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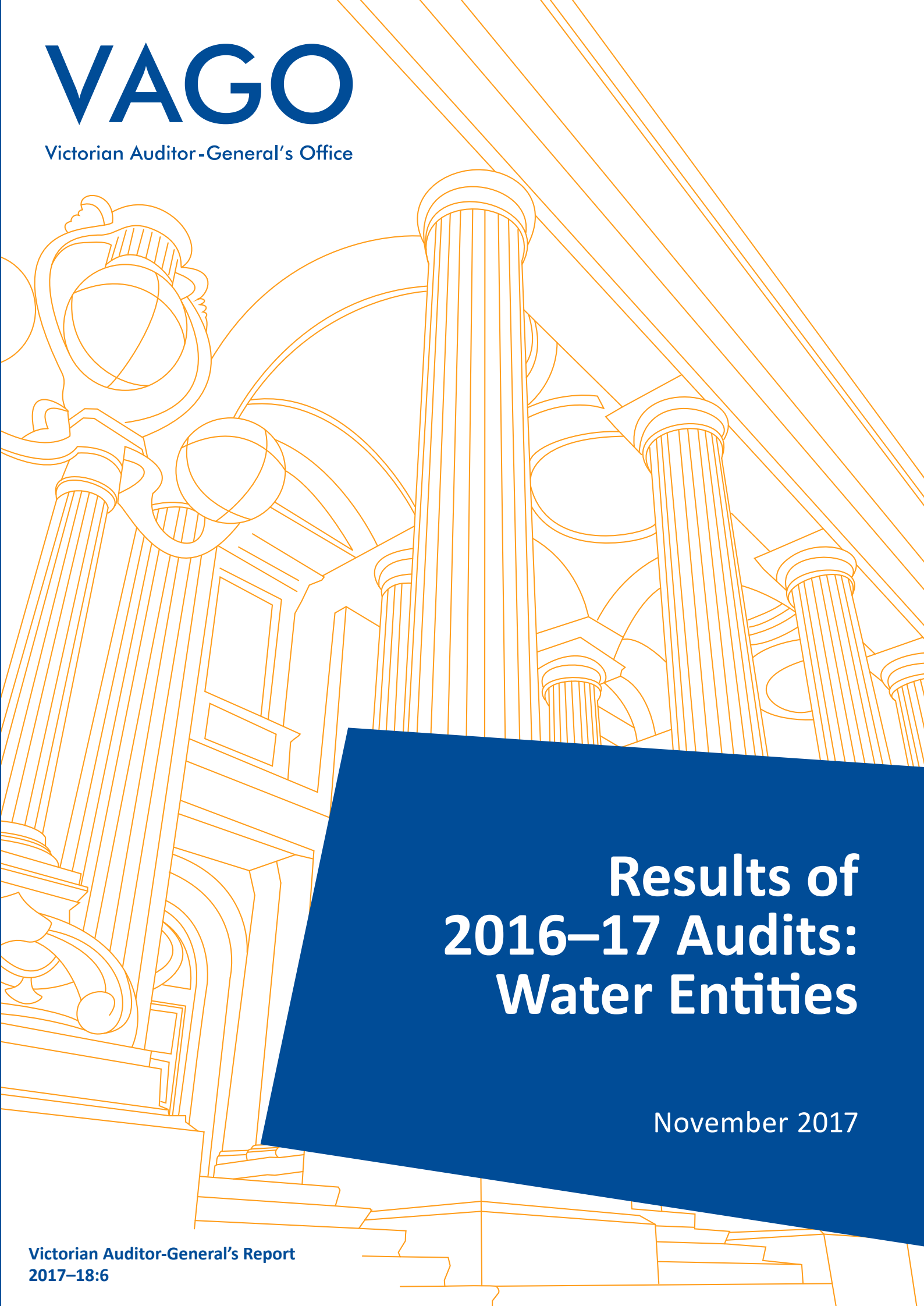

Results of 2016–17 Audits: Water Entities

November 2017

Victorian Auditor-General's Report
2017–18:6

Results of 2016–17 Audits: Water Entities

Ordered to be published

VICTORIAN GOVERNMENT PRINTER
November 2017

PP No 346, Session 2014–17

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ISBN 978 1 925678 06 2

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Victorian Auditor-General's Office

The Hon Bruce Atkinson MLC
President
Legislative Council
Parliament House
Melbourne

The Hon Colin Brooks 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 *Results of 2016–17 Audits: Water Entities*.

