Portfolio Departments and Associated Entities: 2014–15 Audit Snapshot

Victorian Auditor-General's Report

December 2015

2015–16:17

VICTORIA

Victorian
Auditor-General

Portfolio Departments and Associated Entities: 2014–15 Audit Snapshot

Ordered to be published

VICTORIAN
GOVERNMENT PRINTER
December 2015

PP No 123, Session 2014–15

This report is printed on Monza Recycled paper. Monza Recycled is certified Carbon Neutral by The Carbon Reduction Institute (CRI) in accordance with the global Greenhouse Gas Protocol and ISO 14040 framework. The Lifecycle Analysis (LCA) for Monza Recycled is cradle to grave including Scopes 1, 2 and 3. It has FSC Mix Certification combined with 55% recycled content.

ISBN 978 1 925226 46 1

VAGO

Victorian Auditor-General's Office

Auditing in the Public Interest

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

The Hon. Telmo Languiller 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 *Portfolio Departments and Associated Entities: 2014–15 Audit Snapshot.*

This report presents the outcomes and observations of the 2014–15 financial audits of the state's seven portfolio departments, two former portfolio departments and 221 associated entities.

This report informs Parliament about significant issues identified during our audits and complements the assurance provided through individual audit opinions included in the entities' annual reports. It comments on financial outcomes, trends and self-funded entity financial sustainability risks. It also comments on financial reporting and internal controls at the Department of Education & Training and the state's alpine resorts.

Yours faithfully

Dr Peter Frost
Acting Auditor-General

9 December 2015

Contents

Auditor-General's comments

This report presents the outcomes and observations from the 2014–15 financial audits of the seven portfolio departments, two former portfolio departments and 221 associated entities.

With the exception of the financial reports for the Department of Treasury & Finance (DTF) and the Department of Education & Training (DET), Parliament and the Victorian community can have confidence in the 204 finalised 2014–15 financial reports of the portfolio departments and associated entities.

As commented on in my report *Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2014–15* and in this report, I issued a modified audit opinion on the 2014–15 financial reports of both DTF and DET. The audit qualification on DTF's financial report highlights a failure to record the obligation that the state government had at 30 June 2015 to repay Commonwealth funding relating to the cancelled East West Link project. The state should have recognised a $1.5 billion liability and corresponding expense.

The modified audit opinion on DET's financial report related to a failure to maintain proper accounts and records for DET's property, plant and equipment and school-based financial balances within the financial report. This meant $16.8 billion of assets held by the state and the financial transactions of approximately 1 600 schools, were not supported by appropriate underlying records during the 2014–15 financial year.

Significant financial reporting and control issues covering many areas were also identified at DET during the 2014–15 financial audit. DET needs to take action to address a number of outstanding issues and deliver on all project plans currently being developed to ensure remedial actions are effective and timely.

It is pleasing to note that DET has accepted the issues we raised and has committed to taking action to address them. We will work closely with the department, within the bounds of our independence obligations, to provide feedback and advice as they work through these issues.

Further to these issues, the seven portfolio departments had not resolved 32 high- and 17 medium-risk internal control weaknesses, identified by my audit teams during the 2013–14 audits, or earlier. Consequently, the control frameworks in place at the portfolio departments are not as effective as they could be—potentially leading to a greater risk of error or fraud.

Self-funded public sector entities face financial challenges in funding their operations. Many of these entities manage iconic assets and provide important non-financial benefits to the community. If they are to be financially sustainable over the long term, the pricing model used to generate revenue may need amendment, another funding source identified or additional government support provided. These entities should seek longer-term funding agreements from their relevant portfolio departments to provide greater certainty in their operations. This will help balance their need to be financially sustainable against their community service obligations to provide some services at no charge, or at a subsidised charge.

Significant oversight, financial reporting and control issues were identified at some of the state's alpine resorts. These issues were mainly in relation to the arrangements in place at outsourced providers. The resorts will need to address these issues to ensure compliance with legislative requirements.

Dr Peter Frost
Acting Auditor-General

December 2015

Audit summary

This report presents the outcomes and observations from the financial audits of the seven portfolio departments, two former portfolio departments and 221 associated entities that are not addressed in our other sector-based Audit Snapshot reports. At the time of preparing this report, the audits of 24 entities had not been completed.

In December 2014, the government initiated machinery-of-government changes which impacted the 2014–15 financial year. These included changes to the number and scope of portfolio departments and abolishing the former Department of Human Services (DHS) and the former Department of Transport, Planning & Local Infrastructure (DTPLI).

These entities are responsible for delivering key public services and community support programs. It is important that they prepare high-quality financial reports in a timely manner to facilitate an appropriate standard of accountability to Parliament and the Victorian community.

An effective internal control framework supports portfolio departments and associated entities to operate and report reliable, accurate and timely information. In this report we comment on those frameworks, the financial sustainability risks of some self-funded entities, the internal control environment at the Department of Education & Training (DET) and the state's alpine resorts.

Conclusions

Financial reports prepared by portfolio departments and their associated entities are generally accurate but were not always prepared in a timely manner. Their contents can be relied on by Parliament and the public, with the exception of DET and the Department of Treasury & Finance (DTF). As commented on in the *Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2014–15,* a modified audit opinion was issued on the 2014–15 financial reports of both DET and DTF. That report also comments on the untimely preparation of the 2014–15 financial reports by material entities.

Further, the financial sustainability risks of 49 self-funded public sector entities were analysed. These entities face financial challenges in funding their operations—if they are to be financially sustainable over the long term, the pricing model used to generate revenue may need amendment, another funding source identified or additional government support provided. These entities should also seek longer-term funding agreements—at least over the forward estimates period—from their relevant portfolio departments to provide greater certainty in their operations.

Significant financial reporting and control issues were identified at DET during the 2014–15 financial audit. The issues cover many areas of DET's operations. DET needs to take action to address the outstanding issues and monitor and manage all project plans in place to ensure remedial actions are effective and timely.

Significant oversight, financial reporting and control issues were identified at some of the state's alpine resorts during the financial audit of their 31 October 2014 financial reports. These issues were mainly in relation to the arrangements in place at outsourced providers. The resorts will need to address these issues to ensure compliance with legislative requirements.

Findings

Financial reporting outcomes

With the exception of the modified audit opinions issued for DET's and DTF's financial reports, clear opinions were issued for each of the 204 entities that had finalised their financial reports at the time of preparing this report. Twenty-four entities' financial reports are still to be finalised at the date of preparing this report.

DTF's financial report was qualified as they did not correctly account for the state government's obligation at 30 June 2015 to repay Commonwealth funding relating to the cancelled East West Link project. DTF should have recognised a $1.5 billion liability and corresponding expense at that date. The basis for the DET modified audit opinion follows later in this section.

Portfolio departments have 32 outstanding high- and 17 medium-risk rated control weaknesses identified in prior year audits which have not yet been resolved. Portfolio departments should address these weaknesses to minimise a potential material adverse impact on their financial statements and business operations.

We undertook three financial audits by invitation in 2014–15—the Parliament of Victoria, the Australian Health Practitioner Regulation Agency and the Senior Master of the Supreme Court of Victoria. When conducting financial audits by invitation under the *Audit Act 1994*, the Auditor-General cannot consider issues of waste, probity and the lack of financial prudence. We are seeking amendments to the Act to address these anomalies, and to give the Auditor-General the ability to audit these entities' expenditure of public funds as a matter of course, rather than at the discretion of these agencies.

Financial reporting, and control, at the Department of Education & Training

The 30 June 2014 audit of DET observed significant failures in financial control and reporting. During the 2014–15 financial year, a number of these failures became more significant, ultimately resulting in a disclaimer of audit opinion on DET's 2014–15 financial report. This meant that DET was unable to provide the Auditor-General with sufficient, appropriate audit evidence to provide a basis for an audit opinion.

In particular, DET was unable to provide sufficient appropriate evidence to support the transactions and balances of the 1 569 state schools whose financial information is consolidated into DET’s financial report.

We were also unable to obtain sufficient appropriate evidence to support the property, plant and equipment balances in DET's financial report—leading to another audit opinion modification. DET had failed to address long-standing data integrity issues with its asset register and consequently the register is not adequate to support the balances in the financial report. This is a breach of the *Financial Management Act 1994* (FMA).

Financial sustainability risks of self-funded entities

Forty-nine public sector entities are classified as self-funded, because the majority of their revenue is generated from their operations. As a broad rule, self-funded entities should aim to generate sufficient revenue from operations to meet their financial obligations, and to fund asset replacement and new asset acquisitions, if they are to be financially sustainable over the long term.

These entities face significant financial challenges, that if not addressed, may lead to a reduction in the services they provide to the community. If they are to be financially sustainable over the long term, the underlying pricing model used to generate revenue may need amendment, another funding source may need to be identified, cost structure may need review, or additional government support may be required.

We completed an in-depth review of three self-funded entities during 2014–15 to determine what action plans and management practices had been implemented to manage and improve the long-term financial sustainability of their operations. In all cases we identified a balance must be achieved between meeting broader community service obligations or economic development objectives and commercially sustainable outcomes. While pricing policies were different for all three entities, none were able to set prices to cover the long-term replacement of assets. All entities rely on ongoing funding from the state government to fund long-term asset replacement and renewal. Consequently they face longer-term financial sustainability risks.

The challenge for these self-funded entities is to balance their community service obligations and broader economic development objectives, while seeking to become more financially sustainable.

Alpine resorts

Three of the five alpine resorts—Lake Mountain, Mount Baw Baw and Falls Creek—outsourced their financial functions to a private sector service provider. Under the FMA, public sector entities are responsible for maintaining an effective control environment over their transactions. Where functions are outsourced, this requirement extends to the control environment of the outsourced service provider.

These alpine resorts, while retaining responsibility for the completeness and accuracy of their financial reports, placed reliance on the control environment at the outsourced provider including for the completeness and accuracy of transactional data used to prepare these financial reports.

At all three resorts, we identified that the services being undertaken by the outsourced provider did not enable the resorts to fully discharge their statutory reporting obligations. Issues identified include, among other things, inadequate cash handling procedures, non-compliance with revenue processing requirements and poor financial reporting practices.

The resorts need to significantly improve their oversight arrangements to ensure complete compliance with their legislative objectives. We understand that the resorts have implemented measures to improve these arrangements. These improvement measures will be reviewed as part of our financial audits of the resorts for the year ended 31 October 2015.

Recommendations

Number	Recommendation	Page
That portfolio departments:		
1.	address identified internal control issues in a timely manner, especially those rated as high or medium risk	12
2.	implement appropriate monitoring mechanisms to ensure audit findings are resolved by management on a timely basis.	12
That the Department of Education & Training:		
3.	takes action to address all identified internal control issues around its asset records and school-based financial information in a timely manner	28
4.	delivers on all project plans currently being developed and ensures remedial actions related to its asset records and school-based financial information are effective and timely.	28

Recommendations – *continued*

Number	Recommendation	Page
	That the Department of Treasury & Finance, and relevant portfolio departments:	
5.	work with self-funded entities to review their underlying pricing model, sources of funding and cost structures, in order to improve their long-term financial sustainability.	43
	That relevant portfolio departments:	
6.	develop long-term capital funding plans with the self-funded entities within their portfolio.	43
	That self-funded entities:	
7.	seek longer-term funding agreements, at least over the three year forward estimates period, with their portfolio departments.	43
	That the three alpine resorts—Lake Mountain, Mount Baw Baw and Falls Creek—where relevant:	
8.	immediately remedy the issues identified around their internal control environments and other matters identified by the audit during the 2013–14 reporting period	52
9.	review existing contractual arrangements with the outsourced providers to ensure they clearly identify and outline the services and competencies required	52
10.	more actively oversee and manage the services provided by outsourced providers for their resort, including gaining appropriate assurance over the operation of internal controls by those providers.	52

Submissions and comments received

We have professionally engaged with all portfolio departments and named agencies. In accordance with section 16(3) of the *Audit Act 1994* we provided a copy of this report, or relevant extracts, to those agencies and requested their submissions or comments.

We have considered those views in reaching our audit conclusions and have represented them to the extent relevant and warranted. Their full section 16(3) submissions and comments are included in Appendix D.

1 Context

1.1 Introduction

This report covers the outcomes of the 2014–15 financial audits of the seven current portfolio departments, the two former portfolio departments and 221 associated entities that are not included in our other Audit Snapshot reports. Included in these associated entities are the five alpine resort management boards (alpine resorts) which have a financial year ending on 31 October.

The most common financial reporting framework for these entities is the *Financial Management Act 1994* (FMA) and Australian Accounting Standards. Some entities also report under the *Corporations Act 2001*. The financial audits were undertaken in accordance with Australian Auditing Standards.

Figure 1A outlines the structure of this report.

Figure 1A
Report structure

Report part	Description
Part 1: Context	Provides an overview of the financial reporting and audit arrangements for the entities covered by this report. This includes commentary on the machinery-of-government changes during 2014–15.
Part 2: Audit outcomes	Comments on the financial reporting outcomes of the entities covered by this report. This includes internal control weaknesses and other financial reporting issues identified by our audits.
Part 3: Financial reporting and control at the Department of Education & Training	Comments on financial reporting and internal controls at the Department of Education & Training.
Part 4: Financial sustainability risks	Comments on the financial sustainability risks faced by self-funded entities covered by this report.
Part 5: Alpine resorts	Comments on financial reporting and internal controls at the state's five alpine resorts.

Source: Victorian Auditor-General's Office.

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 preparing and printing this report was $175 000.

1.2 Audit of an annual financial report

A typical annual financial audit conducted by VAGO has two aims:

- to give an opinion consistent with section 9 of the *Audit Act 1994* on whether the financial statements are presented fairly in accordance with the relevant financial reporting framework
- to consider whether there has been any wastage of public resources or a lack of probity and financial prudence in the management or application of public resources, consistent with section 3A(2) of the *Audit Act 1994*.

1.2.1 Audit of certain internal controls

Internal controls are systems, policies and procedures that help an entity to reliably and cost-effectively meet its objectives. Sound internal controls enable the delivery of reliable, accurate and timely external and internal reports. An entity's governing body is responsible for developing and maintaining its internal control framework.

Integral to the annual financial audit is an assessment of the adequacy of the internal control framework and 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, but this assessment is not undertaken for the purpose of expressing an opinion on the effectiveness of the entity's internal controls.

Internal control weaknesses identified during an audit do not usually result in a modified audit opinion because an entity will have compensating controls that mitigate the risk of a material error in the financial report, or alternate audit procedures are able to be undertaken. A modification of the audit opinion may be warranted if internal control weaknesses cause significant uncertainty about the accuracy, completeness and reliability of the financial information within the financial report.

Weaknesses in internal controls found during the audit of an entity are reported to its governing body, management and audit committee in a management letter. Our reports to Parliament raise systemic or common weaknesses identified during our assessment of internal controls over financial reporting and selected focus areas. Refer to Part 2.6 of this report for further information about issues identified in relation to internal controls at portfolio departments.

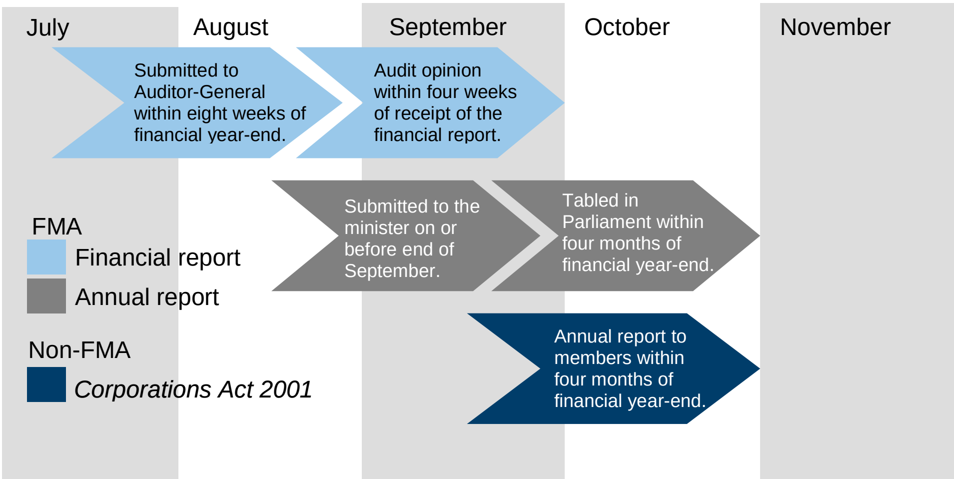
1.3 Reporting framework

Financial statements are required to be prepared in accordance with Australian Accounting Standards and the applicable legislated reporting framework. Under the FMA, the Minister for Finance has the authority to issue directions in relation to financial administration and reporting issues.

