

The Auditor-General provides assurance to Parliament on the accountability and performance of the Victorian Public Sector.

On 12 February 2015, the Auditor-General tabled his financial audit report, *Water Entities: Results of the 2013-14 Audits*.

12 February 2015 | *Water Entities: Results of the 2013-14 Audits*

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## Background

- Victorian water industry comprises 19 water entities and one controlled entity.
- Water entities provide water, sewerage and trade waste services to the Victorian community.

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The Victorian water industry comprises 19 water entities and one controlled entity. A controlled entity is one that is owned or controlled by another entity. The water entities provide water, sewerage and trade waste services to the Victorian community.

This report provides the results of the financial audits of all entities, however, the controlled entity ceased trading in August 2012, therefore our report and this presentation relates predominantly to the 19 water entities.

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**Financial and performance reporting**

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- **Results of financial reports:**
  - Unqualified audit opinions issued for all entities in 2013-14.
  - Financial reports issued within legislative time lines.
- **Results of performance reports:**
  - Unqualified audit opinions issued in 2013-14.
  - Improvement in the quality of performance reports, and they were issued in the legislative time lines.

An unqualified audit opinion is a clear audit opinion that confirms that the financial report and performance report are fairly stated.

Unqualified audit opinions were issued on the financial reports of all entities for 2013-14. Parliament can therefore have confidence in those financial reports.

The average time taken by the 19 water entities to finalise their 2013-14 financial reports was 8.8 weeks. All were finalised within the legislated time lines.

All 19 entities' performance reports also received unqualified audit opinions for 2013-14.

Performance reporting has improved since the prior year—largely due to the efforts of an industry working group and the former Department of Environment and Primary Industries—however further areas still require attention to ensure full compliance with the reporting requirements.

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**Financial results for 2013-14**

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**Net profit before tax \$318.2 million—increase of \$234.5 million.**

- Two metropolitan entities reported higher net profits.
- Four regional urban entities reported a loss.
- Two rural entities continue to generate losses.

The 19 water entities generated a combined net profit before income tax of \$318.2 million for 2013-14, an increase of \$234.5 million.

All four metropolitan water entities reported a net profit in 2013-14, with two metropolitan entities reporting significantly higher profits as a result of increased water, sewerage and other prices, as approved under the regulatory price setting model, and higher consumption.

Though the number of regional urban water entities reporting losses remained the same—four in both years—overall, the regional urban water entities improved their financial performance, reporting a combined net profit before income tax of \$18 million, compared with \$6 million in 2012-13.

The two rural water entities continued to report losses in 2013-14.

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**Financial results for 2013-14 – continued**

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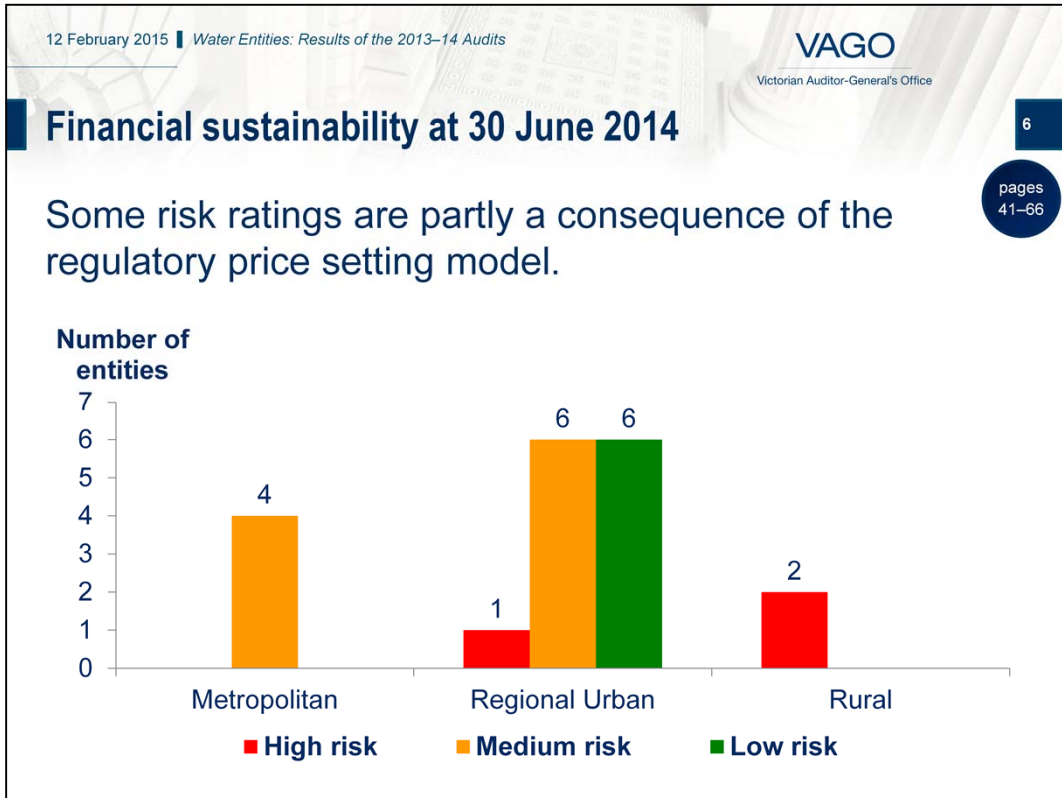
- The sector generated revenue of \$5.6 billion— an increase of \$1.1 billion, or 23.8%.
- Metropolitan water retailers increased water and sewerage charges by \$474.9 million, or 25.5%.
- Regional urban water entities charges increased by 3.5%.
- Rural water entities charges decreased by 3.1%.

