of an effective internal control framework.

Figure C2
Components of an internal control framework



Source: Victorian Auditor-General's Office.

In the diagram:

- the **control environment** provides the fundamental discipline and structure for the controls and includes governance and management functions and the attitudes, awareness, and actions of those charged with governance and management of an entity
- **risk management** involves identifying, analysing and mitigating risks
- **monitoring of controls** involves observing the internal controls in practice and assessing their effectiveness
- **control activities** are policies, procedures and practices prescribed by management to help meet an entity's objectives
- **information and communication** involves communicating control responsibilities throughout the entity and providing information in a form and time frame that allows officers to discharge their responsibilities.

Financial report preparation

Our assessment of financial reporting performance against better practice was based on criteria outlined in Figure C3.

Figure C3
Financial report preparation better practice

Key area	Better practice
Financial report preparation plan	Establish a plan that outlines the processes, resources, milestones, oversight, and quality assurance practices required in preparing the financial report.
Preparation of shell statements	Prepare a shell financial report and provide it to the auditors early to enable early identification of amendments, minimising the need for significant disclosure changes at year-end.
Materiality assessment	Assess materiality, including quantitative and qualitative thresholds, at the planning phase in consultation with the audit committee. The assessment assists preparers to identify potential errors in the financial report.
Monthly financial reporting	Adopt full accrual monthly reporting to assist in preparing the annual financial report. This allows the year-end process to be an extension of the month-end process.
Quality control and assurance procedures	Require rigorous review of the supporting documentation, data and the financial report itself by an appropriately experienced and independent officer prior to providing it to the auditors.
Supporting documentation	Prepare high-standard documentation to support and validate the financial report and provide a management trail.
Analytical reviews	Undertake rigorous and objective analytical review during the financial report preparation process to help to improve the accuracy of the report.
Reviews of controls/ self-assessment	Establish sufficiently robust quality control and assurance processes to provide assurance to the audit committee on the accuracy and completeness of the financial report.
Competency of staff	The preparers of the financial report have a good understanding of, and experience in, applying relevant accounting standards and legislation. They also have effective project management and interpersonal skills.
Financial compliance reviews	Undertake periodic compliance reviews to identify areas of noncompliance or changes to legislation that impact the financial report.
Adequate security	Protect and safeguard sensitive information 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 by Public Sector Entities*, June 2009.

Appendix D. Financial sustainability indicators and criteria

Indicators of financial sustainability

Figure D1
Financial sustainability indicators

Indicator	Formula	Description
Underlying result (%)	Adjusted net surplus / Total 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. Underlying revenue does not take into account one-off or non-recurring transactions. 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 (ratio)	Current assets / Current liabilities	This measures the ability to pay existing liabilities in the next 12 months. A ratio of one or more means there are more cash and liquid assets than short-term liabilities. Current liabilities exclude long-term employee provisions and revenue in advance.
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.
Self-financing (%)	Net operating cash flows / Underlying revenue	Measures the ability to replace assets using cash generated by the entity's 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 (ratio)	Cash outflows for property, plant and equipment / Depreciation	Comparison of the rate of spending on infrastructure with its depreciation. Ratios higher than 1:1 indicate that spending is faster than the depreciating rate. 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 infrastructure are taken from the cash flow statement. Depreciation is taken from the comprehensive operating statement.

Source: Victorian Auditor General's Office.

These indicators should be considered collectively, and are more useful when assessed over time as part of a trend analysis. These indicators have been applied to the published financial information of technical and further education (TAFE) institutes for the period from 2009 to 2013.

The analysis of financial sustainability in this report reflects on the position of each individual entity, and of the TAFE sector. The financial sustainability indicators used in this report are consistent with those used in previous reports to Parliament, and are indicative of the financial sustainability of TAFEs.

Financial sustainability risk assessment criteria

The financial sustainability of each TAFE has been assessed using the risk criteria outlined in Figure D2.