The FMA requires annual reports to be submitted to the relevant minister and tabled in Parliament within four months of the end of the financial year. These reports include the financial report for the entity and any controlled entities, and are required to be prepared and audited within 12 weeks of the financial year end.

Entities reporting under the *Corporations Act 2001* are required to report to their members within four months of the end of the financial year. A summary of the FMA and *Corporations Act 2001* reporting time frames is provided in Figure 1B.

Figure 1B
Legislated financial reporting time frames



Source: Victorian Auditor-General's Office.

As discussed in our report, *Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2014–15* (tabled in Parliament in November 2015), a number of entities were unable to achieve these time frames for the 2014–15 financial year.

1.4 Machinery-of-government changes

Machinery-of-government changes amend the administrative structure of government agencies, in particular portfolio departments. These can be small changes, such as the transfer of a function from one portfolio department to another or significant changes, such as the merging of portfolio departments or the creation or discontinuation of an entity or portfolio department.

In December 2014, the new government initiated machinery-of-government changes which impacted the 2014–15 financial year. These included:

- changes to the number and scope of portfolio departments
- appointment of new departmental secretaries
- changes to ministerial responsibilities.

An Order in Council was issued under the *Public Administration Act 2004*. It renamed the following departments with effect from 1 January 2015:

- the Department of Education & Early Childhood Development was renamed to the Department of Education & Training
- the Department of Environment & Primary Industries was renamed to the Department of Environment, Land, Water & Planning
- the Department of Health was renamed to the Department of Health & Human Services (DHHS)
- the Department of Justice was renamed to the Department of Justice & Regulation
- the Department of State Development, Business & Innovation was renamed to the Department of Economic Development, Jobs, Transport & Resources (DEDJTR).

The Department of Human Services (DHS) and the Department of Transport, Planning & Local Infrastructure (DTPLI) were abolished on 1 January 2015. The operations of DHS were transferred into DHHS. The operations of DTPLI were mostly amalgamated with DEDJTR. Both DHS and DTPLI prepared final financial reports as at 31 December 2014. These were audited and issued with unmodified audit opinions. These financial reports were appended to the DHHS and DEDJTR financial reports at 30 June 2015, respectively.

The Order in Council also transferred a number of functions between portfolio departments.

On 29 December 2014, the Premier made a declaration under section 30 of the *Public Administration Act 2004* that transferred staff and functions between portfolio departments, to affect the machinery-of-government changes, effective 1 January 2015.

The financial impacts of the machinery-of-government changes have been recognised in the 2014–15 financial statements for the relevant portfolio departments, with the assets, liabilities, income and expenditure transferring to the new portfolio departments on 1 January 2015.

2 Audit outcomes

At a glance

Background

This Part covers the results of the 2014–15 audits of the seven portfolio departments, the two former portfolio departments and 221 associated entities.

Conclusion

Parliament can have confidence in the financial reports of the 204 entities given unmodified opinions for 2014–15. The Department of Education & Training (DET) and the Department of Treasury & Finance (DTF) received modified audit opinions for their 2014–15 financial report. Details of these modifications are included in Part 3 of this report and in the *Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2014–15*, respectively.

We undertook three financial audits by invitation in 2014–15—the Parliament of Victoria, the Australian Health Practitioner Regulation Agency and the Senior Master of the Supreme Court of Victoria. When conducting financial audits by invitation under the *Audit Act 1994*, the Auditor-General cannot consider issues of waste, probity and the lack of financial prudence. We are seeking amendments to the *Audit Act 1994* to address these anomalies.

Findings

- There were 32 high- and 17 medium-risk internal control weaknesses reported to portfolio departments in prior years that remained unresolved in 2014–15.
- Thirty-six audit opinions (30 in 2013–14) included an emphasis of matter paragraph to draw attention to a matter or disclosure in their financial report.

Recommendation

That portfolio departments address identified internal control issues in a timely manner, especially those rated as a high or medium risk.

2.1 Introduction

This Part covers the results of the 2014–15 financial audits of the seven portfolio departments, the two former departments and 221 associated entities.

2.2 Conclusion

The financial reports of the portfolio departments and their associated entities for 2014–15 were fairly presented, with the exception of the Department of Education & Training (DET) and the Department of Treasury & Finance (DTF). Both these departments received modified audit opinions for their 2014–15 financial report. At the date of preparing this report, 204 unmodified audit opinions had been issued. The audit of 24 entities had not been finalised at the time this report was prepared.

2.3 Overview of portfolio departments

At 30 June 2015, seven portfolio departments existed. These were the:

- Department of Economic Development, Jobs, Transport & Resources (DEDJTR)
- Department of Education & Training
- Department of Environment, Land, Water & Planning (DELWP)
- Department of Health & Human Services (DHHS)
- Department of Justice & Regulation (DJR)
- Department of Premier & Cabinet (DPC)
- Department of Treasury & Finance.

Part 1 of this report identified a number of changes that occurred during the 2014–15 financial year in relation to machinery-of-government changes. The aims, objectives and key portfolios of each of the new departments are outlined below.

The purpose of DEDJTR is to create conditions to sustainably develop the Victorian economy and grow employment. The department seeks to bring together many of the key functions that drive economic development and job creation across Victoria. Ministerial portfolios responsible for the department are—Public Transport, Employment, Energy and Resources, Roads, Ports, Tourism and Major Events, Industrial relations, Agriculture, and Regional Development.

DET offers learning and development support, services and resources for all Victorians, from birth through to adulthood. The department seeks to provide education, training, development, wellbeing and child health services to achieve improved learning and development outcomes. Ministerial portfolios responsible for the department are—Education, and Training and Skills.

DELWP is tasked with creating liveable, inclusive and sustainable communities. The department recognises the link between the built and natural environment and works to accommodate population growth. Ministerial portfolios responsible for the department are—Planning, Local Government, Environment, Climate Change and Water.

DHHS is responsible for the planning, policy development, funding and regulation of health services and activities that promote and protect Victoria's health. This includes delivery of mental health and aged care services in Victoria. The department is also responsible for housing and community services in Victoria and the development of policies to improve the lives of vulnerable people including children, young people and those living with a disability. Ministerial portfolios responsible for this department are—Health, Mental Health, Housing, Disability, Ageing, Ambulance Services, Sport, and Youth Affairs.

DJR supports a safe, just, innovative and thriving Victoria. Ministerial portfolios responsible for the department are—Police and Emergency Services, the Attorney-General, Bushfire Response, Corrections, Crime Prevention, Liquor, Gaming and Racing Regulation, and Consumer Affairs. The department also has responsibility for the implementation of integrity reform.

DPC's mission is to display leadership and innovation to support the Victorian Government in achieving strong public policy and service delivery outcomes for all Victorians. The department supports the Premier, the Deputy Premier, the Special Minister of State as well as the following portfolios—Aboriginal Affairs, Multicultural Affairs, the Prevention of Family Violence, and Veterans.

DTF provides the government with economic, financial and resource management policy advice to assist in delivering policy outcomes. The department supports the Treasurer and Minister for Finance.

2.4 Audit opinions issued

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

Unmodified audit opinions were issued on 204 financial reports, compared with 204 in 2013–14, although 36 of these were issued with an emphasis of matter (EoM) paragraph (30 in 2013–14). Twenty-four audits were not complete at the time of publication (five in 2013–14). Two modified audit opinions were issued in 2014–15 (one in 2013–14).

Modified audit opinions

DET and DTF received modified audit opinions on their 2014–15 financial reports.

The DET financial report was issued with a disclaimer of audit opinion. The reasons for the modification and more information regarding the DET opinion are outlined in Part 3.

The DTF financial report was issued with a modified audit opinion in relation to administered transactions and balances within the financial report. The reasons for this were set out in the *Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2014–15*. The modification related to the incorrect treatment of the state's obligation at 30 June 2015 to return Commonwealth Government funding related to the East West Link project.

Emphasis of matter

An auditor can draw a reader's attention to a matter or disclosure in the financial report to provide important context, including where the financial report has been prepared using a special purpose framework. Financial reports that include an EoM paragraph in the audit opinion still present the entity's financial information fairly and can be relied upon by the user.

In 2014–15, 25 audit opinions relating to special purpose financial reports covered by this report were issued with an EoM paragraph, compared to 26 in 2013–14. These EoM paragraphs drew attention to the basis of preparation of the financial report.

In addition, 15 (four in 2013–14) audit opinions contained an EoM for other reasons, as detailed in Figure 2A. Some of these 15 audit opinions also received a second EoM due to the special purpose basis of preparation of the financial report, and are included in the 25 opinions identified above.

Figure 2A
Opinions issued with an emphasis of matter

Entity	Reason
International Fibre Centre Limited	The EoM paragraph drew the users' attention to the fact that the financial report was prepared on a going concern basis, despite there being material uncertainty surrounding the continued existence of the company.
Domestic Building (HIH) Indemnity Fund	The EoM drew the users' attention to the fact that the report was prepared on the basis that the entity would cease, due to the wind up of the entity on 31 July 2015.
State Library of Victoria Foundation Tourism Victoria Victoria Major Events Company Limited	The EoM drew the users' attention to the fact that there was uncertainty about the entity's ability to continue as a going concern.
VFMC Ontario Inc	The EoM drew the users' attention to the fact that the report was prepared on the basis that the entity would be wound up on 10 March 2015.
VFMC Private Equity (Insurance) Trust 4 & VFMC Private Equity (Superannuation) Trust 4 VFMC Private Equity 1A Trust & VFMC Private Equity 1B Trust VFMC UK Investment Trust	The EoM drew the users' attention to the fact that the report was prepared on the basis that the entity would be wound up on 6 March 2015.

Figure 2A
Opinions issued with an emphasis of matter – *continued*

Entity	Reason
Port Phillip and Westernport Catchment Management Authority Mount Baw Baw Alpine Resort Lake Mountain Alpine Resort VicForest	The EoM drew the users' attention to the fact that the entity had not complied with certain Standing Directions of the Minister for Finance during 2014–15.
Linking Melbourne Authority	The EoM drew the users' attention to the Minister for Roads' announcement that the Linking Melbourne Authority is to be wound up and disbanded following the government's decision to discontinue the East West Link project.
Recreational Fishing Licence Trust Account	The EoM drew the users' attention to the fact that the report was prepared for the purposes of fulfilling the Secretary's financial reporting obligations under the *Fisheries Act 1995.*

Source: Victorian Auditor-General's Office.

2.5 Audits by invitation

An entity that does not meet the definition of an authority under the *Audit Act 1994* is not required to have the Auditor-General conduct its annual financial audit. However, under section 16G of the *Audit Act 1994*, the Auditor-General can accept an invitation to conduct the financial audit of an entity that is not an 'authority'.

Before accepting such an invitation, the Auditor-General must be satisfied that the person or body exists for a public purpose and that it is practicable and in the public interest, for the Auditor-General to conduct the audit.

The Auditor-General conducted the financial audit of three entities by invitation in 2014–15 (three in 2013–14), being:

- Parliament of Victoria
- Australian Health Practitioner Regulation Agency
- Senior Master of the Supreme Court of Victoria.

When conducting financial audits by invitation under section 16G, the Auditor-General cannot consider issues of waste, probity and the lack of financial prudence. These issues are required considerations for all other financial audits conducted by the Auditor-General and are generally expected aspects of public sector audits.

This limitation of scope means that there are lower standards of accountability for these entities audited by invitation than for the rest of the public sector. We are seeking amendments to the *Audit Act 1994* to address these anomalies, and to allow an audit of these entities' expenditure of public funds.

2.6 Internal controls relevant to the preparation of financial reports at portfolio departments

Internal controls at the seven portfolio departments, to the extent that they were reviewed as part of our financial audits, were adequate for maintaining the reliability of external financial reporting, except as identified previously in Section 2.4 in relation to the audit modifications identified. A number of control weaknesses were reported to departmental secretaries and management during the course of the 2014–15 audits.

When issues are identified, the audit team will issue a formal management letter to the secretary of a portfolio department, as the accountable officer, listing details of the issues. The issues will typically be discussed and agreed to by management with action plans and responsible officers documented.

Internal control weaknesses reported to the secretary and audit committee should be actioned and resolved in a timely manner.

2.6.1 General internal controls

In 2014–15, 57 extreme, high or medium-risk rated internal control issues were reported through formal management letters to portfolio department's audit committees and secretaries (47 in 2013–14). Low-risk items are only reported to management.

Figure 2B shows the reported issues by area and risk rating. The risk ratings are detailed in Appendix A. Figure 2B excludes low risk issues raised.

Figure 2B
Reported issues by area and risk rating in 2014–15

	Risk rating of issue		
Area of issue	**Extreme**	**High**	**Medium**
IT controls	–	11	9
Financial reporting processes	–	2	8
Outsourced arrangements	–	7	–
Assets	1	9	2
Expenditure, payroll and employee benefits	–	3	4
Following up internal audit findings	–	1	–
Total	**1**	**33**	**23**

Source: Victorian Auditor-General's Office.

Information technology (IT) security-related issues continue to be raised and again account for the majority of our higher-risk audit findings. These issues are discussed in the *Financial Systems Controls Report: Information Technology 2014–15* report tabled in Parliament in October 2015, which highlighted that a total of 462 IT audit findings were identified at 45 entities selected for review. Similar to the previous year, management at these entities continued to be slow to act on the findings. This demonstrates the need for more focused attention and oversight of IT issues by accountable officers and governance bodies, including audit committees.

The *Financial Systems Controls Report: Information Technology 2014–15* report also identified that each year VAGO is finding a large number of IT systems and software which are either no longer supported or fast approaching the end of support by the vendor. This poses IT security and operational risks to IT environments. These risks increased the potential for error or misstatement in financial statements.

The *Financial Systems Controls Report: Information Technology 2014–15* report also identified that while there have been positive developments in the governance of outsourced IT arrangements, more effort is required by entities to enhance the visibility and accountability over outsourced activities and to assess the impact these activities have on entities' control environments.

Financial reporting process issues are typically in relation to poor reconciliation preparation, controls surrounding journals and the financial statement report preparation process as a whole. These issues should be addressed by portfolio departments as soon as possible to reduce the risk of fraud or error.

The majority of the issues identified surrounding assets are in relation to DET. Further detail is included in Part 3.

Portfolio departments should seek to address extreme- and high-risk rated issues as soon as possible to reduce potential weaknesses in their control frameworks.

Status of prior period issues

The status of internal control issues identified in prior periods which include both the 2013–14 and earlier financial years, and that remained outstanding at the time of the 2014–15 audit are presented and communicated to portfolio department secretaries and audit committees through the current years' management letters.

These issues are monitored to ensure weaknesses identified in control environments are followed up and addressed. Figure 2C shows the internal control deficiency issues identified in prior periods with the resolution status by risk—for extreme, high and medium-rated risks only.

Figure 2C
Prior periods internal control deficiency issues–resolution status by risk

	Risk rating of issue		
Area of issue	**Extreme**	**High**	**Medium**
Ongoing	–	32	17
Completed	2	6	33
Total	**2**	**38**	**50**

Source: Victorian Auditor-General's Office.

All extreme risks identified in prior periods were resolved by the time of the 2014–15 audits. There were 32 internal control weaknesses rated as a high and 17 medium risk, reported to departmental secretaries and audit committees in prior periods that remained unresolved at the time of the 2014–15 audits. The number of the ongoing high-risk issues is particularly concerning. This lack of timely resolution means that the control frameworks in place at the portfolio departments are not as effective as they should be. Management should seek to address the issues raised on a timely basis, to rectify any weaknesses in their control environment as soon as possible and to mitigate the risk of material errors occurring in their financial reports. Weak controls can expose departments to fraud and error.

The main areas these high-risk issues relate to are:

- obtaining assurance over the controls at outsourced providers
- IT security-related issues
- software approaching end of life support from software vendor
- excessive and negative annual leave balances.

The majority of these issues are addressed in more detail in the *Financial Systems Controls Report: Information Technology 2014–15* report.

Recommendations

That portfolio departments:

1. address identified internal control issues in a timely manner, especially those rated as a high or medium risk
2. implement appropriate monitoring mechanisms to ensure audit findings are resolved by management on a timely basis.