The 19 entities generated revenue of \$5.6 billion, an increase of \$1.1 billion, on the prior year.

The three metropolitan water retailers increased their total water and sewerage charges to customers by \$474.9 million during 2013-14.

However, they had increased costs of approximately \$490 million for bulk water, sewerage and other charges they paid to Melbourne Water—the system's wholesaler. Both increases are a consequence of higher regulated prices and consumption.

The regional urban water entities charges increased 3.5 per cent in 2013-14, and the rural water entities charges combined, decreased by 3.1 per cent.



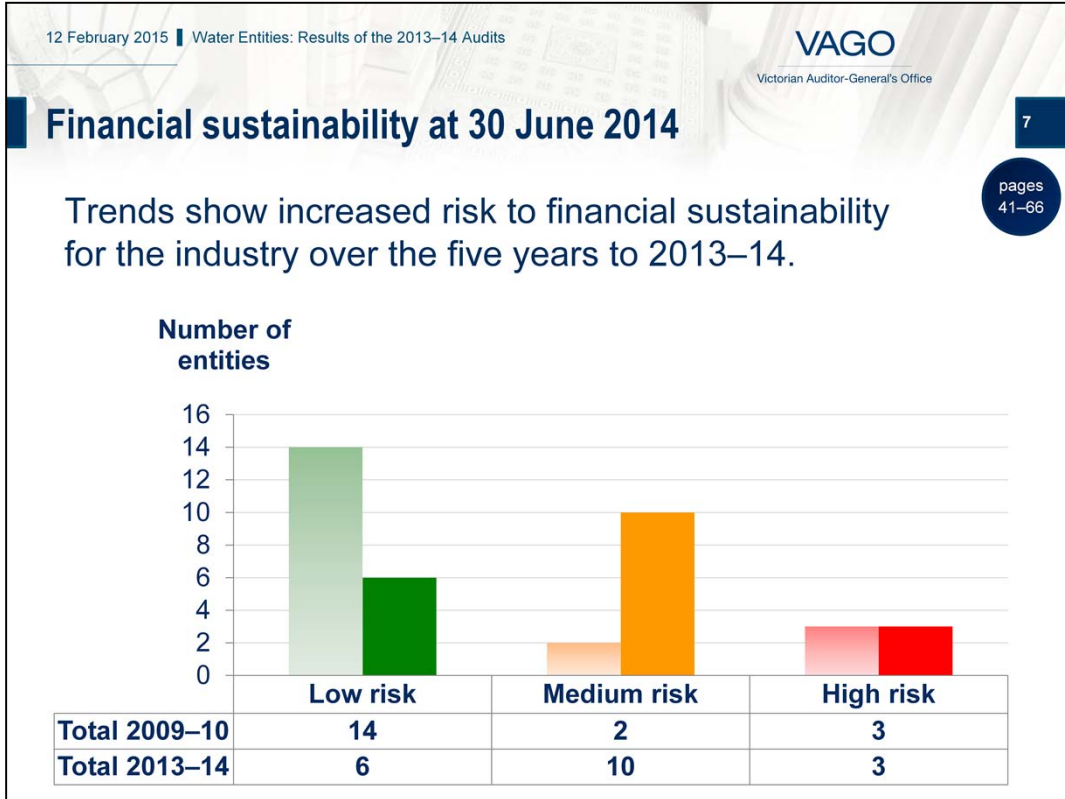
Our report highlights financial sustainability risks of water entities, using seven financial sustainability indicators as at 30 June 2014, and trends over a five-year period.

The indicator results are calculated using the financial transactions and balances of each entity's statutory financial report. Financial sustainability should be viewed from both a short- and long-term perspective and over the trend period.