Figure D2
Financial sustainability indicators – risk assessment criteria

Risk	Underlying result	Liquidity	Debt-to-equity	Self-financing	Capital replacement
High	Negative 10% or less Insufficient revenue is being generated to fund operations and asset renewal.	Less than 0.7 Immediate sustainability issues with insufficient current assets to cover liabilities.	More than 60% Potential long-term concern over ability to repay debt levels from own source revenue.	Less than 10% Insufficient cash from operations to fund new assets and asset renewal.	Less than 1.0 Spending on capital works has not kept pace with consumption of assets.
Medium	Negative 10%–0% A risk of long-term run down to cash reserves and inability to fund asset renewals.	0.7–1.0 Need for caution with cash flow, as issues could arise with meeting obligations as they fall due.	40–60% Some concern over the ability to repay the debt from own source revenue.	10–20% May not be generating sufficient cash from operations to fund new assets.	1.0–1.5 May indicate spending on asset renewal is insufficient.
Low	More than 0% Generating surpluses consistently.	More than 1.0 No immediate issues with repaying short-term liabilities as they fall due.	Less than 40% No concern over the ability to repay debt from own source revenue.	More than 20% Generating enough cash from operations to fund new assets.	More than 1.5 Low risk of insufficient spending on asset renewal.

Source: Victorian Auditor-General's Office.

The overall financial sustainability risk assessment has been calculated using the ratings determined for each indicator as outlined in Figure D3.

Figure D3
Overall financial sustainability risk assessment

Risk rating	Risk indicators
🔴	High risk of short-term and immediate sustainability concerns indicated by: • **red** underlying result indicator or • **red** liquidity indicator
🟠	Medium risk of long-term sustainability concerns indicated by either: • **red** self-financing indicator • **red** debt-to-equity indicator • **red** capital replacement indicator
🟢	Low risk of financial sustainability concerns—there are no high-risk indicators

Source: Victorian Auditor-General's Office.

Financial sustainability trend key:

▲ = Improving trend
▼ = Deteriorating trend
● = No substantial trend identified.

TAFEs

Five-year mean

TAFEs	5-year mean					
	Underlying result (%)	Liquidity	Debt-to-equity (%)	Self-financing (%)	Capital replacement	Overall risk assessment
Advance	-4.5%	2.9	0.0%	-0.1%	1.3	🟠
Bendigo	5.6%	2.0	0.0%	11.0%	2.3	🟢
Box Hill	5.2%	4.3	0.0%	8.0%	2.7	🟠
Central Gippsland	10.7%	2.0	1.6%	19.5%	3.9	🟢
Chisholm	10.3%	3.2	0.0%	13.0%	2.4	🟢
Gordon	11.4%	5.3	0.0%	14.4%	1.4	🟢
Goulburn Ovens	8.9%	3.7	0.0%	14.4%	1.8	🟢
Holmesglen	4.1%	4.2	0.0%	9.8%	2.4	🟠
Kangan Institute	9.8%	3.0	0.0%	16.2%	2.5	🟢
Northern Melbourne	1.7%	4.3	0.0%	6.5%	2.5	🟠
South West	3.3%	2.4	1.5%	11.3%	1.8	🟢
Sunraysia	1.2%	3.2	0.0%	6.9%	1.2	🟠
William Angliss	0.6%	2.7	0.8%	3.6%	1.6	🟠
Wodonga	11.3%	3.7	0.0%	17.5%	2.8	🟢
TAFE average	**5.7%**	**3.4**	**0.3%**	**10.9%**	**2.2**	🟢

Source: Victorian Auditor-General's Office.

Underlying result

	Underlying result (%)						
TAFEs	**2009**	**2010**	**2011**	**2012**	**2013**	**5-year mean**	**Trend**
Advance	10.8%	8.2%	12.8%	-3.4%	-50.9%	-4.5%	▼
Bendigo	9.5%	23.5%	-5.8%	0.5%	0.3%	5.6%	▼
Box Hill	4.7%	3.4%	14.2%	6.7%	-2.9%	5.2%	▼
Central Gippsland	11.2%	24.2%	20.5%	12.7%	-15.0%	10.7%	▼
Chisholm	7.3%	14.1%	4.7%	2.7%	22.6%	10.3%	▲
Gordon	8.3%	17.6%	17.2%	13.2%	0.8%	11.4%	▼
Goulburn Ovens	24.3%	1.6%	-8.1%	15.4%	11.2%	8.9%	▼
Holmesglen	5.6%	10.0%	7.8%	2.8%	-5.8%	4.1%	▼
Kangan Institute	16.0%	19.3%	11.3%	-0.9%	3.2%	9.8%	▼
Northern Melbourne	15.1%	9.4%	8.9%	3.3%	-28.1%	1.7%	▼
South West	14.6%	12.1%	4.2%	-1.7%	-12.6%	3.3%	▼
Sunraysia	3.6%	2.8%	-5.3%	0.3%	4.6%	1.2%	▲
William Angliss	12.4%	5.4%	-1.8%	-1.9%	-11.3%	0.6%	▼
Wodonga	1.9%	23.4%	7.4%	22.5%	1.3%	11.3%	▼
TAFE average	**10.4%**	**12.5%**	**6.3%**	**5.1%**	**-5.9%**	**5.7%**	▼