3 Financial reporting and control at the Department of Education & Training

At a glance

Background

In 2014–15 the Department of Education & Training (DET) failed to adequately address a number of previously identified deficiencies in relation to records supporting property, plant and equipment, and school-based transactions and balances. As a result, we issued a disclaimer of audit opinion on DET's 2014–15 financial report.

Conclusion

DET needed to make improvements to the quality of its financial reporting processes and supporting records in 2014–15, but changes made were not sufficient or timely.

Findings

- On 29 October 2015 the Acting Auditor-General issued a disclaimer of audit opinion on DET's 30 June 2015 financial report.
- DET had not maintained, and we were unable to obtain, sufficient appropriate evidence to support the transactions and balances of the 1 569 state schools, whose financial information was consolidated into the DET financial report.
- DET had not maintained, and we were unable to obtain, sufficient and appropriate evidence to support the property, plant and equipment balances in the financial report. DET failed to address long standing data integrity issues with its asset register and consequently the register is not adequate to support the balances in the financial report—a breach of the *Financial Management Act 1994*.

Recommendations

That the Department of Education & Training:

- takes timely action to address all outstanding management letter items
- follows through on all project plans related to its asset records and school-based financial information currently being developed and ensures deliverables are effective and timely.

3.1 Background

In the 2013–14 financial year the former Department of Education & Early Childhood Development (DEECD), the predecessor of the Department of Education & Training (DET), received a modified audit opinion. The detailed reasons for this opinion were set out in the *Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2013–14.*

The audit opinion on DEECD's 2013–14 financial report was modified with respect to a $1.58 billion economic obsolescence adjustment to the carrying value of school buildings at 30 June 2014 and the reclassification of the period's school building impairment of $2.15 billion as a fair value adjustment.

Specifically, the audit opinion was modified because the:

- accounting policy adopted to strike the fair value of school building assets—specifically including an economic obsolescence adjustment—was not appropriate
- key valuation assumptions and judgements for school buildings were not supported by sufficient appropriate evidence
- reclassification of previously reported 30 June 2013 balances did not accord with Australian Accounting Standards
- DEECD included comments in the accountable officer’s and chief finance officer’s declaration that were inappropriate.

DEECD's accounting policy for economic obsolescence resulted in a significant write down of taxpayer investments in school buildings which were continuing to deliver educational outcomes. We determined this was not in accordance with Australian Accounting Standards, and not in the public interest.

In addition to the modifications referred to above, we also reported to Parliament that the financial report preparation process at DEECD was poor. We identified many areas for improvement and made a number of significant recommendations to DEECD, in our annual management letter, to assist them to improve their processes.

DEECD was renamed to DET effective from 1 January 2015.

Although DET amended their property, plant and equipment (PPE) accounting policy and reinstated the PPE values previously written off as economically obsolete, we were unable to obtain sufficient appropriate evidence for material parts of the financial report in 2014–15, related to PPE and school-based financial information. As a result, we issued a disclaimer of audit opinion on DET.

DET needed to make significant improvements to the quality of its financial reporting in 2014–15, but changes made were not enough or timely. This Part outlines the financial reporting and control issues at DET that lead to a disclaimer of audit opinion being issued.

DET has accepted the issues we raised and has committed to taking action to address them. We will work closely with the department, within the bounds of our independence obligations, to provide feedback and advice as they work through these issues.

3.2 Disclaimer of audit opinion

On 29 October 2015, the Acting Auditor-General issued a disclaimer of audit opinion on DET's 30 June 2015 financial report. DET was unable to provide the Acting Auditor-General with sufficient, appropriate audit evidence to provide a basis for an audit opinion.

The Australian Auditing Standards require the issue of a disclaimer of audit opinion when an auditor has been unable to obtain sufficient appropriate audit evidence, and the possible effects on the financial report of undetected misstatement could be both material and pervasive.

For DET's 30 June 2015 financial report, we were unable to obtain sufficient appropriate evidence to support the property, plant and equipment transactions and balances, and also the schools-related transactions and balances. This meant we were not able to form an opinion on the following line items in the financial report:

Balance sheet:

- property, plant and equipment ($16.830 billion)
- physical asset revaluation surplus ($7.382 billion)
- non-financial physical assets classified as held for sale ($107.9 million)
- cash and deposits ($557.8 million of a total $715.3 million)
- other financial assets ($132.5 million).

Comprehensive income statement:

- supplies and services expenditure ($1.107 billion of a total $2.690 billion)
- other income ($510.1 million of a total $523.3 million)
- depreciation ($296.4 million of a total $296.4 million)
- employee expenses ($247.3 million of a total $5.478 billion)
- sales of goods and services revenue ($160.9 million of a total $214.4 million)
- other operating expenses ($50.9 million of a total $122.6 million)
- interest income ($19.9 million of a total $19.9 million)
- net gain/(loss) on non-financial assets ($22.8 million of a total $22.8 million)
- other economic flows—changes in physical asset revaluation surplus ($815.5 million of a total $815.5 million).

As a result of the line items above, we were also unable to form an opinion on the:

- net result ($150.8 million)
- comprehensive result ($974.3 million)
- net worth ($17.668 billion)
- physical asset revaluation surplus column in the Statement of Changes in Equity
- cash flows from/(used in) operating activities, purchases of non-financial assets and cash and deposits at the end of the financial year in the Cash Flow Statement.

The volume of line items in the financial report we were unable to form an opinion on, coupled with the magnitude of the value for each, led us to conclude that the impact on the financial report as a whole was both material and pervasive. The consequence of this conclusion was a disclaimer of audit opinion.

Detail regarding why DET was unable to provide, and consequently why we were unable to obtain, sufficient appropriate evidence to support the school transactions and balances, and PPE transactions and balances, is provided below.

3.3 School transactions and balances

The DET financial report includes the consolidated transactions and balances of 1 569 state government schools. Schools individually operate and maintain their own financial records using a common software system that enables DET to extract the financial data for inclusion in DET's financial report.

Operating such a devolved and large system leads to a number of challenges for DET to obtain appropriate financial information from the schools, and assure itself that the information received is both complete and accurate. Adding to this, schools operate on a financial year that ends in December. This is not aligned to DET's financial year, which ends in June.

The schools transactions and balances are material to DET's financial report and impact all four financial statements—the Comprehensive Income Statement, Balance Sheet, Statement of Changes in Equity, and Cash Flow Statement.

The risks around school transactions and balances also increased in 2014–15 as a result of the Independent Broad-based Anti-corruption Commission (IBAC) investigation into possible corrupt use of public funds by senior departmental employees including through a number of program coordinator schools. The IBAC investigations meant the control environment at schools was assessed as weak, and was considered to have a higher risk by our office, of not detecting or preventing misstatements, whether caused by fraud or error.

In these circumstances, where there is increased risk, the Australian Auditing Standards require the auditor to obtain additional evidence. Accordingly, we sought more evidence than in previous years to substantiate school transactions and balances where they were material to DET’s financial statements. However, when we sought this evidence, we identified further concerns.

There are two parts to DET's internal assurance processes over schools transaction and balances. These consisted of:

- school council financial audit (SCFA) program conducted for the 2014 calendar year, thereby providing assurance over the first half of the DET financial year (1 July 2014 to 31 December 2014)
- analytical review of the school-based transactions from 1 January 2015 to 30 June 2015 and a review of the balances at 30 June 2015.

We concluded that we were unable to place reliance on the work of the SCFA program for the period 1 July 2014 to 31 December 2014. This was because the findings arising from the SCFA program raised concerns over the completeness of school transactions and further concerns over the control environment at schools. We were also unable to obtain sufficient appropriate evidence in relation to the completeness of school revenue.

We also concluded that the analytical review conducted by DET did not provide sufficient appropriate evidence over school-based transactions and balances for the second half of the financial year to 30 June 2015.

In these circumstances, and in light of the requirements of the Australian Auditing Standards, we considered what other additional audit procedures were practical and possible to undertake to obtain the relevant audit evidence to form an audit opinion. However, it was not practicable in all the circumstances to design and undertake sufficient additional audit procedures to be in a position to form an opinion.

3.3.1 School council financial audit program

Each year DET engages external audit firms to conduct SCFAs. These audits are undertaken for a sample of schools to provide reasonable assurance over:

- financial management activities and governance of school councils
- accuracy and completeness of school financial statements for the purpose of consolidation into DET's financial report
- school governance and the management of school finances to individual schools.

These reasonable assurance audit opinions, issued by the external audit firms, state that the school financial statements are presented fairly and comply with the *School Finance Manual* for the period 1 January to 31 December each year. A number of qualifications were identified through this process. This is discussed below.

Schools are selected for audit in a particular year—using a risk based approach—when they meet one of the following criteria:

- average annual operating revenue over three years is greater than $3.5 million
- the school has not been audited in the previous four years
- the school has performed poorly in a previous SCFA
- the school changed status in the past 12 months—e.g. opened, closed or merged
- an audit has been requested by the Regional Monitoring and Support Division or the Financial Services Branch of DET.

The 2014 SCFA program audited 451 Victorian government schools. This is 29 per cent of all Victorian government schools.

Reliance on SCFAs

We sought to place reliance on the SCFAs to obtain reasonable assurance over the schools transactions and balances for the period 1 July 2014 to 31 December 2014.

In accordance with the requirements of the auditing standards, we reviewed the audit scope, audit program, sampling approach and composition of the external firms' audit teams. We found that as part of the SCFA program:

- the number of transactions tested for revenue and expenditure items, and for line items in the balance sheet, was small—with sample sizes ranging from four to 10
- time and resources used to conduct the audits were low—with some school audits conducted in eight hours using limited senior audit staff
- the audit program did not address all the required audit assertions for a reasonable assurance audit opinion to be issued under Australian Auditing Standards
- testing of balance sheet items at 31 December 2014 does not provide any assurance about the existence and accuracy of assets or obligations at 30 June 2015
- no comfort was obtained about whether the information captured and reported at 30 June 2015 is complete—it does not provide assurance that all transactions and balances have been captured and recorded at 30 June 2015.

The time applied to conduct an audit of a school is summarised in Figure 3A. This shows a significant variation in the hours spent conducting an audit between the two contracted firms.

Figure 3A
Time applied to conduct an audit of a school

School audit category	Hours
Category 1 schools—Small Average annual operating revenue over three years is less than $750 000	8.0 to 12.5
Category 2 schools—Medium Average annual operating revenue over three years is between $750 000 and $3.5 million	14.5 to 16.0
Category 3 schools—Large Average annual operating revenue over three years is greater than $3.5 million	18.0 to 23.0

Source: Victorian Auditor-General's Office.

For Category 1 and 2 schools—which are subject to an audit only every four years unless other risks are identified—eight hours of audit work every four years is not sufficient to provide reasonable assurance to DET. This, when coupled with the risk and results observed from the SCFA, reduced the reliance that could be gained from the SCFA program.

When comparing the auditing requirements of schools to similar entities, such as those registered with the Australian Charities and Not-for-profits Commission (ACNC), the audit of government schools falls short. For example, any registered charity with annual revenue greater than $1 million must have a full financial audit performed each year. This audit would include financial statements and note disclosures.

This $1 million threshold for a full audited financial report annually is significantly lower than the $3.5 million threshold adopted by DET for government schools. If government schools were to follow the ACNC requirements as best practice, approximately 500 government schools would be required to prepare full general purpose financial reports and have these audited each year.

Results of the SCFA program

Upon completion of the yearly SCFA program, DET compiles and summarises the results. DET considers any audit qualifications issued, management letter points raised and the auditors assessment of the overall control environment at each school.

The results of the SCFA program are consolidated and provided to the Portfolio Audit and Risk Committee (PARC), and the secretary of DET. Along with this information, any agreed management actions to address observed issues are provided.

There were two key findings from the SCFA program for 2014 that impacted the reliance that we could place on the SCFA program:

- 57 per cent of the audited schools received a modified opinion because there was no effective control over revenue collected as cash
- the control environment at 32 per cent of schools was assessed as being unsatisfactory or in need of improvement.

The 57 per cent of audited schools that received modified audit opinions, received these because they had no effective controls in place for cash revenue collected from activities such as fundraising, donations, camps, excursions, before and after school care, uniform shops and levies. In total, these revenue balances were material to the school's financial statements. It can be extremely difficult to implement effective controls over cash collections in some instances, such as fundraising. Modifications due to fundraising and donations revenue accounted for 44 per cent of the total modifications reported. However, the qualifications issued were not limited to instances where these activities were material.

The auditors identified that there were inadequate records and reconciliations of cash at some schools, and therefore the schools could not demonstrate the existence of effective controls over the completeness of revenue and cash.

Given that 57 per cent of schools' audited received modified audit opinions there was no effective audit approach that could be adopted to gain sufficient audit evidence to form an opinion on schools' cash related revenue.

DET provide the school audit teams with an assessment tool to rate the control environment at each school. For the 31 December 2014 audits, 32 per cent of schools were rated as either 'unsatisfactory' or 'in need of improvement'. As part of this program 'unsatisfactory' means the school was observed to have no controls in place and 'in need of improvement' means that the school had controls but they were either not effective or not operating for the full year. Either of these ratings leads to a conclusion that the individual school's controls are not reliable. It is a significant concern, and risk, to DET that a conclusion was reached indicating 32 per cent of the state's government schools do not have reliable controls in place.

In response to our assessment of the increasing risk around school transactions and balances, we assessed the SCFA program results for the past six audit cycles to identify any patterns or trends. Our analysis confirmed that the inherent risk is increasing. The control environment at schools is declining and the number of qualifications are increasing. While over the same time period the level of assurance DET has obtained over schools transactions and balances has decreased, potential corrupt conduct is being investigated by IBAC.

The results of the SCFA program over the past six years, from 2009 to 2014, show various trends:

- The proportion of schools audited has declined. In 2014, 29 per cent of schools were audited compared to a high of 44 per cent in 2010. This means that DET is now getting less assurance about schools' financial data and controls.
- The qualifications on locally raised funds have increased from 2012 to 2014. In 2011, SCFA auditors commenced qualifying only where the revenue collected as cash was material. This saw the number of qualifications drop initially from 2011 to 2012, but they have been increasing since then.
- Overall the audit ratings for schools show that the reliability of internal controls have declined from 2013 to 2014 since the rating system was introduced. Specifically, there has been a 41 per cent increase in the number of schools assessed as having no controls, ineffective controls, or controls not operating for the period audited.
- The number of management letter points are increasing. There were 2 221 points raised in 2014, up by 11 per cent from 1 995 in 2013, and the number of management points increased by 36 per cent over the same period.
- Management letter points regarding controls over cash and the completeness of revenue have increased 69 per cent from 36 in 2013 to 61 in 2014. Specifically, the deficient controls relate to those over internet banking, bank accounts, cash handling, EFTPOS and issuing receipts.

These results demonstrate that the effectiveness of controls in place at schools are declining. This decline does not appear to be adequately addressed by the audit and assurance program currently in place.

3.4 School liquidity

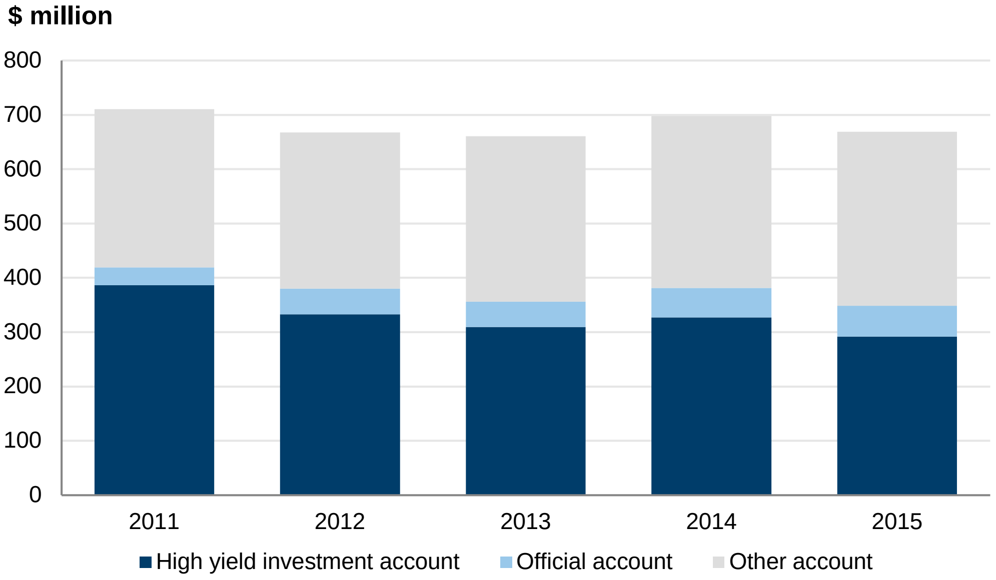
DET requires the principal of each government school to maintain enough liquidity to fund the operations of the school, and be able to pay the schools debts as and when they become due.