Three entities had a high financial sustainability risk rating at 30 June 2014 due to the magnitude of their operating losses. These in part are a consequence of the regulated pricing model, where there is a shortfall between the price set and the total operating costs. We intend to take a closer look at the regulatory price setting model in the future.

The number of entities rated as having a medium financial sustainability risk at 30 June 2014 increased from seven to 10, with this being the first year that all metropolitan water entities are rated medium risk.

For the metropolitan sector, trends for five of the seven risk indicators declined over the period—in particular, three of the four metropolitan water entities' ability to replace assets using cash generated by their operations has deteriorated.



Trends show there is an increased risk to financial sustainability for the industry over the five years to 2013-14. In 2009-10, 14 water entities were assessed as low risk, with two water entities classified as medium risk. A different picture is evident at 30 June 2014.

## Key challenges for water entities

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- Repaying growing debt.
- Meeting ongoing financial obligations to the state.
- Addressing efficiency measures from sector reform.

While increased profitability is apparent for some water entities in 2013–14, several continue to face challenges repaying growing debt, while also continuing to meet ongoing financial obligations to the state such as taxes and levies, and addressing efficiency measures from sector reform, as experienced with the former government's Fairer Water Bills initiative.

The depth and breadth of debt refinancing is an area we plan to assess more closely in future reports.



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**Audit committees**

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Audit committees across the sector were found to be effective.

Opportunities for improvement exist:

- audit committees' engagement with internal and external auditors
- nature and conduct of self-assessments
- fraud reporting
- committee charters.

We reviewed the effectiveness of audit committees in discharging their responsibilities, including how they oversee an entity's control environment, the accountability of senior management and key outputs, and their relationship with internal and external auditors.

Our review shows a satisfactory situation, where the role is being carried out in an effective manner.

We did, however, identify opportunities for improvement to audit committees' engagement with internal and external auditors, the nature and conduct of self-assessments and fraud reporting. Further, elements of committee charters also require improvement to reflect better practice.

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**Gifts, benefits and hospitality**

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**Gifts, benefits and hospitality offered and/or accepted by the four metropolitan water entities—**

- 423 in 2012-13
- 588 in 2013-14.

**Overall, the four metropolitan water entities had the minimum required policies in place.**

Gifts, benefits and hospitality are offered by, and provided to, water entities and employees for a variety of reasons.

There is an expectation that water entity employees should hold high standards of ethical behaviour and not accept gifts, benefits or hospitality from parties seeking to unfairly influence decision-making.

The number of gifts, benefits and hospitality offered and/or accepted by the four metropolitan water entities increased from 423 in 2012-13, to 588 in 2013-14.

We assessed the management practices and oversight of gifts, benefits and hospitality at the four metropolitan water entities. The main types of gifts, benefits and hospitality received were:

- tickets to sporting events
- luncheons, and
- dinners.

Overall, the entities had the minimum required policies in place, which are appropriate to manage the receipt of gifts, benefits and hospitality.

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**Gifts, benefits and hospitality – *continued***

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Opportunities for improvement include:

- consistency with the Victorian Public Sector Commission's framework
- require completion of declarations
- improve information in registers.

Although policies and procedures were in place, improvements are needed to:

- improve their gifts, benefits and hospitality policies to ensure they are fully consistent with the Victorian Public Sector Commission's framework and the former Department of Environment and Primary Industries' model policy and guidance, and that policies are reviewed within specified time frames
- require all staff to complete a gift, benefit and hospitality declaration form for reportable gifts, which incorporates all better practice elements set out by the Commission and the former Department, and retain in a central repository
- enhance the contents of their gift registers to include all elements proposed in the Commission's framework and the former Department's model policy and guidance.

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## Key recommendations

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3.	That water entities further refine their reporting processes by conducting materiality assessments, preparing analytical reviews and preparing quality shell financial statements.
4.	That the Department of Environment, Land, Water and Planning engage early with water entities to ensure that all applicable indicators are included in the corporate plans of water entities.
5.	That water entities where relevant provide internal and external auditors with open invitations to attend committee meetings and access to committee documentation for upcoming meetings.
12.	That water entities, where relevant improve their gifts, benefits and hospitality policies to ensure they are fully consistent with Victorian Public Sector Commission's framework

Overall, 18 recommendations have been made:

- three specifically relate to financial reporting processes and 1 relates to performance reporting processes for water entities
- two specifically relate to the Department of Environment, Land, Water and Planning regarding the performance reporting framework
- 5 recommendations for water entities to consider regarding audit committees, and
- seven recommendations for all water entities to consider regarding management practices and oversight of gifts, benefits and hospitality.

The four key recommendations driven from the report are shown here.

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