Source: Victorian Auditor-General's Office.

Liquidity

	Liquidity						
TAFEs	**2009**	**2010**	**2011**	**2012**	**2013**	**5-year mean**	**Trend**
Advance	2.9	4.2	3.6	2.2	1.8	2.9	▼
Bendigo	3.0	1.8	1.6	2.0	1.8	2.0	▼
Box Hill	5.3	4.6	3.8	3.6	4.4	4.3	▼
Central Gippsland	2.7	2.8	1.4	1.4	1.5	2.0	▼
Chisholm	2.6	3.0	2.6	2.5	5.5	3.2	▲
Gordon	4.2	4.6	5.4	6.2	6.3	5.3	▲
Goulburn Ovens	2.8	3.7	3.0	4.9	4.0	3.7	▲
Holmesglen	6.5	5.2	5.2	2.8	1.4	4.2	▼
Kangan Institute	3.4	4.7	2.3	2.7	1.8	3.0	▼
Northern Melbourne	4.0	5.8	4.9	5.1	1.8	4.3	▼
South West	2.4	2.7	2.3	2.7	1.8	2.4	▼
Sunraysia	3.8	3.5	2.6	3.9	2.0	3.2	▼
William Angliss	4.2	4.3	1.9	1.8	1.3	2.7	▼
Wodonga	4.7	4.8	1.9	2.8	4.0	3.7	▼
TAFE average	**3.7**	**4.0**	**3.0**	**3.2**	**2.8**	**3.4**	▼

Source: Victorian Auditor-General's Office.

Debt-to-equity

	Debt-to-equity (%)						
TAFEs	**2009**	**2010**	**2011**	**2012**	**2013**	**5-year mean**	**Trend**
Advance	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	▲
Bendigo	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	●
Box Hill	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	●
Central Gippsland	0.0%	0.0%	0.0%	0.0%	7.8%	1.6%	▼
Chisholm	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	●
Gordon	0.0%	0.0%	0.0%	0.0%	0.1%	0.0%	▼
Goulburn Ovens	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	●
Holmesglen	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	●
Kangan Institute	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	●
Northern Melbourne	0.1%	0.0%	0.0%	0.0%	0.0%	0.0%	▲
South West	0.0%	0.0%	0.0%	0.0%	7.5%	1.5%	●
Sunraysia	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	●
William Angliss	0.0%	0.0%	0.0%	0.0%	4.1%	0.8%	▼
Wodonga	0.2%	0.0%	0.0%	0.0%	0.0%	0.0%	▲
TAFE average	**0.0%**	**0.0%**	**0.0%**	**0.0%**	**1.4%**	**0.3%**	▼

Source: Victorian Auditor-General's Office.

Self-financing

TAFEs	Self-financing (%) 2009	2010	2011	2012	2013	5-year mean	Trend
Advance	14.9%	8.7%	19.8%	2.5%	-46.3%	-0.1%	▼
Bendigo	12.0%	25.8%	5.2%	9.4%	2.6%	11.0%	▼
Box Hill	4.3%	11.2%	15.9%	8.8%	-0.4%	8.0%	▼
Central Gippsland	17.9%	30.5%	20.7%	28.2%	0.2%	19.5%	▼
Chisholm	7.4%	14.0%	17.3%	4.2%	22.0%	13.0%	▲
Gordon	10.4%	14.2%	31.2%	13.3%	2.8%	14.4%	▼
Goulburn Ovens	25.9%	9.9%	7.7%	14.3%	14.4%	14.4%	▼
Holmesglen	8.3%	14.2%	7.9%	13.7%	4.6%	9.8%	▼
Kangan Institute	17.6%	27.7%	23.6%	1.9%	10.3%	16.2%	▼
Northern Melbourne	19.5%	12.9%	12.1%	8.5%	-20.6%	6.5%	▼
South West	18.2%	18.7%	16.1%	6.7%	-3.0%	11.3%	▼
Sunraysia	7.6%	8.8%	2.0%	7.6%	8.3%	6.9%	▲
William Angliss	14.3%	6.3%	2.8%	0.4%	-5.6%	3.6%	▼
Wodonga	7.7%	29.4%	21.2%	29.2%	-0.3%	17.5%	▼
TAFE average	**13.3%**	**16.6%**	**14.5%**	**10.6%**	**-0.8%**	**10.9%**	▼