Each school is required to have an official bank account and a high yield investment bank account (HYIA). The official bank account is to be used for the day to day running of a school and receives money provided from government sources and locally raised funds such as subject contributions, donations and fund raising. An HYIA has been established by DET for each school into which they pay monies related to the Student Resource Package (SRP) and other DET programs.

Schools are allowed to maintain additional bank accounts at an institution that they determine to be appropriate. Schools with additional funds can therefore hold term deposits, and create accounts for funds received as part of approved tax deductible building and library funds.

Figure 3B below shows the total money held in school bank accounts from 2011 to 2015, by the type of account. It shows that the level of cash held by government schools, and where it is being held. The total balance remained reasonably consistent over the last five years.

Figure 3B
School bank balance by type



Source: Victorian Auditor-General's Office.

The amount of cash held varies between schools. There were 51 schools with more than $2 million in the bank at 30 June 2015. There were approximately 58 schools with less than $20 000 in the bank at 30 June 2015. A further 29 schools had official accounts in overdraft at 30 June 2015, in breach of DET's rules.

Schools with total bank balances of $2 million or more are generally within the greater Melbourne metropolitan area, have enrolment levels that average 1 100 students, and high levels of locally raised revenue.

Schools with total bank balances below $20 000 are more reliant on departmental funding. These schools typically have enrolment levels that average 115 students, indicating that their capacity to raise local funds may be lower than schools with higher enrolments.

This is consistent with our findings reported in *Additional School Costs for Families* tabled in February 2015. That report found that parent payments have become essential to a schools operations, and that those schools better able to obtain parent payments and other locally raised funds are in stronger financial positions than those less able to do so.

Through Standing Direction 4.5.6 *Treasury Risk Management* of the *Financial Management Act 1994* (FMA), the Minister for Finance requires all public sector entities to invest any amounts more than $2 million in non-trading accounts with the Treasury Corporation of Victoria (TCV). We identified 19 schools breaching this requirement with more than $2 million in non-trading accounts that had not invested with TCV. This is in breach of the requirements of the Standing Directions of the Minister for Finance.

In addition, the Standing Direction requires public sector agencies to undertake all investments and financial arrangements with a financial institution that is either a state owned entity or has a credit rating that is the same as or better than the State of Victoria (therefore AAA rating). This requirement is also not followed by all schools.

3.5 Property, plant and equipment

DET were unable to provide sufficient appropriate evidence to demonstrate that adequate accounts and records exist to support the PPE transactions and balances in the financial report at 30 June 2015.

Through our audit work in 2014–15 and previous financial years, we have consistently identified and reported significant weaknesses observed with the records, and method of recording transactions and balances relating to PPE at DET. These issues have not been adequately addressed when raised in prior periods.

The compounding effect of not addressing issues year on year has meant that the asset register, which is the principle underlying record for PPE, now does not support the amounts reported in the DET financial report. This means that DET does not have in place a complete and accurate asset register at 30 June 2015—this is contrary to the requirements of the FMA.

3.5.1 History of concerns

DET performed a full revaluation of PPE at 30 June 2013. VAGO issued a clear audit opinion on these financial statements however we raised a high-risk issue in the management letter regarding the integrity of data in the asset register. In that same financial audit cycle, we also flagged previously reported PPE issues that remained unresolved.

The revaluation process identified a number of discrepancies in PPE data between the asset register and what was sighted by the valuers. While appropriate action was taken to resolve these discrepancies to arrive at a materially correct valuation figure in the financial report, and the outcome of this work was taken up in the DET general ledger, the underlying asset register was not updated. At 30 June 2015, the underlying asset register had still not been updated to correct these values.

In the subsequent 2013–14 financial year, we sought to verify the PPE movements since the conduct of the valuation. We were unable to do this as DET could not provide listings to support additions. The limited incomplete listings and evidence regarding asset disposals was tested but identified errors.

DET's inability to provide sufficient appropriate evidence to allow us to verify PPE movements was reported to management, and the DET PARC through the final management letter, and to Parliament in the *Auditor-General's Report on the Annual Financial Report of the State 2013–14* (tabled in November 2014). In addition, the management letter also re-raised the high-risk issue from 2012–13 regarding data integrity in the asset register that had not been actioned. Management accepted the recommendation that they should perform a data cleansing exercise and verify that the data in the asset register was complete and accurate. They committed to this being done by November 2014, but did not deliver on this commitment.

3.5.2 Financial year ended 30 June 2015

In 2014–15 we again sought to substantiate the PPE movements for the financial year in order to gain comfort over the PPE balances reported for 30 June 2015. The audit approach also planned to review the data cleansing performed, however DET failed to undertake this work by November 2014, as committed.

Although we were largely and belatedly provided with listings making up the PPE movement lines within the PPE note disclosure, most attempts to verify samples taken from these lists failed. The testing undertaken identified that:

- assets held for sale do not comply with Australian Accounting Standards
- assets are not capitalised on a timely basis
- assets are not capitalised on a component basis, that is, with sufficient detail
- assets that are disposed of are not removed from the asset register on a timely basis
- the work in progress balance inappropriately has negative balances and was not being reviewed and cleared in a timely manner
- assets are being incorrectly written off as repairs and maintenance expenditure
- $21.9 million of land and buildings was found to be missing from the register and was not correctly reinstated as a prior period error.

In addition, the general ledger and the asset register have large reconciling items which remain unresolved from 30 June 2013 as a result of the valuation discrepancies identified at that time still not being corrected in the asset register. This consequently meant that the managerial valuation conducted at 30 June 2015 using data from the asset register was neither complete nor accurate.

3.5.3 Asset register

DET implemented a new asset register (Atrium) during the 2014–15 financial year. The implementation of a new asset register has been DET's ongoing principal response to address our previously raised concerns, including the PPE data integrity issues. However, the implementation of Atrium was delayed and the processing of significant PPE activity was not performed until May 2015.

At the time we completed our audit, in September 2015, the valuations module of Atrium was not working. Consequently, asset values were unable to be amended for changes such as revaluations and impairments. This also meant that the discrepancies in asset data and values dating back to 30 June 2013 could not be corrected.

DET is required by section 44 of the FMA to keep proper accounts and records to sufficiently explain the financial operations and financial position of the department. The FMA further requires (section 44B) that a department maintain a register of assets. The Minister for Finance has determined in Standing Direction 3.4.9 *Physical and intangible assets* that public sector agencies must implement and maintain an effective internal control framework for asset management to ensure that assets are identified, recorded accurately and accounted for in accordance with Australian Accounting Standards.

DET's failure to maintain proper accounts and records, including a complete and accurate asset register, is a breach of the FMA.

3.6 Control environment observations

DET's 2014–15 financial statements required increased audit scrutiny as the inherent risk of the audit was assessed as high, and DET's internal control system was assessed as weak. Consequently, as required by Australian Auditing Standards, we placed no reliance on the control environment at DET. Our assessments were underpinned by judgements which considered:

- the significant observations and findings in prior audits including the audit qualification issued to the former DEECD in 2013–14
- management's judgement and estimates, and the availability of evidence to support decisions
- the department being slow to respond to high-risk concerns around school-based financial information, assurance over schools financial information and asset records
- the IBAC public examinations which specifically identified:
  - governance and accountability gaps
  - alleged corrupt practices embedded within the department, including at a number of schools, over an extended period
  - withholding of information from VAGO
- concern with departmental governance identified by independent reviews, and a VAGO performance audit around strategic planning occurring at the time of the financial audit
- serious matters raised by independent advisers around DET's preparedness for the 2014–15 financial statements.

The Acting Auditor-General has subsequent to the finalisation of the financial audit, tabled his report *Department of Education & Training: Strategic Planning* in October 2015. That report identified ineffective organisation-wide governance and poor implementation of the strategic plan at DET.

Further observations on elements of the control environment reviewed during the audit are provided below.

3.6.1 Fraud and corruption

The secretary of DET reported to the Auditor-General that the department had identified $2.5 million of actual or suspected fraud and corruption in 2014–15. Although there were 20 reported incidents of actual or suspected fraud committed by employees, DET was unable to quantify the estimated value of 18 of these instances. Consequently, the total estimated loss of public funds due to fraud and corruption could be considerably higher.

As shown in Figure 3C the estimated loss and number of reported incidents of actual or suspected fraud and corruption have both increased year on year for the past three financial years.

Figure 3C
Reported fraud and corruption

Year	Number of reported incidents	Estimated loss ($)
2012–13	9	22 635
2013–14	12	401 206
2014–15	20	2 540 000

Source: Victorian Auditor-General's Office.

In 2012–13, the department reported nine instances of fraud and or corruption with an estimated loss of $22 600. This increased to 12 instances and an estimated loss of $400 000 in 2013–14.

In 2014–15 there were 20 reported instances underpinning the estimated loss of $2.5 million.

DET is the subject of a current IBAC investigation into alleged corruption primarily through the 'program coordinator schools' This process has referred to $2.5 million of suspicious transactions. However, IBAC has indicated it is possible that the total amount of corrupt payments may be higher.

As an immediate response to the IBAC investigation, the secretary abolished the program coordinator schools model and outlined a number of actions the department would take including the establishment of an Integrity Committee. This committee will be responsible for overseeing the development of an integrity reform program.

3.6.2 Audit committee

DET has in place a PARC to assist the secretary in fulfilling her governance and oversight responsibilities and obligations under the FMA.

PARC has a number of objectives including but not limited to providing advice to the secretary as to whether there are adequate, appropriate and effective controls in place to manage and control key risks, and to meet external regulatory, compliance and public accountability requirements. In this respect, there is an important link between the role of the external auditor and PARC.

When undertaking the financial audit we considered the operations of PARC for 2014–15 against the principles in the Australian National Audit Office's Better Practice Guide: *Public Sector Audit Committees: Independent assurance and advice for Accountable Authorities.* The objectives of PARC are consistent with the principles in the guide including a role in reviewing financial reporting, performance reporting, system of risk oversight and management, and system of internal control.

We identified a number of areas where the effectiveness of PARC could be improved. However, as the financial year progressed most of these areas were also identified by PARC and addressed. Specifically, we observed that:

- there is now a more open exchange of information between PARC and the external auditors, with a standing invitation to each meeting
- minutes of meetings now include discussions and outcomes for in camera sessions so a clear and concise record is available
- monitoring of the implementation of internal audit recommendations is now occurring
- all internal audit reports are being provided to PARC and their completion tracked, including ad hoc audits which previously had no transparency at PARC
- the content of management reports has been reviewed with a specific focus on school-based financial information to monitor performance and identify trends at schools.

Throughout 2014–15, PARC has implemented a system to track and monitor progress of agreed management actions and time frames of recommendations from internal auditors and Auditor-General's performance audits. The implementation of that new process has identified that many of the management actions are long overdue.

PARC has yet to start tracking financial audit recommendations. Given the history of poor and slow action to address financial audit issues, this is a missed opportunity for DET and PARC. Going forward, it will be important for PARC to have a role in monitoring the progress and implementation of agreed actions, with an independent critical eye.

The members of PARC last reviewed their own performance by completing an annual evaluation survey in October 2014. The committee asked itself 18 questions and scored itself with an average rating of 3.9 out of five. All but one of the areas of improvement implemented in 2014–15 were flagged in that self-review which calls in to question the effectiveness of that review. It is therefore pleasing that an external review was initiated by the Chair of PARC in 2015 which will assess the effectiveness of PARC in achieving its objectives, including consideration of the outcomes of the recent IBAC hearings and DET's IBAC response work plan. This review was due for completion during October 2015.

At the time of preparing this report, VAGO has not seen the outcome of this review.

3.7 Audit findings

At the finalisation of the 2013–14 financial audit we concluded and reported to Parliament that DET's financial report preparation processes were poor.

While acknowledging that DET have taken some steps to improve in 2014–15, there is still a significant amount of work to be done to improve the policies, processes and practises that underpin the preparation of a robust and timely financial report.

We would continue to rate the financial report preparation practises at DET as poor, however we are encouraged that the changes made to date indicate DET are improving. Specifically, we are aware that shortly after the finalisation of the 2014–15 financial audit, DET engaged an independent advisory firm to prepare a project plan including milestones and deliverables, to guide financial reporting improvements for 2015–16.

Prior year management letter points

In 2013–14, we raised 20 management letter points, 11 of which were rated either extreme or high risk.

DET addressed all issues around the economic obsolescence adjustment that lead to a qualified audit opinion being issued in 2013–14. As a result, that qualification was removed in 2014–15. DET also addressed our concerns regarding unrecorded bank accounts.

However, critical issues raised regarding assurance over school transactions and balances, and PPE were not adequately addressed. Specifically, DET have not successfully delivered 14 management action plans within the committed time frame to address all high-risk issues. This has contributed significantly to the disclaimer of audit opinion being issued in 2014–15.

The failure to execute the agreed management action plans has resulted in a protracted 2014–15 financial audit and the escalation of risk ratings attached to issues —from high to extreme—for carried forward issues pertaining to schools transactions and balances, PPE and the preparation of the financial report.

The implementation of management action plans is critical going forward to ensure that DET addresses issues in a timely manner and to reduce the risk of further and ongoing modifications to our audit opinion.

Recommendations:

That the Department of Education & Training:

3. takes action to address all identified internal control issues around its asset records and school-based financial information in a timely manner
4. delivers on all project plans currently being developed and ensures remedial actions related to its asset records and school-based financial information are effective and timely.

4 Financial sustainability risks

At a glance

Background

This Part comments on the financial sustainability risks of self-funded entities. These entities generate the majority of their revenue from their own operations, rather than from government funding.

Self-funded entities should aim to generate sufficient revenue from their operations to meet their financial obligations and to fund asset replacement.

Conclusion

A review of these entities indicates that many may be unable to set fees and charges at a level that would enable them to generate sufficient revenue to meet their obligations as they fall due and to ensure the long-term renewal of their assets. Over the long term, such financial challenges may reduce the service potential of assets and consequently reduce the services that can be provided to the community, or broader economy, if another funding source is not identified.

Self-funded entities need to balance community service obligations, broader economic development objectives and maintaining financial sustainability.

Findings

Four of the 49 self-funded entities were rated as having a high financial sustainability risk. These entities are generally not generating enough revenue to fund their depreciation costs which means they may not be able to renew their assets as required to continue offering services to the community.

Recommendation

That the Department of Treasury & Finance, and relevant portfolio departments, works with self-funded entities to review their underlying pricing model, sources of funding and cost structures, to improve their long-term financial sustainability.

4.1 Introduction

Self-funded entities should aim to generate sufficient revenue from their operations to meet their financial obligations, and to fund asset replacement and renewal. Their ability to do this depends on how they can generate revenue and control costs.

Self-funded entities charge for their services. However, given the nature of these entities, their governing boards can have limited capability to improve their financial sustainability through increased fees and charges. This potentially compromises the services that they are able to offer the community or broader economy in future years, unless additional sources of revenue can be identified.

In this Part we reviewed the financial sustainability risks of entities that generate the majority of their revenue from their own operations, rather than from government funding. Forty-nine entities were identified as being self-funded in 2014–15, compared with 45 in 2013–14.

The seven portfolio departments and all other entities predominately funded through government grants have been excluded from this assessment. The financial sustainability risks of public hospitals, local government, water and tertiary education entities are assessed and reported to Parliament in our sector-specific Audit Snapshot reports. They are excluded from this assessment.

4.2 Changes in entities

The number of audited entities considered to be 'self-funded' and covered in this report increased by four in 2014–15. A list of changes is provided in Figure 4A.

Figure 4A
Changes to self-funded entities audited in 2014–15

Entities audited by our office for the first time in 2014–15
Gippsland Health Alliance
Hume Rural Health Alliance
Loddon Mallee Rural Health Alliance
Grampians Rural Health Alliance
South West Alliance Rural Health
Entities wound up during the 2013–14 financial year
Murray Valley Citrus Board

Source: Victorian Auditor-General's Office.