Source: Victorian Auditor-General's Office.

Capital replacement

TAFEs	Capital replacement 2009	2010	2011	2012	2013	5-year mean	Trend
Advance	1.7	1.5	2.3	0.8	0.2	1.3	▼
Bendigo	2.2	7.1	1.1	0.6	0.3	2.3	▼
Box Hill	4.9	0.9	0.9	3.0	4.0	2.7	▼
Central Gippsland	2.9	5.8	6.7	2.9	1.1	3.9	▼
Chisholm	2.1	4.2	2.0	1.0	2.7	2.4	▲
Gordon	2.3	2.3	0.9	1.5	0.2	1.4	▼
Goulburn Ovens	5.6	1.6	0.8	0.7	0.5	1.8	▼
Holmesglen	2.1	5.1	3.3	1.2	0.4	2.4	▼
Kangan Institute	1.7	3.7	5.0	1.1	1.0	2.5	▼
Northern Melbourne	4.4	3.0	2.1	2.1	1.1	2.5	▼
South West	3.4	2.4	1.7	1.0	0.7	1.8	▼
Sunraysia	1.5	1.4	1.0	0.6	1.4	1.2	▼
William Angliss	4.0	1.9	1.1	0.6	0.5	1.6	▼
Wodonga	1.5	4.8	2.0	3.0	2.9	2.8	▲
TAFE average	**2.9**	**3.3**	**2.2**	**1.4**	**1.2**	**2.2**	▼

Source: Victorian Auditor-General's Office.

Appendix E. 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.

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.

Asset useful life

An asset's useful life is the period over which it is expected to provide the entity with economic benefits. Depending on the nature of the asset, the useful life can be expressed in terms of time or output.

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.

Auditor's opinion

Written expression within a specified framework indicating the auditor's overall conclusion on the financial (and performance) reports based on audit evidence obtained.

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 these assets
- expenditure on new assets, including buildings, infrastructure, plant and equipment

Clear audit opinion – financial report

A positive written expression provided when the financial report has been prepared and presents fairly the transactions and balances for the reporting period in accordance with the requirements of the relevant legislation and Australian Accounting Standards.

Also referred to as an **unqualified audit opinion.**

Clear audit opinion – performance statement

A positive written expression provided when the performance statement has been prepared and presents fairly the performance indicators and results of performance for the reporting period in accordance with the requirements of the relevant legislation.

Also referred to as an **unqualified audit opinion.**

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 state 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 value of an asset over its expected useful life.

Employee benefits provision

The liability recognised for employees' accrued service entitlements, including all accrued costs related to employment comprising of wages and salaries, leave entitlements, redundancy payments and superannuation contributions.

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 that is relevant to the users of the auditor's report but is not of such nature that it affects the auditor's opinion—i.e. the auditor's opinion remains unmodified.

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.

Equity or net assets

Residual interest in the assets of an entity after deduction of its liabilities.

Expense

Outflows or other depletions of economic benefits in the form of incurrence of liabilities or depletion of assets of the entity.

Fair value

The amount for which a financial or non-financial asset could be exchanged between knowledgeable and willing parties in an arm's-length transaction.

Financial delegation

A schedule that specifies the level or approval required for each transaction category to facilitate the execution of functions necessary for the efficient operation of the entity.

Financial reporting direction

Financial reports are prepared in accordance with Australian Accounting Standards and Interpretations as issued by the Australian Accounting Standards Board (AASB). When 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 sustainability

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

Financial year

A period of 12 months for which a financial report (and performance report) is prepared.

Going concern

An entity which is expected to be able to pay its debts as and when they fall due, and continue in operation without any intention or necessity to liquidate or otherwise wind up its operations.

Internal audit

A function of an entity's governance framework that examines and reports to management on the effectiveness of risk management, control and governance processes.

Internal control

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 error and fraud and protecting the entity’s resources.

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.

Masterfile

A database of records pertaining to one of the main subjects of an information system, such as customers, employees and vendors. Masterfiles contain descriptive data that does not often change, such as name, address and bank account details.

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.

Net result

The net result is calculated by subtracting an entity’s total expenses from the total revenue, to show what the entity has earned or lost in a given period of time.

Non-reciprocal

Transfers in which an entity receives assets without directly giving equal value in exchange to the other party to the transfer.

Performance statement

A statement containing predetermined performance indicators and targets and actual results against these for that financial year, with an explanation for any significant variance between the results and the targets.

Qualified audit opinion – financial report

A qualification is issued when the auditor concludes that an unqualified opinion cannot be expressed due to one of the following reasons:

- disagreement with those charged with governance
- conflict between applicable financial reporting frameworks
- limitation of scope.

A qualified opinion shall be expressed as being except for the effects of the matter to which the qualification relates.

Relevant

Measures or indicators used by an entity are relevant if they have a logical and consistent relationship to an entity's objectives and are linked to the outcomes to be achieved.

Revaluation

Recognising a reassessment of values for non-current assets at a particular point in time.

Revenue

Inflows of funds 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 result 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.

TAFE sector

TAFE sector refers to the 14 technical and further education (TAFE) institutes.

VET

Vocational education and training (VET) courses are the principal course offerings at TAFEs.

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 the Department of Education and Early Childhood Development, the Department of Treasury and Finance and each of the 14 technical and further education institutes with a request for submissions or comments.

The submissions and comments provided 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.

Responses were received as follows:

RESPONSE provided by the Secretary, Department of Education and Early Childhood Development

Department of Education and Early Childhood Development

Office of the Secretary

2 Treasury Place
East Melbourne, Victoria 3002
Telephone: +61 3 9637 2000
DX 210083
GPO Box 4367
Melbourne, Victoria 3001

COR004705

RECEIVED
01 AUG 2014
VICTORIAN AUDITOR-GENERAL'S OFFICE

Mr John Doyle
Auditor-General
Victorian Auditor-General's Office
Level 24, 35 Collins Street
MELBOURNE 3000

Dear Mr Doyle

Thank you your letter of 23 July 2014 providing the Department of Education and Early Childhood Development with the opportunity to comment, under section 16(3) of the *Audit Act 1994*, on the proposed audit report *Technical and Further Education Institutes: Results of the 2013 Audits*.

The Department accepts the six recommendations. The Department's action plan outlining actions which the Department commits to taking to address the recommendations is included at Attachment 1.

Completion of the actions addressing the recommendations will be monitored via the Department's internal audit tracking registers and reviewed regularly by the Executive Board and the Portfolio Audit and Risk Committee as part of the Department's standard procedures.

Given the significant reforms to Victoria's vocational training system over the last few years, I am pleased that you have found that 10 of the 14 stand-alone TAFE institutes have responded sufficiently to the changed funding and market conditions.

Of the four TAFE institutes that you have found have not responded sufficiently:

- Advance TAFE – has subsequently integrated with GippsTAFE to form Federation Training
- NMIT – as identified in your report, following changes to board membership and the appointment of an interim CEO, has identified and is implementing a range of operational initiatives to improve its financial performance
- South West TAFE – has been allocated $7.7 million from the TAFE Structural Adjustment Fund to improve its financial sustainability
- Holmesglen Institute – has very substantial cash reserves which diminishes the incentive to respond.

It has become increasingly evident that strong governance and management is critical to TAFE institutes successfully adapting to a more competitive environment. This has been

This original has been printed in black and white on recycled paper to reduce cost and environmental impact.

RESPONSE provided by the Secretary, Department of Education and Early Childhood Development – continued

supported by the strengthened governance arrangements for TAFE institutes that have been implemented over the last few years, in response to a number of recommendations, including those of the Auditor-General in the 2011 TAFE Governance report.

The Department would welcome further discussion on two matters for future reports:

- using student numbers, rather than enrolments, as an indicator of training delivery and proxy for revenue
- the assessment of financial sustainability.