4.3 Financial sustainability risks

We analysed the financial trends and patterns of the self-funded entities by examining four core indicators. The indicators used were the net result, liquidity, internal financing and capital replacement, as they reflect the outcomes of an entity's funding and expenditure policies, and indicate whether the entities are subject to higher financial sustainability risks.

Financial sustainability risks should be viewed from both the short- and long-term perspective. The short-term indicators, in this case the net result and liquidity indicators, measure an entity's ability to maintain adequate liquid assets, and to generate an operating surplus over the short term. The long-term indicators, the internal financing and capital replacement indicators, identify whether adequate funding is available and being spent on asset renewal to maintain the quality of service delivery and to help meet community expectations and the demand for services.

Appendix B describes the financial sustainability indicators, risk assessment criteria and the benchmarks used in this report.

Financial sustainability risk assessments

During the 2014–15 financial year we reviewed and amended the definition of some of the financial sustainability risk indicators to improve reporting to Parliament. These new definitions are used across all our Audit Snapshot reports and are applied directly to the individual entity's audited financial statements, without adjustment. Details of the changes are included in Appendix B.

Figure 4B provides a summary of the financial sustainability results of self-funded entities at 30 June 2015.

Figure 4B
Financial sustainability risk assessment, 2014–15

Risk rating	2014–15
High	4
Medium	17
Low	28
Total	**49**

Source: Victorian Auditor-General's Office.

A major driver of these sustainability risks is the difficulty in setting fees and charges at a level that would enable the entities to meet their financial obligations as they fall due, and ensure the long-term maintenance and replacement of their assets.

Most of the self-funded entities identified as having higher financial sustainability risks have a similar requirement to provide services or broader economic and cultural benefits to the state, generally at prices below what would be required to generate sufficient revenue to replace and upgrade assets. Typically these entities are not able to maintain financially sustainable operations independently of the government given the community service overlays and broader economic development objectives attached to their operations. The requirement to balance these sometimes conflicting objectives can lead to an operational focus on meeting community and broader economic outcomes, at the expense of the entity's financial sustainability. This was evidenced in the case study reviews we conducted at three self-funded entities.

For entities entrusted with the maintenance of large assets providing significant community benefit, the long-term maintenance of these assets may be better served through greater funding involvement by the responsible portfolio department. Alternatively, longer-term asset maintenance and renewal funding plans from the responsible portfolio department could be introduced to provide these entities with certainty, at least over the three years forward estimates period.

Many of the self-funded entities are not publically disclosing the level of service they are providing to the community. Additional focus on, and transparent reporting of, community services provided—the number of free programs conducted during a year for example—could lead to improved performance through additional government funding, a greater appreciation by the public of services being provided, and potentially additional public generated funding, such as donations or bequests.

4.4 Case studies

We selected three self-funded entities for further analysis. These entities were selected as they represent the spectrum of self-funded entities including a mix of 'iconic' assets, scale of operations and differing abilities to set charges.

This analysis included looking at their operational challenges, action taken to address operational risks, the financial management practices that are in place and how the entities ensure their long-term sustainability.

We found that while all three are quite different operationally, their ongoing challenges are very similar and are indicative of the position of most self-funded entities.

4.4.1 State Sport Centres Trust

The State Sport Centres Trust (SSCT) is a statutory authority responsible for governing the Melbourne Sports Hub’s four venues being the Melbourne Sports and Aquatic Centre (MSAC), the State Netball and Hockey Centre (SNHC), Lakeside Stadium and the MSAC Institute of Training.

The SSCT facilities are accessed by almost 3 million people each year, house a number of state sports tenants and also host multiple major events annually.

SSCT operates under the *State Sport Centres Act 1994* and the *State Sport Centres (Amendment) Act 2004*. These Acts set out the functions of the SSCT which include, among other things—the management, operation, maintenance, care, improvement, use and promotion of MSAC and the SNHC and associated land. The Acts also require SSCT to submit a business plan for these centres to the Minister for Sport and to set prices, with the minister's approval.

The services provided by SSCT, as part of meeting key government objectives, include:

- **holding major events**—building and maintaining Victoria's capacity to attract and retain major events such as the State Open and Age Swimming Championships and the Australian School Volleyball Championships
- **supporting representative teams**—supporting state-level and professional sporting teams such as the Melbourne United basketball team and the South Melbourne Football Club
- **supporting peak athletes**—supporting athlete development through the provision of high-quality performance coaching, training and sports science facilities
- **supporting the state's sports system**—providing access to appropriate facilities that support the statewide administration of sport, including supporting Basketball Victoria, Athletics Victoria and Netball Victoria
- **improving participation**—which involves increasing the participation in and the access and use of the facilities by the public.

These key public service offerings are agreed annually with Sport and Recreation Victoria and the Minister for Sport through an annual business plan to provide broader health and wellbeing benefits to the public.

SSCT is focused on the ongoing management and operation of the facilities and ensuring they are available to accommodate major events, elite athletes and sporting associations. This responsibility includes the day-to-day maintenance of the facilities. SSCT currently operates on the basis that it is responsible for appropriately planning for, and providing advance notice to government of, significant capital funding requirements. To date, funding of significant capital works have been conducted through a partnership with additional funding from the state. SSCT does this through implementing an asset maintenance regime and by planning and seeking capital funding, to enable the facilities to be maintained to an appropriate standard.

SSCT needs to generate financially sustainable results while balancing significant services to the community and other entities at subsidised revenues, such as rental subsidies provided to various Victorian sporting associations.

Financial sustainability results

SSCT's financial sustainability results at 30 June 2015 are shown in Figure 4C.

Figure 4C
Financial sustainability results, 30 June 2015

Entity	Net result (%)	Liquidity (ratio)	Internal financing (%)	Capital replacement (ratio)
State Sport Centres Trust	-45.61%	1.15	-81.29%	0.50

Source: Victorian Auditor-General's Office.

As shown in Figure 4C, SSCT's results indicate both short- and long-term financial sustainability issues. These issues have been evident over a number of years, as SSCT balances the requirements of meeting community demand, government policies and financially independent operations.

For the year ended 30 June 2015, SSCT generated revenue of $21.8 million, which included $1.6 million of government grants for operational purposes. These government grants are provided to SSCT based on specific funding agreements with the relevant portfolio department to achieve the key government objectives identified above. Against its total revenue, SSCT delivered a deficit result of $9.9 million, largely due to depreciation charges of $9.1 million. SSCT broadly operates on a break-even basis from cash flows, i.e. when depreciation is excluded.

While SSCT has an obligation to meet the key government objectives identified above, it also has the ability to generate income from other sources to supplement revenue received from government. This includes hiring out function rooms, providing access to the gym and pool facilities and on-site catering.

In order to plan and manage these operating circumstances, SSCT prepares four-year operating forecasts. These forecasts currently include $1.5 million in annual operating grant funding from the state government in exchange for the delivery of agreed activities, as outlined in the business plan. These operating forecasts indicate break-even results on a cash flow basis, i.e. when depreciation is excluded.

SSCT also prepares a detailed annual business plan, which receives Ministerial approval.

Funding model

In line with the analysis above, SSCT has identified key operational risks around the ongoing funding and maintenance of its facilities. In order to mitigate these risks it has sought greater certainty of future funding from the government—both in terms of operational funding and capital funding.

The need to ensure short-term maintenance is appropriately conducted and funded, lies with SSCT. Longer-term funding of significant and larger-scale capital works are typically outside the scope of SSCT's daily operations and internal funding abilities. These longer-term costs currently need to be covered by the capital funding provided to SSCT by the state government.

Improvements to the funding model and strategic plans have now been implemented to provide greater certainty to SSCT. These improvements include the recent creation of funding agreements for both operational and capital funding covering the next three years. Previously a formal funding model or agreement had not been in place for asset management and renewal.

Pricing

SSCT charges for the majority of the services it provides to the general public and other entities. In almost all cases the prices of these services are subject to approval by the Minister, with limited scope for the SSCT to independently adjust prices.

Part of the annual business plan that SSCT submits to the Minister is a comparison with other sporting facilities, both state controlled and private sector, to ensure pricing is consistent and benchmarked. This annual plan also identifies the level of subsidies and rental rebates provided by SSCT to various Victorian sporting associates.

Asset base

SSCT currently manages approximately $335 million in assets, largely comprised of MSAC, SNHC and Lakeside Stadium. These centres are large, multi-purpose venues providing a significant number of services to patrons annually. MSAC and SNHC are 18 and 14 years old respectively, and require maintenance each year. Large scale capital and maintenance works on these buildings are typically funded by capital funding provided from the state government. Such funding is treated as a contribution of capital and therefore does not affect the operating result of SSCT.

The current capital funding model is forecasting a total of $11.8 million in capital funding from the state government over the three years from 2015–16. This funding will be used to facilitate and fund the creation of a specific Asset Management Plan and critical works to the facilities.

Sustainability reviews

Since 2012, a number of financial sustainability reviews over SSCT's operations have been commissioned by the responsible department as part of budget submissions for additional capital funding. These reviews were performed by private sector consultants. The reviews have generally found that SSCT is not financially sustainable, and is not likely to be, without ongoing government support. The sustainability reviews forecast out to 2017–18 and identified that additional government funding was required to ensure SSCT's assets remained operational and useable. The current funding agreements in place with the state government run until 2017–18 and address the shortfall requirements identified by these reviews.

The reviews have identified that since the expansion of SSCT's facilities to house the 2006 Commonwealth games and the transfer of the Lakeside Stadium to SSCT, the SSCT's ability to be self-sufficient has declined. These reviews have identified that the addition of high operating cost assets such as the MSAC Outdoor Pool and Lakeside Stadium, which attract low revenue streams, mean that the government needs to continue to provide ongoing financial support to SSCT.

These sustainability reviews also note that many of the facilities and services provided by SSCT provide significant public benefit and cost more to operate than can be commercially charged for their use. Closure of these facilities to save costs would greatly impact on a number of sports outcomes for the state including major events, elite athletes, representative teams and overall sports participation. The state maintains a strong focus on the development of sport and sporting facility infrastructure and accordingly the ongoing maintenance of SSCT facilities is considered of significance to the state and the people of Victoria.

The reviews also identified a number of options to increase revenue and allow for a more self-sufficient operation including reducing the level of rental revenue subsidies provided by SSCT to Victorian sporting organisations, increasing the price of commercial offerings and altering the current pricing model to generate a greater level of income from facility memberships. Interestingly, the sustainability reports identify that subsidies and reduced rates of hire provided to other sports entities alone cost SSCT (through reduced revenue) almost $4 million a year. While the benefit of these subsidies and reduced rental levels is not questioned, allocating the operational responsibility for these costs to SSCT restricts its ability to operate on a commercially independent basis.

The reviews also found that SSCT management team have been proactive in trying to improve operations and financial results, and have performed well when benchmarked against other states.

Conclusion

Given the nature of SSCT's operational arrangements it is dependent on the government to set objectives, pricing decisions and provide ongoing funding. This is especially apparent to address longer-term asset renewal and financial sustainability risks.

While SSCT's financial results and position indicate sustainability risks, the required funding identified by SSCT's internal plans and the externally conducted sustainability reviews suggest that recent funding agreements with the state government are sufficient to maintain operations at their current levels, albeit in a difficult balancing act. Should this support be reduced, the ability of SSCT to continue to maintain the facilities would be compromised. The continuation of longer-term funding arrangements and agreements would also provide a greater level of certainty.

4.4.2 Docklands Studios Melbourne Pty Ltd

Docklands Studios Melbourne Pty Ltd (the Studio) provides studio facilities for hire for film and television production. The Studio is one of only three major studio complexes in Australia that service the film and television industry.

The Studio is a state government business enterprise which works closely with Film Victoria to promote Victoria's incentives, locations and screen services. It contributes to the broader Victorian economy by servicing the film and television industry and attracting projects to Victoria.

Financial sustainability results

The Studio has delivered a net deficit in each of the past five financial years of approximately $1.4 million annually after annual depreciation charges of approximately $2.0 million. Operating revenue and expenditure have remained consistent over each of the past five years. Cash flows from operations have typically been positive.

Figure 4D shows the Studio's financial sustainability results at 30 June 2015.

Figure 4D
Financial sustainability results, 30 June 2015

Entity	Net result (%)	Liquidity (ratio)	Internal financing (%)	Capital replacement (ratio)
Docklands Studios Melbourne Pty Ltd	-35.54%	2.03	300.47%	0.16

Source: Victorian Auditor-General's Office.

As evident in Figure 4D, the Studio's results indicate some financial sustainability issues, however, these are mainly in the longer term.

For the year ended 30 June 2015 the Studio generated revenue of $3.8 million. This included no government grant revenue. Against this revenue, the Studio delivered a deficit result of $1.4 million, largely due to depreciation charges of $2.3 million. The Studio received $0.2 million in capital improvements during the year from the state.

Funding model

The majority of the Studio's revenue is generated through the rental of facilities and cost recoveries for services provided. The services are typically charged at commercial rates. The largest, regular expense incurred by the Studio, other than depreciation, is maintenance of its assets, which are now over 10 years old.

Pricing

While the Studio charges for its services, a significant factor in attracting productions are the additional incentives provided and investments made, by the state government to producers to conduct their projects in Victoria. These incentives are not captured in the Studio's financial statements, as they are a cost incurred by the state government and paid directly to the producer. These incentives can vary between each production.

Asset base

The Studio maintains buildings and improvements of approximately $43 million and given the current operating results, will require additional capital funding from the state government to replace and upgrade significant assets in the longer term. The need for this longer-term capital funding has been identified by the Studio in its forecast business plans.

While the Studio maintains an operating surplus, excluding depreciation, future maintenance and replacement of the studio facilities is not sufficiently covered through current operational results. Accordingly, the Studio is heavily dependent on longer-term capital funding from the state government. Such funding is treated as a contribution of capital and therefore does not affect the operating result of the Studio.

The Studio has progressively built up cash reserves as an Asset Management Fund which sets aside self-generated funds for use in maintaining assets. The Studio currently sets aside additional funds each year into the Asset Management Fund to fund necessary works for the next year. The fund forecasts maintenance works on a rolling basis, allowing the studio to better analyse, plan and prioritise its maintenance costs. This is an important initiative undertaken by the Studio. However, the Asset Management Fund is not designed to cover the cost of significant improvements to the asset base into the future.

Sustainability reviews

The Studio has identified a number of operational risks which focus on the loss of key, long-term clients and revenue, as well as the ongoing maintenance and improvement of facilities. These risks are mitigated through a number of strategies including the creation of annual financial budgets (including asset expenditure budgets), marketing initiatives to attract and retain clients and a focus on maintaining a close working relationship with Film Victoria.

In terms of planning for ongoing maintenance of the facilities, the Studio has prepared an Asset Management Plan and Life Cycle Analysis which forecast and provide for future maintenance costs.

The Studio is also reliant on the ongoing access to facilities. The land on which the Studio operates is Crown land. This is leased from the state government and there is a current lease in place until 2024. Annual rental costs are approximately $0.4 million.

Conclusion

The Studio has a lower short-term financial sustainability risk given its liquidity position and relatively strong operating result (before depreciation) but higher long-term sustainability risks given its capital replacement indicators. The Studio's long-term future is heavily dependent on government support to provide:

- incentives to, and investment in, production companies
- capital funding to renew, replace and upgrade facilities
- access to the land on which the Studio operates.

4.4.3 Victorian Arts Centre Trust

The Victorian Arts Centre Trust (VACT) manages key performance venues in Melbourne, including Hamer Hall, the Arts Centre Theatres Building, the Sidney Myer Music Bowl and an extensive performing arts collection. The functions of the VACT are outlined in the *Victorian Arts Centre Act 1979* and include, among other things, to:

- control, manage, operate and maintain the Arts Centre
- present and produce performances
- promote the use of the Arts Centre
- provide leadership in the promotion and development of performing arts
- maintain, conserve, develop and promote the State's performing arts collection.

The Act also requires VACT to endeavour to enrich the cultural, educational, social and economic life of the people of Victoria.

VACT's spire is generally considered a defining Melbourne landmark. VACT is one of Australia's significant performing arts centres and has almost 3 million visitations and facility uses annually. VACT also provides a number of free programs to the public and members of the community who may not be able to access performing arts due to disadvantage.

Arts Centre Melbourne recently celebrated its 30th anniversary and over that time it has played a leading role in showcasing local and international performing arts, and has ongoing partnerships with Australian music, opera, theatre and dance companies as well as presenting its own performing arts program.