Use of student numbers, rather than enrolments

Following the introduction of a fully contestable vocational training market in 2009, there has been strong growth in the number of government subsidised enrolments, with the number of enrolments increasing 76 per cent, from 381,300 in 2008 to 645,000 in 2012. During this same period, government subsidised enrolments at the 14 stand-alone TAFE institutes increased by 18 per cent from 181,000 in 2008 to 213,300 in 2012.

Following this strong period of growth, government subsidised enrolments decreased marginally from 2013 to 2012 – by 4 per cent across the training system, and by 2.5 per cent at TAFE institutes.

This data demonstrates that, while your report is correct in identifying a decrease in activity from 2012 to 2013, this decrease follows a period of sustained growth across the training system and at TAFE institutes.

Your report uses student numbers, rather than enrolments, to measure training activity by TAFE institutes. Enrolments are a better proxy for the volume of training delivery and associated revenue than student numbers. I would encourage you to consider using enrolments, rather than student numbers, to measure training activity in future reports.

Assessment of financial sustainability

I accept that the approach and methodology that is used by your office to assess the financial sustainability of entities has been used for a number of years and is consistent across the public sector. I would welcome the opportunity for officers from my Department to work with officers from your office to develop a set of further financial sustainability indicators and thresholds that take into consideration the specific circumstances of the entity.

I note from your letter of 23 July 2014 that your reports are unable to include any information that would prejudice any investigations or proceedings by other bodies.

Should you wish to discuss the content of this response further, please contact Marianne Lourey, Executive Director, TAFE Transition Taskforce, Department of Education and Early Childhood Development, on 9637 2496 or by email: lourey.marianne.e@edumail.vic.gov.au.

Yours sincerely

Richard Bolt
Secretary

31/7/2014

RESPONSE provided by the Secretary, Department of Education and Early Childhood Development – continued

Attachment 1 – Response to the recommendations

VAGO Report – *TAFE institutes: Results of the 2013 Audits*

The Department welcomes the opportunity to comment on the audit report and accepts the recommendations, either in full or in part. The Department's specific management response for each recommendation is outlined below:

Recommendation #	Action(s)	Indicative Timeframes
1 In line with better practice report preparation, and in order to improve the quality of reporting, TAFE institutes prepare shell financial statements; improve financial compliance reviews, analytical reviews, materiality assessments and quality assurance practices; and address the competency of staff involved.	**Accept** The quality of report preparation is the responsibility of the Board of the TAFE institute. This recommendation will be included in the Department's Strategic Dialogue meetings with TAFE institutes to ensure that they are aware of this recommendation and are actioning it appropriately.	2nd half 2014
2 DEECD works with TAFE institutes to develop a robust framework that specifies reporting requirements, mandates a core suite of relevant and appropriate key performance indicators, and guides entities in establishing suitable targets and effectively analysing performance.	**Accept, noting that full implementation will be possible for 2015 annual reports** In 2013, DEECD introduced a strengthened performance and accountability framework for TAFE institutes. Central to this is the Strategic Planning Guidelines for TAFE institutes that provide a framework for planning and reporting, based on best practice in other public entity sectors. It includes guidance on the legislative requirement for TAFE institutes to have a strategic plan (which is commercial-in-confidence) and publicly available annual statement of corporate intent, each with their own key performance indicators (with targets) that should be measured, monitored and reported. The core set of key performance indicators comprises:	1st half 2016

Recommendation #	Action(s)	Indicative Timeframes
	• Financial indicators – the return on investment is defined in the Strategic Planning Guidelines. A long term and 2014 target has been agreed with each TAFE institute. They are set out in the Minister's Annual Statement of Expectations and the institutes' Annual Statement of Corporate Intent. • Non financial indicators - DEECD is leading a national pilot on outcomes-based performance indicators which will be able to inform the development of a suite of common outcomes-based key performance indicators that would apply to all training providers, including TAFE institutes, enabling comparability across the training system. Once developed, targets for these measures will be agreed and set out in the Minister's Annual Statement of Expectations and the institutes' Annual Statement of Corporate Intent. The *Guidelines for 2014 TAFE institute annual reports* will require that, for each key performance indicator in the annual statement of corporate intent, the following information is provided in the annual report: • Prior year's actual • Target • Actual • Explanation for any variance between target and actual. The full set of key performance indicators will include the institute-specific indicators based on their own key strategic initiatives and the core indicators as set out above (once developed). Given the timing of this trial, the core non-financial indicators will not be available for reporting by TAFE institutes until the 2015 annual reports. DEECD will continue to monitor the relevance of key performance indicators submitted by the TAFE institutes and the guidance it provides in their development.	