As part of regular state government funding, VACT is required to meet certain objectives including targets for the number of performances each year, minimum attendance levels and the achievement of a broad range of cultural and artist level support as well as the exhibition, promotion and maintenance of the state’s performing art collection. Given these broader non-commercial requirements to provide services to the community and the state, VACT is not expected to focus solely on achieving a commercially sustainable result. VACT is therefore faced with the challenge of being financially sustainable, maintaining a 30-year-old facility and providing access to significant levels of cultural benefits to the community.

Faced with a more culturally diverse and younger demographic, VACT is looking at ways of working differently to increase audience engagement. This includes using spaces more innovatively and exploring new delivery models and general audience development.

Financial sustainability results

Over the past five years, VACT has generated mixed results varying from deficits of over $7 million, before depreciation, through to surplus results of $6 million, before depreciation.

In 2014–15 VACT generated revenue of almost $80 million and a surplus before depreciation of $2.5 million. Depreciation charges for the year were $16.0 million, leading to a net deficit of $13.5 million.

Figure 4E shows VACT's financial sustainability results at 30 June 2015.

Figure 4E
Financial sustainability results 30 June 2015

Entity	Net result (%)	Liquidity (ratio)	Internal financing (%)	Capital replacement (ratio)
Victorian Arts Centre Trust	-17.09%	1.33	141.79%	0.44

Source: Victorian Auditor-General's Office.

VACT's sustainability results indicate longer-term issues with low capital replacement indicator results. By not being able to generate enough revenue to fund the depreciation of its assets, the ability of VACT to renew these assets as required could be jeopardised.

Funding model

VACT currently receives almost $15 million annually in non-indexed, ongoing operational grants from the state government, and an additional $7 million in sustainability and programming funding which is due to sunset in 2015–16. State government funding represented 27 per cent of VACT's total income in 2014–15, with the balance of revenue being self-generated through a range of activities, including parts of its performing arts program. The state government has also provided for more than $16 million in capital funding over three years until 2016–17 to fund critical asset renewal. This capital funding is treated as a capital contribution and does not affect VACT's operating result.

VACT maintains significant and iconic assets. The ongoing funding and maintenance of these assets is an important focus of VACT. In order to mitigate the risks associated with not maintaining these assets, it has sought greater certainty of future operational and capital funding from the government.

VACT's objectives include a focus on improving cultural outcomes for the state. This involves the ongoing management and operation of the facilities and ensuring they are available to deliver appropriate programs. This responsibility includes the day-to-day maintenance of the facilities. VACT is responsible for appropriately planning for, and providing advance notice to government of, significant capital funding requirements. Traditionally large-scale capital works are funded by the state government. VACT's role in relation to larger scale capital works is therefore to plan appropriately and seek funding, not to fund it from operational revenue.

The scale of maintenance work regularly undertaken by VACT necessitates a process of prioritisation. This focuses on the most critical work, which typically addresses the ability of VACT to hold productions or to ensure the safety of patrons and staff.

In addition to its own productions, VACT also generates revenue through resident companies and other local and international entities holding productions across the centre's facilities. Revenue generated by the productions can arise in a number of forms, including the production company paying a tenancy fee or VACT taking more of a partnership approach and sharing through arrangements in relation to box office takings. Many international touring productions are planned several years in advance. Due to VACT's long-term funding position it is difficult for VACT to enter into longer-term planning and risk sharing arrangements.

Pricing

VACT broadly has the ability to set prices as it sees fit. Given its unique nature, a benchmarking exercise against other Victorian facilities is difficult as there are no state controlled entities in the performing arts sector of a similar size. VACT considers broader market rates, when setting its pricing.

VACT provides some programs at no or nominal cost as part of key objectives including free events throughout school holidays, access to parts of the facilities and collection at no cost and low-cost programs that provide access to performing arts for young people from challenging and disadvantaged circumstances.

Asset base and sustainability reviews

VACT holds property, plant and equipment of almost $500 million. These assets are mostly comprised of the arts centre land and buildings, works of art and the performing arts collection. This large asset base requires a significant level of maintenance.

In order to gain a greater understanding of the costs required to meet its legislative objectives, maintain service levels and maintain the assets—and therefore the revenue required to cover these costs—Creative Victoria (formerly Arts Victoria) commissioned a major review of VACT's base funding and business model in 2013. This review identified that annual, ongoing funding above current base funding levels may be required to ensure the ongoing viability of the Arts Centre. The shortfall identified by the review was up to $12 million a year and has been partly addressed with the state government allocating an additional $7 million in sustainability and programming funding, however, this additional funding is set to end in June 2016.

Creative Victoria has recently commissioned a further review into VACT's operations by a private sector consultant. This review is due for completion in late 2015 with findings expected to inform future funding model decisions.

Conclusion

Given the nature of VACT's operations and cultural importance, it is difficult for it to not be reliant on the government to provide ongoing funding.

While VACT's financial indicators are not indicating significant short-term sustainability issues, ongoing support from the state government is required to ensure continued operation. Should this support be reduced, the ability of VACT to continue to maintain its facilities and deliver productions, programs and subsidised events in line with its responsibilities would be compromised.

While partly self-funded, VACT has significant community service obligations and is reliant on government support and funding—especially in terms of significant asset upgrades and works. Accordingly, longer-term sustainability risks exist for VACT, as its financial indicators suggest. The ongoing operating and capital support from the state government currently seeks to fully fund long-term asset renewal and upgrade.

4.5 Pricing

A significant challenge faced by self-funded entities is their ability to set prices for all their services, including their broader community service obligations. Our case studies highlight that constraints exist in the ability of self-funded entities to set prices that would recuperate or fund long-term asset replacement—largely due to the high-cost nature of the assets they control and the level of public benefit they provide through subsidised pricing arrangements.

Additionally, the way these entities are set up and the funding model in which they operate tends to focus on the stewardship and operation of assets—as distinct from the ongoing replacement, improvement, expansion and upgrade. These longer-term strategic decisions are broadly set by the state government as part of broader policy making decisions. Not surprisingly, given that the current funding and pricing models do not fully allow for adequate capital renewal and replacement, our sustainability indicators highlight long-term financial sustainability risks.

While pricing is a significant factor in terms of the ability for self-funded agencies to be financially sustainable in the longer term, the Department of Treasury & Finance should work with these entities and their relevant portfolio departments to find an appropriate balance between the fee-setting model and other revenue sources, to enhance their ability to improve their financial sustainability within the context of their operations.

4.6 Conclusion

Our case study reviews highlight that some self-funded entities are unable to set their fees and charges at a level that would enable them to generate sufficient revenue to meet their obligations as they fall due, and to ensure the long-term maintenance and replacement of their assets. In many cases, this is due to the broader community services and other benefits these entities provide at minimal or subsidised rates. If these entities were to set and charge prices for all their services at a point that would allow them to fund significant asset works from their own revenue, the community may not use the services available.

Most of the self-funded entities identified as having higher financial sustainability risks are required to balance the provision of services or broader economic and cultural benefits to the state, generally at below commercial prices, with maintaining financially sustainable operations.

For those entities entrusted with the maintenance and renewal of large assets providing significant public benefit, the long-term maintenance and renewal of these assets may be better served through longer-term funding plans from the responsible portfolio department that could be introduced to provide these entities with greater financial certainty.

The entities in our case studies submit funding submissions to the relevant portfolio department and state government for both operational and capital funding. They have all had financial sustainability reviews conducted, however, their existing funding, pricing and cost structures create long-term financial sustainability risks.

While they are predominantly self-funded, by charging some users and generating revenue from sources other than the state, these entities have significant community service obligations or broader economic outcomes. In this regard, they rely on additional operational and capital funding from the state. Therefore, the current capital funding model results in longer-term financial sustainability risks as the funding for the renewal and upgrade of assets is reliant on state funding.

Recommendations

5. That the Department of Treasury & Finance, and relevant portfolio departments, work with self-funded entities to review their underlying pricing model, sources of funding and cost structures, in order to improve their long-term financial sustainability.
6. That relevant portfolio departments develop long-term capital funding plans with self-funded entities within their portfolio.
7. That self-funded entities seek longer-term funding agreements, at least over the three year forward estimates period, with their portfolio departments.

5 Alpine resorts

At a glance

Background

This Part analyses the financial reporting of the five Victorian alpine resorts for the year ended 31 October 2014. It also discusses the oversight and internal control issues observed during the 31 October 2014 financial audits.

Conclusion

Significant oversight, financial reporting and control issues were identified at some of the state's alpine resorts during the financial audit of their 31 October 2014 financial reports. These issues were mainly in relation to the oversight of outsourced providers. This contributed to the financial reports of these resorts being late for the reporting period to 31 October 2014. The resorts have accepted the issues we raised and have committed to taking action, or have taken action, to address them.

Findings

- The financial reports of Lake Mountain and Mount Baw Baw received clear audit opinions with the inclusion of emphasis of matter paragraphs drawing attention to noncompliance with the *Financial Management Act 1994* and the *Alpine Resorts (Management) Act 1997.*
- Failure to adequately oversight the outsourced private provider has meant significant weaknesses in cash flow management, noncompliance with legislation, weak internal controls and errors in financial reporting were identified.

Recommendations

That Lake Mountain, Mount Baw Baw and Falls Creek alpine resorts:

- immediately remedy the issues identified around their internal control environments and other matters identified by audit during the 2013–14 reporting period
- review existing contractual arrangements with the outsourced providers to ensure they clearly identify and outline the services and competencies required
- more actively oversee and manage the services provided by outsourced providers for their resort, including gaining appropriate assurance over the operation of internal controls by those providers.

5.1 Introduction

Victoria's alpine resorts are located at Mount Buller, Mount Stirling, Falls Creek, Mount Hotham, Mount Baw Baw and Lake Mountain. Each alpine resort is overseen and managed by a government appointed alpine resort management board.

The alpine resort management boards (the resorts) are established under the *Alpine Resorts (Management) Act 1997* (the Act). The Act sets out the objectives of an alpine resort, and prescribes the governance and financial arrangements the resorts must apply. Under the Act, the resorts are fully accountable for their financial management and financial performance.

This Part analyses the financial reporting of the five Victorian alpine resorts for the year ended 31 October 2014. It also discusses the oversight and internal control issues observed during the 31 October 2014 financial audits.

5.2 Conclusion

Significant oversight, financial reporting and control issues were identified at some of the state's alpine resorts during the financial audit of their 31 October 2014 financial reports. These issues were mainly in relation to outsourced providers. This contributed to the financial reports of these resorts, for the reporting period to 31 October 2014, to be late. The three alpine resorts have accepted the issues we raised and have committed to taking action, or have taken action, to address them.

The resorts have advised that they have implemented measures to improve the arrangements in place with outsourced providers. These measures will be reviewed as part of our financial audits of the resorts, for the year ended 31 October 2015. We will work with the resorts, within the bounds or our independence obligations, to provide feedback and advice as they work through these issues.

5.3 Financial reports for 31 October 2014

For the financial year ending 31 October 2014, all five alpine resorts have finalised their financial reports and received clear audit opinions.

As entities reporting under the *Financial Management Act 1994* (FMA), all five resorts should have completed their financial statements by 23 January 2015. Only the Mount Hotham and Mount Buller and Mount Stirling resorts met this time frame.

The audit opinions of Lake Mountain and Mount Baw Baw included an 'emphasis of matter' paragraph drawing attention to areas of noncompliance with the Act. Both Lake Mountain and Mount Baw Baw have outsourced arrangements for operations including key financial functions. As a result of the outsourced arrangements, we identified a number of breaches of the FMA and the Act that, due to their significance, have been bought to the attention of readers of the financial report in the emphasis of matter paragraph of our audit report. As required by the Australian Auditing Standards, we did not place any reliance over the control environment at both resorts, but rather gained sufficient and appropriate evidence from alternative substantive audit procedures to form an opinion on the balances in the financial report.

The financial report for the year ended 31 October 2014 for Falls Creek was completed in November 2015. The delay in the finalisation of Falls Creek was mainly attributed to issues around fixed asset balances, resulting in prior period error adjustments in the financial report, and the integrity of the underlying data within the fixed asset register. The rapid change in finance team members during the transition to the outsourced private operator further contributed to the delay at this resort.

A full discussion of our observations of the outsourced arrangements, and consequential breaches of the FMA and the Act, that resulted in the emphasis of matter paragraphs in the audit opinions, is provided below.

5.4 Outsourced arrangements

Under the FMA, each alpine resort is responsible for maintaining an effective control environment over all financial transactions. Where functions are outsourced this responsibility remains, and consequently the resorts must oversee and gain assurance on the adequacy of the control environment of the outsourced provider, in accordance with Standing Direction 2.4 *Authorisations, Delegations and Procedures*.

The operational and financial functions of Lake Mountain and Mount Baw Baw's are outsourced to a private sector provider. As part of these arrangements, the private sector provider is contracted to manage the day-to-day operations of the resorts and associated 'back-office' functions including:

- finance and accounting
- human resources
- marketing
- information technology.

In September 2014, Falls Creek also entered into an outsourcing arrangement with the same private sector provider. However, the arrangements at Falls Creek differed in that outsourced functions were restricted to 'back-office' functions as listed above, with the resort retaining its own management and operational staff.

Our audits of the resorts identified a number of deficiencies in relation to the monitoring, oversight and accountability at these three resorts who had outsourced arrangements in place. The issues stemmed from the resorts lacking adequate oversight over the outsourced provider's delivery of services. Figure 5A summaries the key themes identified at these resorts.

Figure 5A
Issues identified during the 2013–14 audits of the alpine resorts

Issue area	Lake Mountain	Mount Baw Baw	Falls Creek
Lack of oversight of outsourcing arrangements	•	•	•
Poor cash flow management		•	
Noncompliance with legislation	•	•	
Internal control environment deficiencies	•	•	•
Lack of preparedness for financial year end	•	•	•

Note: These issues were reported in the three alpine resorts' respective management letters and closing reports.
Source: Victorian Auditor-General's Office.

At Lake Mountain and Mount Baw Baw, we identified that the management agreements in place between the resorts and the private service provider did not specify the need for the provider to comply with the requirements of the FMA, the Standing Directions of the Minister for Finance or the Department of Treasury & Finance's financial reporting directions and guidance when completing monthly or annual reporting.

At all three resorts who had engaged the outsourced provider, we identified that the financial services provided did not enable the resorts to discharge their statutory financial reporting obligations.

The resorts have advised that they have implemented measures to improve the arrangements in place with outsourced providers. These measures will be reviewed as part of our financial audits of the resorts, for the year ended 31 October 2015. We will work with the three resorts, within the bounds or our independence obligations, to provide feedback and advice as they work through these issues.

5.4.1 Cash flow management

Mount Baw Baw did not adequately monitor its cash flow requirements for the period ended 31 October 2014. As a result, cash flow issues arose and when identified, the resort made a request for funding to the former Department of Environment and Primary Industries, now the Department of Environment, Land, Water & Planning, on 24 October 2014. The request was approved, but the department did not make the payment until 5 November 2014.

The delay in the submission, and subsequent receipt of the funds meant that the resort did not have enough cash available to meet its obligations at 31 October 2014. As a result, the outsourced private provider took action to manage the obligations of the resort by:

- using the private provider's own corporate purchasing card and the personal credit cards of staff to meet creditor payments totalling $48 507
- advancing the resort $32 540, which was repaid by the resort in November 2014.

These actions were outside the outsourced provider's responsibility. The inadequate management of the resort's short-term cash flow requirements diminishes management's ability to make sound expenditure decisions and potentially increases costs associated with procuring cash from alternative sources.

5.4.2 Noncompliance with legislation

Under section 2.4 of the Standing Directions issued by the Minister for Finance (Standing Directions) under the FMA there are a number of requirements and restrictions on who financial authorisation responsibilities can be delegated to, including a specific restriction that delegation cannot be given to a contractor or consultant.

Each resort’s enabling legislation is the Act. The Act sets out the objectives of a resort and prescribes the governance and financial arrangements the resort must adhere to.

Under the arrangements in place at Lake Mountain and Mount Baw Baw, the outsourced private provider was responsible for all financial transactional processing, including creating and approving financial obligations in relation to the day-to-day operation of the resorts. This is in breach of the Standing Directions and the FMA.

The Standing Directions also have specific requirements relating to treasury risk management, revenue transaction processing and cash handling. Breaches of all these directions occurred at Mount Baw Baw.