RESPONSE provided by the Secretary, Department of Education and Early Childhood Development – continued

Recommendation #	Action(s)	Indicative Timeframes
3 TAFE institutes improve the quality of performance statements by including comparative information and explanations of significant variances observed.	**Accept** As part of the transition to a strengthened performance and accountability framework, DEECD is providing advice to TAFE institutes that the performance statements contained in their annual reports need to be more relevant and linked to the key performance indicators in their annual statements of corporate intent. This change is expected to take effect for the 2014 TAFE institute annual reports.	1st half 2015
4 DEECD acts to mitigate the risk of misstatement of performance by TAFE institutes by ensuring adequate scrutiny of information reported.	**Accept** As part of the transition to a strengthened performance and accountability framework, DEECD is providing advice and working with TAFE institutes to ensure that their performance reporting is relevant and linked to the key performance indicators in their strategic plans and annual statements of corporate intent.	Ongoing
5 TAFE institutes document and define high value, high risk and complex procurement in the context of their business so that there is clarity on when and where probity should be applied.	**Accept** Procurement matters are a responsibility of the Board of the TAFE institute. This recommendation will be included in the Department's Strategic Dialogue meetings with TAFE institutes to ensure that they are aware of this recommendation and are actioning it appropriately.	2nd half 2014
6 TAFE institutes adopt a schedule for periodic review of all key financial policies to ensure they remain current.	**Accept** The development of institute financial policies is the responsibility of the Board of the TAFE institute. This recommendation will be included in the Department's Strategic Dialogue meetings with TAFE institutes to ensure that they are aware of this recommendation and are actioning it appropriately.	2nd half 2014

RESPONSE provided by the Chief Executive Officer, Box Hill Institute

BOX HILL INSTITUTE
Global Educators
Melbourne - Australia

31 July2014

Mr John Doyle
Auditor-General
Victorian Auditor-General's Office
Level 24
35 Collins Street
MELBOURNE VIC 3000

RECEIVED
31 JUL 2014
VICTORIAN AUDITOR-GENERAL'S OFFICE

Dear Mr Doyle

***Audit Act 1994* S16(3) – Proposed Audit Report**
Technical and Further Education Institutes: Results of the 2013 Audits

Thank you for your letter 23 July 2014 addressed to Mr Joe Piper enclosing extracts from the proposed report. By way of introduction I am responding as the new Chief Executive Office.

The Institute has reviewed the proposed Audit Report chapter *6 Internal Controls*. Your recommendations for the TAFE system regarding interim controls relating to procurement, financial controls and delegations are accepted. Box Hill Institute will ensure appropriate reviews of policies and procedures are conducted regularly and built into reporting systems and overseen by appropriate governance bodies.

Your finding relating to Box Hill Institute having not updated its Financial Delegations Register since 2011 is accepted. The Institute has updated its Financial Delegation Register and will revise it at least annually to ensure it reflects the current organisational structure and any changes to financial and procurement policies.

Your finding in relation to probity Issues at Box Hill Institute relating to executive contract entitlements is noted. The Institute will ensure that all executive contracts are compliant with standard State Government terms and conditions and address any pre-existing anomaly.

Yours sincerely

Mr Norman Gray AM
Chief Executive Officer

Postal Address: Private Bag 2014 Box Hill Victoria 3128
465 Elgar Road Box Hill Victoria 3128
T +61 3 9286 9222 F +61 3 9286 9438
www.boxhill.edu.au

ABN: 76 268 630 462
CRICOS Provider No. 02411J
Box Hill Institute of TAFE

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Report title	Date tabled
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Victorian Auditor-General's Office
Level 24, 35 Collins Street
Melbourne Vic. 3000
AUSTRALIA

Phone: +61 3 8601 7000
Fax: +61 3 8601 7010
Email: comments@audit.vic.gov.au