Our review of unusual balances at Mount Baw Baw identified discrepancies related to cash transactions that management could not readily identify or adequately explain. The resort commissioned an investigation, including the appointment of forensic auditors, which identified significant control deficiencies in the management of physical cash on site, and poor reconciliation practices. These resulted in surplus cash which could not be allocated to specific income streams in the financial systems. The lack of cash handling controls exposes the resort to a fraud and reputational risk.

Mount Baw Baw also borrowed money from a financial institution that was neither a state-owned entity or a financial institution with a credit rating equal to or greater than the state's current AAA rating. This is contrary to the FMA and the requirements of the Act.

Lake Mountain failed to comply with the requirements of the Act as all monies received on behalf of the resort were not paid into the resort's general bank account. During 2013–14, funds received from operations were initially banked into an account controlled by the service provider prior to being used for making payments on behalf of the resort or transferred to the resort's bank account.

5.4.3 Internal control deficiencies

During the course of our audits we identified a number of internal control weaknesses at the outsourced provider, which were reported to the resorts for action.

Transition to the outsourced provider and data migration

The outsourcing of key finance functions at Mount Baw Baw and Falls Creek during 2013–14 necessitated the transfer of key knowledge and data from in-house staff to the outsourced private provider.

Falls Creek encountered a rapid change in finance team members during the transition which resulted in a loss of knowledge and a consequential breakdown of the control environment.

There was a lack of rigour around the data migration of the Falls Creek and Mount Baw Baw financial data from the existing systems to those of the outsourced provider. The payroll data transferred was not complete and accurate. This meant management was able to place only limited reliance on the integrity of employee leave balances with additional work having to be conducted by management to verify this data.

Reconciliations

At Lake Mountain, Mount Baw Baw and Falls Creek, we observed deficiencies in the monthly reconciliation of key financial balances. In particular, the reconciliations prepared were not independently reviewed, not completed in a timely manner and were not supported by adequate documentation. These deficiencies increase the risk of inaccurate and incomplete information being used to prepare the financial statements.

Performance incentive payments

The agreements in place between the outsourced provider and the resorts include clauses around the payment of an annual performance incentive upon achievement of key performance criteria.

At Lake Mountain, a performance incentive payment was made to an executive of the outsourced private provider which was not separately disclosed to the resort for approval. The bonus was included with a claim for expenses but not separately identifiable, therefore it was not clear to the resort that a performance incentive payment had been made. The payment of incentive payments without appropriate transparency and resort approval is poor practice. We noted that once the resort became aware of the payment, reimbursement was requested from the private provider.

Other internal control deficiencies

Other issues were noted at the resorts which indicate poor oversight and internal controls. These included issues around:

- **journals**—lack of independent review at two resorts
- **bank account signatories**—former employees still listed as bank signatories at two resorts
- **purchasing cards**—poor record keeping and a lack of independent review of purchases at one resort
- **procurement**—one resort did not follow appropriate procedures to gain exemption from the public tender process for a contract, however, the exemption was belatedly awarded
- **records management**—poor retention and management of key documentation identified across the three resorts.

Given the extent of these internal control weaknesses, we did not place any reliance on the control environment at these resorts for the purposes of conducting our audit. Under the Australian Auditing Standards, we gained sufficient and appropriate evidence using alternative substantive audit procedures to form an opinion on the balances in the financial report.

5.4.4 Lack of preparedness for year end

An important aspect of financial management and stewardship, and the primary mechanism by which the resorts meet their external financial accountability obligations, is the preparation and publication of annual audited financial statements.

Significant delays were encountered during the finalisation phase of the audits of the three resorts due to their failure to:

- prepare key schedules to support significant disclosures in the financial report
- prepare and implement a financial reporting timetable
- undertake a quality assurance review over supporting documentation and schedules
- understand and implement changes to accounting standards
- understand and apply the requirements of the FMA reporting framework
- assure the quality of the financial report provided for audit.

The failure to develop quality assurance processes over financial information increases the risk of material misstatement and results in a higher level of errors. These failures meant that the audits of Lake Mountain, Mount Baw Baw and Falls Creeks identified 227 errors and adjustments that equated to $45.7 million of changes to the draft financial statements. The resorts accepted our adjustments, and the time required to process our adjustments contributed to the resorts being unable to meet their statutory time lines.

Common financial reporting areas requiring adjustment across the resorts were:

- **accounting for infrastructure, property, plant and equipment**—including the application of new accounting standards, fair value assessments, calculation of depreciation, compliance with capitalisation thresholds, appropriate records management and maintenance of fixed asset systems
- **inadequate revenue recognition**—including the existence of unallocated income and accounting for recurrent funding and contributed capital
- **management judgements and estimates**—including impairment testing, appropriate recognition of accruals and adequacy of cut-off procedures
- **accounting for employee entitlements**—including the application of changes in accounting standards, verification of data migration and appropriate maintenance of related systems
- **accounting for inventory**—including appropriate recognition and measurement of inventory and conduct of stocktakes
- **preparation and presentation of off balance sheet disclosures**—including the accuracy of underlying schedules and retention of documentation to support such disclosures.

The issues identified were included in the three alpine resorts' respective management letters and closing reports. The resorts have accepted the issues we raised and have committed to taking action, or have taken action, to address them. We will work with the three alpine resorts, within the bounds or our independence obligations, to provide feedback and advice as they work through these issues.

Recommendations

That the three alpine resorts—Lake Mountain, Mount Baw Baw and Falls Creek—where relevant:

8. immediately remedy the issues identified around their internal control environments and other matters identified by the audit during the 2013–14 reporting period
9. review existing contractual arrangements with the outsourced providers to ensure they clearly identify and outline the services and competencies required
10. more actively oversee and manage the services provided by outsourced providers for their resort, including gaining appropriate assurance over the operation of internal controls by those providers.

Appendix A. Management letter risk ratings

The table below shows the risk ratings applied to management letter points raised during an audit review.

Figure A1
Risk definitions applied to issues reported in audit management letters

Rating	Definition	Management action required
Extreme	The issue represents either: • a control weakness which could cause or is causing **severe** disruption of the process or severe adverse effect on the ability to achieve process objectives and comply with relevant legislation, or • a **material** misstatement in the financial report has occurred.	Requires immediate management intervention with a detailed action plan to be implemented within one month. Requires executive management to correct the material misstatement in the financial report as a matter of urgency to avoid a modified audit opinion.
High	The issue represents either: • a control weakness which could have or is having a **major** adverse effect on the ability to achieve process objectives and comply with relevant legislation, or • a **material** misstatement in the financial report that is likely to occur.	Requires prompt management intervention with a detailed action plan implemented within two months. Requires executive management to correct the material misstatement in the financial report to avoid a modified audit opinion.
Medium	The issue represents either: • a control weakness which could have or is having a **moderate** adverse effect on the ability to achieve process objectives and comply with relevant legislation, or • a misstatement in the financial report that is not material and has occurred.	Requires management intervention with a detailed action plan implemented within three to six months.
Low	The issue represents either: • a **minor** control weakness with minimal but reportable impact on the ability to achieve process objectives and comply with relevant legislation, or • a misstatement in the financial report that is likely to occur but is not expected to be material, or • an opportunity to improve an existing process or internal control.	Requires management intervention with a detailed action plan implemented within six to 12 months.

Source: Victorian Auditor-General's Office.

Appendix B. Financial sustainability risk assessment indicators

Financial sustainability risk assessment indicators

This Appendix sets out the definitions, criteria and changes made to the financial indicators from prior years that assist us in conducting our assessment of risks to financial sustainability across the public sector.

The financial sustainability indicators used in this report are indicative and merely highlight risks to ongoing financial sustainability.

It is important to note that forming a definitive view of financial sustainability requires a holistic analysis that moves beyond historical financial considerations to also include consideration of financial forecasts and plans, operations and an entity's environment, particularly the regulatory environment in which entities operate.

The core indicators used in our financial sustainability analysis in Part 4 are shown in Figure B1. These indicators should be considered collectively, and are more useful when assessed over time as part of a trend analysis.

Figure B1
Four core indicators of financial sustainability

Indicator	Formula	Description
Net result (%)	Net result ÷ Total revenue	A positive result indicates a surplus, and the larger the percentage, the stronger the result. A negative result indicates a deficit. Operating deficits cannot be sustained in the long term. Net result and total revenue is obtained from the comprehensive operating statement.
Liquidity (ratio)	Current assets ÷ Current liabilities	This measures the ability to pay existing liabilities within the next 12 months. A ratio of one or more means there are more cash and liquid assets than short-term liabilities. Current assets and current liabilities are taken from the balance sheet.
Internal financing (%)	Net operating cash flow ÷ Net capital expenditure	This measures the ability of an entity to finance capital works from generated net cash flow. The higher the percentage, the greater the ability for the entity to finance capital works from their own funds. A negative result indicates a deficit in operating cash flows. Net operating cash flows and net capital expenditure are obtained from the cash flow statement.

Figure B1
Four core indicators of financial sustainability – *continued*

Indicator	Formula	Description
Capital replacement (ratio)	Cash outflows for property, plant and equipment ÷ Depreciation	Comparison of the rate of spending on property, plant and equipment with its depreciation. Ratios higher than 1:1 indicate that spending is faster than the depreciation 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 property, plant and equipment are taken from the cash flow statement. Depreciation is taken from the comprehensive operating statement.

Source: Victorian Auditor-General's Office.

Financial sustainability risk indicator changes

We wish to draw attention to a number of changes made to the presentation of financial sustainability risk indicators in the 2014–15 report as compared to prior year's reports.

The driver for these changes has been to place a greater focus on a high-level picture of entity result and key risk areas, and to bring consistency to our analyses.

As a result of these changes, this report has shifted away from displaying an overall financial sustainability risk rating for each entity and from listing individual entity financial sustainability risks.

For the 2014–15 report, we have identified four core indicators that are being used in all four 2014–15 Audit Snapshot reports. These four core indicators are outlined in Figure B1.

It is important to also note that all indicators used in our assessments are now directly calculated from financial transactions and balances reported as per published financial reports—no adjustments have been made to these figures. This is to ensure consistency amongst entities within the sector and across sector reports.

Changes to the definition of certain risk indicators

Following a review, the financial sustainability risk indicators used in this report have changed slightly from prior years. A summary of changes to the indicators is shown in Figure B2.

Figure B2
Changes to indicators

Indicator from prior reports	Changed	Removed	Replaced with
Underlying result	Yes	Yes	Net result
Liquidity	Yes[(a)]	No	–
Self-financing ratio	Yes	Yes	Internal financing ratio
Capital replacement ratio	No	–	–

(a) The calculation of the liquidity ratio has been modified slightly with no allowance made for any adjustments or exclusions to the audited financial statement results, when determining current assets and current liabilities.
Source: Victorian Auditor-General's Office.

It is also noted that the indicator results are based on the consolidated entity results, rather than just the parent entity.

Financial sustainability risk assessment

The financial sustainability of entities has been assessed using the risk assessment criteria outlined in Figure B3. These ranges have also been reviewed and amended where applicable, to ensure consistency across all our Audit Snapshot reports.

Figure B3
Financial sustainability indicators – risk assessment criteria

Risk	Net result	Liquidity	Internal financing	Capital replacement
High	**Less than negative 10%** Insufficient revenue is being generated to fund operations and asset renewal.	**Less than 0.75** Immediate sustainability issues with insufficient current assets to cover current liabilities.	**Less than 10%** Limited cash generated 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% to 0%** A risk of long-term run down to cash reserves and inability to fund asset renewals.	**0.75–1.0** Need for caution with cash flow, as issues could arise with meeting obligations as they fall due.	**10–35%** 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 risks with repaying short-term liabilities as they fall due.	**More than 35%** 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.

Appendix C. 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.

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.

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.

Capital grant / capital purpose income

Government funding given to an agency for the purpose of acquisition or building of capital assets such as buildings, land or equipment.

Clear audit opinion

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 unmodified audit opinion.

Deficit

Total expenditure exceeds total revenue resulting in a deficit.

Depreciation

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

Disclaimer of audit opinion

A disclaimer is issued when the auditor is unable to obtain sufficient appropriate audit evidence to enable them to form an opinion on all or part of the financial statements. The lack of evidence is material and pervasive to the financial report.

Also referred to as a **modified audit opinion**.

East West Link project

The East West Link project was a proposed 18 kilometre cross city road in Melbourne, connecting the Eastern Freeway at Hoddle Street to CityLink, and the Port of Melbourne precinct and the Western Ring Road at Sunshine West.

Emphasis of matter

A paragraph included in an auditor's report to which draws the users of the financial reports' attention to a particular note or disclosure which, in the auditor's opinion, is fundamental to the user's understanding of the financial report.

Entity

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, other than those relating to contributions by owners, that results in a decrease in equity during the reporting period.

Financial Management Act 1994

An Act of the State of Victoria that establishes the financial administration and accountability of the public sector, as well as annual reporting to the Parliament by all departments and public sector entities.

Financial report

Structured representation of the financial information, which usually includes accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time, or the changes therein for a period in accordance with a financial reporting framework.

Financial sustainability

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

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.

Governance

The control arrangements in place that are used to govern and monitor an entity's activities in order to achieve its strategic and operational goals.

Impairment

The amount by which the value of an asset held by an entity exceeds its recoverable amount.

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.

Investment

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

Liability

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

Management letter

A letter issued by the auditor to the governing body, the audit committee and management of an entity outlining weaknesses in controls and other issues identified during the financial audit.

Material error or adjustment

An error that may result in the omission or misstatement of information, which could influence the economic decision of users taken on the basis of the financial statements. Materiality depends on the size and nature of the omission or misstatement judged in the surrounding circumstances.

Materiality

Information is material if its omission or misstatement could influence the 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.

Modified audit opinion

A **qualified** or **disclaimed** audit opinion issued when the auditor cannot be satisfied that the financial report is not free from material misstatement.

Net result from operations

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. The operational net result excludes capital income and expenditure items (but not depreciation expenses).

Qualified audit opinion

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 is expressed as being 'except for' the effects of the matter to which the qualification relates.

Also referred to as a **modified audit opinion**.

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.

Standing Direction

The Standing Directions of the Minister for Finance support the *Financial Management Act 1994* by specifying matters that must be complied with by government departments and public bodies to:

- implement and maintain appropriate financial management practices
- achieve a consistent standard of accountability and financial reporting.

Appendix D.

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 all portfolio departments and named agencies 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 Treasury & Finance

Department of Treasury & Finance

1 Treasury Place
East Melbourne Victoria 3002
Telephone: +613 9651 5111
DX210759

RECEIVED
30 NOV 2015
VICTORIAN AUDITOR-GENERAL'S OFFICE

30 NOV 2015

Dr Peter Frost
Acting Auditor-General
Victorian Auditor-General's Office
Level 24, 35 Collins Street
MELBOURNE VIC 3000

Peter
Dear ~~Dr Frost~~

PROPOSED DRAFT: *PORTFOLIO DEPARTMENTS AND ASSOCIATED ENTITIES REPORT 2014-15*

Thank you for your letter of 20 November 2015 inviting a response to the proposed performance audit report: *Portfolio departments and associated entities report 2014-15.*

The Department of Treasury and Finance notes the findings of the report and broadly accepts the recommendations.

A proposed action plan for implementation of each relevant recommendation for the department is attached to this letter.

Thank you for the opportunity to comment on the report.

Yours sincerely

David Martine
Secretary

VICTORIA State Government

RESPONSE Provided by the Secretary, Department of Treasury & Finance – continued

Department of Treasury and Finance

Auditor-General's performance audit on Portfolio departments and associated entities report 2014-15

30 November 2015

The Department welcomes the opportunity to comment on the audit report. The Department's specific management response is detailed below.

Recommendation	Proposed action	Completion date
That portfolio departments: 1. address identified internal control issues in a timely manner, especially those rated as high or medium risk	Issues identified by the Auditor-General are considered as a matter of priority by the Department's audit committee. In considering these issues, responsibilities are assigned and timeframes established to address issues raised. Currently, DTF has three prior period findings relating to the IT environment that have not been fully addressed. One finding relating to expiring vendor support for the Oracle financials application has taken longer than expected due to a Whole of Government approach required to address this issue.	This process has commenced and is ongoing.
2. implement appropriate monitoring mechanisms to ensure audit findings are resolved by management on a timely basis	Progress on addressing these issues is monitored by the Department's audit committee. This process has worked effectively and the Department will work to ensure that matters raised by the Auditor-General are considered and addressed in a timely manner.	This process has commenced and is ongoing.

Recommendation	Proposed action	Completion date
That the Department of Treasury & Finance, and relevant portfolio departments: 5. work with self-funded entities to review their underlying pricing model, sources of funding and cost structures, in order to improve their long-term financial sustainability	DTF supports continuing to work with portfolio agencies to review the pricing, cost structures and funding of these entities, with a view to improving the long-term financial sustainability of these entities. Often the pricing model, either for commercial or policy reasons, does not always allow these entities to fully recover depreciation. While operating commercially, most entities are sufficiently self-funding to cover direct cash operating costs but not sufficiently self-funding to fully provide for asset replacement or upgrading. Fully or partially funding the depreciation costs out of the budget process would result in potentially large cash reserves being held for many years by these entities. Decisions on whether and when the State wishes to fund asset replacement or upgrading or new asset acquisitions for these entities is a future policy decision, which the State should make at the time the assets are required to be replaced or upgraded. Entities can seek funding as part of the annual budget process in the context of whole of government asset management and service delivery objectives and priorities.	Ongoing
That relevant portfolio departments: 6. develop long-term capital funding plans with the self-funded entities within their portfolio	In relation to self-funded entities within the DTF portfolio, DTF will continue to work with these entities to ensure that they identify their long term capital funding requirements. However, decisions on whether and when the State wishes to provide additional capital funding to an entity is a future policy decision of the Government of the day.	Ongoing

RESPONSE provided by the Secretary, Department of Education & Training

Department of
Education & Training
Office of the Secretary

2 Treasury Place
East Melbourne Victoria 3002
Telephone: +613 9637 2000
DX210083

RECEIVED
27 NOV 2015
VICTORIAN AUDITOR-GENERAL'S OFFICE

COR 013778

Dr Peter Frost
Acting Auditor-General
Victorian Auditor-General's Office
Level 24, 35 Collins Street
MELBOURNE VIC 3000

Dear Dr Frost

RE: Portfolio Departments and Associated Entities: 2014-15 Audit Snapshot

Thank you for your letter dated 20 November 2015 which included extracts pertaining to the Department of Education and Training for the proposed Auditor-General's Report on the Portfolio Departments and Associated Entities: 2014-15 Audit Snapshot.

I appreciate the invitation to provide submissions or comments from the Department and have taken the opportunity to provide a response for inclusion in the report.

The disclaimer audit opinion issued highlights that the Department of Education and Training (DET) must continue to progress a number of key actions to improve the quality of its record keeping particularly in relation to property, plant and equipment as well as schools financial data. DET accounts for 29 per cent of state government expenditure and is keenly aware that its record keeping must be robust and reliable. Schools are a vital and integral part of our community and Victoria has more than 1,500 government schools with buildings and land worth more than $16.8 billion, 22 per cent of the State's asset base.

We are cognisant of issues previously raised by VAGO and a program of work was designed and commenced in the last financial year to begin to address these matters. We committed to:

- improve the capture, store and management of asset information, and to conduct a data cleanse by November 2014
- implement new asset register software to address weaknesses, review governance controls for reconciliation approvals, and provide training to staff on undertaking reconciliations by 30 June 2015.

VICTORIA State Government

RESPONSE provided by the Secretary, Department of Education & Training – continued

These commitments were met through the implementation of a new asset management system (software) in December 2014 which included a pre-implementation data cleanse. Additionally, governance controls have been reviewed and staff training provided by both internal technical experts and external accounting professionals. However, while the Department has done considerable work to improve its processes and record keeping, we acknowledge these are only the first improvement steps and it is clear we need to do more. As we progress improvements to the asset management system we will work closely with VAGO to ensure auditability and data integrity issues are a priority.

In addition, the Department has recently commenced a project to strengthen its record keeping processes, systems and controls. In 2014/15 more than 1,500 government schools generated approximately 8 million transactions covering a wide range of school activities i.e.–paying for petrol for the school bus, depositing cash raised at the school fete. The Department will work with your office to agree a methodology for providing comfort to VAGO in relation to these transactions nothing that supporting audit evidence is stored locally at over 1,500 school sites.

We acknowledge your recommendation to change long-standing accounting practices relating to how schools report transactions to the Department. As I have previously publicly attested to and you acknowledge in this report, I am leading a major program of work to strengthen governance and implement more robust financial controls and oversight. This will include providing schools with strong guidelines and oversight on the issues raised through improving available financial management advice and support.

The Department is in the process of redesigning the school council financial audit program as part of a refresh of its government schools financial assurance framework. The Department has engaged independent expertise to provide advice on the proposed redesign and is currently in the process of consulting with VAGO on the proposal.

Key areas of the Department involved in the refresh of the schools financial assurance framework are working closely to ensure consistency and adequacy of our response to VAGO's findings.

In addressing the matters raised through IBAC public examinations, the Department has established an Integrity Committee comprising senior departmental leaders and independent integrity experts to oversee the integrity change program. This program includes the establishment of five integrity leadership groups, the incorporation of integrity measures into executive Performance Development Plans and linking the closure of audit issues to Executive Officer performance, and the development and implementation of a whistleblower 'hot-line' to help employees report corruption and misconduct. The progress and effectiveness of the integrity reform agenda will be independently reviewed by the Victorian Public Sector Commission.

It is pleasing that your report notes a range of improvements already identified and addressed by the Department's Portfolio Audit and Risk Committee (PARC). An external review of PARC's effectiveness was completed in November 2015 and it is expected that PARC will progress the actions arising on a timely basis as part of its continuous improvement agenda.

2

VICTORIA State Government

RESPONSE provided by the Secretary, Department of Education and Training – continued

Finally, your report noted that monitoring is now occurring of the implementation of internal audit recommendations. A system to track and monitor progress of agreed management actions from internal audits and VAGO performance audits has actually been in place for a number of years and is subject to a continuous improvement process. A framework has been prepared, to be endorsed shortly by PARC, on the follow-up of ad hoc internal audits. PARC has accepted VAGO's observations around the tracking of VAGO financial audit recommendations, and the Department's follow up and reporting process will now incorporate the status of these recommendations.

Thank you again for the opportunity to provide comment on the proposed audit report.

Yours sincerely

Gill Callister
Secretary

26/ 4/2015

3

VICTORIA State Government

RESPONSE provided by the Secretary, Department of Environment, Land & Planning

Department of Environment
Land, Water & Planning

8 Nicholson Street
East Melbourne, Victoria 3002
PO Box 500
East Melbourne, Victoria 8002
www.delwp.vic.gov.au

RECEIVED
- 1 DEC 2015
VICTORIAN AUDITOR-GENERAL'S OFFICE

Ref: SEC011729

Dr Peter Frost
Acting Auditor-General
Victorian Auditor-General's Office
Level 24
35 Collins Street
MELBOURNE VIC 3000

0 1 DEC 2015

Dear ~~Dr Frost~~ Peter

PROPOSED AUDIT REPORT PORTFOLIO DEPARTMENTS AND ASSOCIATED ENTITIES: RESULTS OF THE 2014-15 AUDITS

Thank you for your letter of 20 November 2015 providing the opportunity to comment on the proposed audit report *Portfolio Departments and Associated Entities: Results of the 2014-15 Audits*.

The Department of Environment, Land, Water and Planning notes the report's findings and the recommendations directed to the alpine boards. The department takes matters of governance and accountability seriously and is working with the alpine boards to address the issues raised in the report.

Thank you for the opportunity to comment on the report.

Yours sincerely

Adam Fennessy
Secretary

Any personal information about you or a third party in your correspondence will be protected under the provisions of the *Privacy and Data Protection Act 2014*. It will only be used or disclosed to appropriate Ministerial, Statutory Authority, or departmental staff in regard to the purpose for which it was provided, unless required or authorized by law. Enquiries about access to information about you held by the Department should be directed to the Privacy Coordinator, Department of Environment, Land, Water and Planning, PO Box 500, East Melbourne, Victoria 8002.

VICTORIA State Government

RESPONSE provided by the Chief Executive Officer, Arts Centre Melbourne

RECEIVED
30 NOV 2015
VICTORIAN AUDITOR-GENERAL'S OFFICE

Arts Centre Melbourne

Portfolio Departments and Associated Entities: Results of the 2014-15 Audits - Invitation to comment – VACT Response

The Victorian Arts Centre Trust welcomes VAGO's considered analysis of the challenges facing self-funded entities, and in particular the insights contained in its case study of VACT.

VACT has undertaken a number of initiatives in recent years to seek to manage the challenges of balancing financial sustainability, maintaining a thirty year old facility and providing access to significant levels of cultural benefit to a diverse and changing audience.

VACT's key assets are its buildings and its collections, and its ability to use them to provide a high quality experience for the three million visitors using them each year. This presents a significant challenge with ageing buildings and end of life theatre equipment and, as noted by VAGO, the scale of maintenance required is very high. The low capital replacement indicator results highlighted by VAGO are a major concern for VACT. In addition to the declining condition of key assets the potential for the Arts Precinct to draw visitors, including increased interstate and overseas tourists into the area is very significant and VACT is currently preparing a business case for redevelopment, working closely with Creative Victoria.

To increase audience engagement VACT has looked to use its spaces in new ways including the new, well received Supersense festival in 2015. This new approach has also been adopted through collaboration with a newly established consortium of partners across the Southbank precinct in planning for a new Asia-Pacific Triennial of Performing Arts (AsiaTOPA) in 2017, designed to reach new audiences. In addition VACT continues to offer the broad range of events for the community for which it is well known.

VAGO's report recognises the significant challenges a performing arts organisation such as VACT faces in entering into longer term planning and risk sharing arrangements when funding is often short term in nature. The need for longer term funding certainty is being considered as part of the third party base funding and business model review referred to by VAGO.

This base funding review is particularly critical for VACT given that $7m of funding is currently due to end in June 2016 and, as VAGO's observes, 'should the level of ongoing funding be reduced the ability for VACT to continue to maintain and deliver productions, programs and subsidized events in line with (VACT's) responsibilities would be compromised'.

Claire Spencer
CEO

CREATIVE VICTORIA

State Government Victoria

100 St Kilda Road
Melbourne 3004
Australia
PO Box 7585
St Kilda Road Vic 8004

T +61 3 9281 8000
F +61 3 9281 8282
info@artscentremelbourne.com.au
artscentremelbourne.com.au
ABN 83 295 983 059

RESPONSE provided by the Chief Executive Officer, Falls Creek Resort Management Board

Falls Creek Resort Management
ABN 21 789 770 569
1 Slalom Street, Falls Creek VIC 3699
PO Box 50, Falls Creek VIC 3699

Telephone 03 5758 1200
Facsimile 03 5758 3415
fcrm@fallscreek.com.au
www.fallscreek.com.au

FallsCreek
Resort Management

RECEIVED
30 NOV 2015
VICTORIAN AUDITOR-GENERAL'S OFFICE

Dr. Peter Frost
Acting Auditor General
Victorian Auditor General's Office
Level 24, 35 Collins Street
Melbourne VIC 3000

RE: File No: 31154/01
Proposed Audit Report ***Portfolio Departments and Associated Entities: Results of the 2014-15 Audits***

Dear Dr Frost

Thank you for your communication of November 20th, 2015 advising the Falls Creek Resort Management Board of the proposed contents of the above report as they pertain to the Alpine Resorts and more specifically Falls Creek.

The recommendations directed toward Falls Creek are being actively implemented or remedies sought to ensure their application at the earliest opportunity.

We thank you for the assistance.

Yours Sincerely

Stuart Smythe
Chief Executive Officer
Falls Creek Resort Management Board

RESPONSE provided by the Chairperson, Lake Mountain Alpine Resort Management Board

lakemountain
ALPINE RESORT

27 November 2015

RECEIVED
27 NOV 2015
VICTORIAN AUDITOR-GENERAL'S OFFICE

Dr Peter Frost
Acting Auditor-General
Victorian Auditor-General's Office
Level 24, 35 Collins Street
MELBOURNE VIC 3000

By email: Peter.Frost@audit.vic.gov.au

Dear Dr Frost

Re: *Audit Act 1994*, s16(3) - *Portfolio Departments and Associated Entities* report

In response to your letter of 20 November, the Board submits it comments to be included in the report *Portfolio Departments and Associated Entities: Results of the 2014-2015 Audits.*

The Lake Mountain Alpine Resort Management Board ("the Board") acknowledges the findings and recommendations in the Proposed Report that relate to Lake Mountain Alpine Resort ("the Resort"). The Board has continued to undertake efforts to improve financial management and reporting systems. The engagement of the private sector operator to manage the operations of the Resort, and the Board's accounting system, first took place in December 2012. This was a direct result of the Board proactively pursuing the private sector operator to improve the effectiveness of its management of the Resort and to improve financial sustainability.

After taking advice from legal advisors, government officers and contractors, the Board put in place arrangements believed to be fully compliant with the required regulatory environment. The Board also formed the view, after the VAGO end of year audit for financial year 2012-2013 and the completion of its internal audit program for 2013-2014 conducted on behalf of the Board by an external accounting firm with significant State Government experience, that its systems of internal controls over the accounting system were adequate. The year-end audit of the financial year 2013-2014 revealed otherwise. This resulted in a delay in the signing of the financial statements to February 2015. The VAGO audit also revealed that there were technical breaches of the *Alpine Resorts (Management) Act 1992* (Vic.) as monies flowed into a bank account controlled by the Board's commercial operator prior to being used to cover operational expenditure of the Board, or being transferred to the Board's general account. The VAGO audit also revealed a technical breach of the *Financial Management Act 1994* and the Standing Directions of the Minister for Finance, in that authority was granted to staff of the commercial contractor to enter into some transactions without specific Board approval, albeit that there were agreed limits to this authority and delegations of authority in place. The Board notes that all monies were appropriately accounted for, notwithstanding these breaches.

These transgressions have now been rectified. The Board has set up a system modifying the method of providing funds to operate the Resort, and has removed any authority for the commercial operator, or

RESPONSE provided by the Chairperson, Lake Mountain Alpine Resort Management Board – continued

lakemountain ALPINE RESORT

its employees, to enter into any transaction that would impose a financial obligation on the Board, without prior Board approval.

In recontracting the commercial operator from 1 May 2015, the Board clearly specified the services required in administering the Board's financial accounting and management system, and the deliverables. This included ensuring that the commercial operator develops and implement a rigorous and robust system of internal controls over its accounting system. The Board has also contracted the commercial operator to provide an independent attestation from a third party professional firm of accountants that these internal controls are operating effectively.

Further, the Board has restructured its sub-committees, monthly financial reporting and review systems, in an effort to ensure that there is more direct monitoring of the internal control environment, and to ensure that all of the matters identified during the audit processes are addressed and remedied.

Yours sincerely,

Tony Thompson
Chairperson
Lake Mountain Alpine Resort Management Board

cc Johnathan Kyvelidis, VAGO
Lake Mountain Alpine Resort Management Board members

2 | Page

Auditor-General's reports

Reports tabled during 2015–16

Report title	Date tabled
Follow up of Collections Management in Cultural Agencies (2015–16:1)	August 2015
Follow up of Managing Major Project (2015–16:2)	August 2015
Follow up of Management of Staff Occupational Health and Safety in Public Schools (2015–16:3)	August 2015
Biosecurity: Livestock (2015–16:4)	August 2015
Applying the High Value High Risk Process to Unsolicited Proposals (2015–16:5)	August 2015
Unconventional Gas: Managing Risks and Impacts (2015–16:6)	August 2015
Regional Growth Fund: Outcomes and Learnings (2015–16:7)	September 2015
Realising the Benefits of Smart Meters (2015–16:8)	September 2015
Delivering Services to Citizens and Consumers via Devices of Personal Choice: Phase 2 (2015–16:9)	October 2015
Financial Systems Controls Report: Information Technology 2014–15 (2015–16:10)	October 2015
Department of Education and Training: Strategic Planning (2015–16:11)	October 2015
Public Hospitals: 2014–15 Audit Snapshot (2015–16:12)	November 2015
Auditor General's Report on the Annual Financial Report of the State of Victoria, 2014–15 (2015–16:13)	November 2015
Local Government: 2014–15 Audit Snapshot (2015–16:14)	November 2015
Responses to Performance Audit Recommendations 2012–13 and 2013–14 (2015–16:15)	December 2015
East West Link Project (2015–16:16)	December 2015

VAGO's website at www.audit.vic.gov.au contains a comprehensive list of all reports issued by VAGO.

Availability of reports

All reports are available for download in PDF and HTML format on our website www.audit.vic.gov.au

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