Yours faithfully

Andrew Greaves
Auditor-General

15 November 2017

Contents

Audit overview 7

Conclusion 7
Findings 7
Recommendations 9
Submissions and comments 10

1 Audit context 11

1.1 What do water entities do? 13
1.2 Framework for water regulation 14
1.3 How water entities fund their operations 16
1.4 Report structure 19

2 Results of audits 21

2.1 Financial report audit opinions 21
2.2 Performance report audit opinions 27

3 Internal controls 29

3.1 Context 29
3.2 Assessment of internal controls 29
3.3 Post asset revaluation implementation 33

4 Financial outcomes 39

4.1 Overview of the sector's financial results 40
4.2 Metropolitan water entities 41
4.3 Regional urban water entities 48
4.4 Rural water entities 52

Appendix A. *Audit Act 1994* section 16—submissions and comments 57

Appendix B. Water entities 61

Appendix C. Acquittal of audits 63

Appendix D. Management letter risk ratings 65

Appendix E. Financial sustainability risk indicators and summaries 67

Appendix F. Financial and performance reporting framework 89

Appendix G. Glossary 97

Acronyms

AASB	Australian Accounting Standards Board
AIMS	Asset information management system
AMAF	*Asset Management Accountability Framework*
CMA	Catchment management authority
CO_2	Carbon dioxide
DELWP	Department of Environment, Land, Water and Planning
DRP	Disaster recovery plan
EBITDA	Earnings before interest, tax, depreciation and amortisation
EPA	Environment Protection Authority
ESC	Essential Services Commission
EWOV	Energy and Water Ombudsman of Victoria
FASL	Fixed asset sub-ledger
FMA	*Financial Management Act 1994*
FRD	Financial Reporting Direction
FTE	Full-time equivalent
IASB	International Accounting Standards Board
IT	Information technology
KPI	Key performance indicator
MRD	Ministerial Reporting Direction
PREMO	Performance, Risk, Engagement, Management and Outcomes
VAGO	Victorian Auditor-General's Office
VGV	Valuer-General Victoria
WIRO	Water Industry Regulatory Order
WRRG	Waste and Resource Recovery Group

Audit overview

Water entities provide a range of water services, including supplying water and sewerage services, managing bulk water storage and looking after specific recreational areas, such as caravan parks. Victoria's water sector is made up of 19 water entities and one controlled entity.

The board of each water entity reports to the Minister for Water through the Department of Environment, Land, Water and Planning (DELWP).

The Essential Services Commission (ESC) is responsible for regulating and approving the maximum prices each water entity charges its customers for supplying water and providing sewerage and other services.

This report outlines the results of our financial audits of the water entities, and our observations, for the year ended 30 June 2017. We also discuss our audits of entities' performance reports and analyse the financial results and outcomes for the water entities.

Conclusion

We have assessed the sector as financially sustainable, with no immediate short-term risks identified. In the longer term, some water entities will need to consider the risks associated with their ability to replace or renew assets and repay debt.

Findings

Results of financial audits

We issued clear audit opinions to the 19 water entities for the financial year ended 30 June 2017, consistent with our 2015–16 results.

We assessed the quality of financial reporting processes against better practice criteria. Overall, the water entities used good-quality processes to prepare their financial reports, and they presented timely and accurate draft statements for audit. However, they need to improve the preparation and quality of financial statements and the development of their financial report preparation plans.

The sector began to streamline its financial reports in 2016–17, to improve the structure and disclosure content of financial statements, which will enhance their readability. We commend the sector for its commitment to this process.

Overall, the sector has used the streamlined financial reporting process as an opportunity to realign and refresh the structure and content of its financial statements, however there are further areas for improvement that will allow entities to better customise their financial reports.

Results of performance report audits

We issued clear audit opinions on the performance reports for all 19 water entities, consistent with the 2015–16 reporting period.

Our past reports have highlighted that the water sector's performance reporting processes are not as mature as those used for financial reporting. This was again apparent in the 2016–17 reporting period.

We encourage the sector to focus more on the processes and quality of its performance reporting and to shift its mindset when preparing annual performance reports. Instead of being seen as a compliance document, performance reports can serve a far greater purpose in communicating key financial and non-financial results to water entities' customers.

Internal controls

To the extent that we test water entities' internal controls, we found them adequate for ensuring reliable financial reporting. However, we found instances where entities need to strengthen their key internal controls.

In particular, we identified weaknesses in two key areas in 2016–17:

- information technology (IT) controls, which protect computer applications, infrastructure and information assets from threats to security and access
- the monitoring and maintenance of infrastructure assets, property, plant and equipment records and data.

In relation to IT controls, we continue to observe weaknesses in key financial and operational systems each year, depending on which systems we test. This indicates that water entities are not taking the lessons learnt from audit issues reported against particular key systems and applying them to other relevant systems to minimise risks across the organisation.

As part of the financial audit process, we also monitored internal control weaknesses identified in previous audits, to ensure entities are resolving them promptly. Encouragingly, 77 per cent of prior-year high- and medium-risk matters were resolved during 2016–17.

Post asset revaluation implementation

Each year, we select one internal control area and perform a more detailed review of the controls and related operating environment. This year, we focused on how well water entities input their asset revaluation results from the 2015−16 revaluation into their internal systems.

Comprehensive, accurate and up-to-date asset information is vital for effective asset management, particularly in asset-intensive organisations such as water entities.

Our assessment showed mixed results. Entities with better implementation processes reported that improved quality of asset data allowed them to make better asset-related decisions across the organisation. In contrast, entities that were unable to update their asset systems with revaluation data in a timely fashion were at an increased risk of making business decisions based on inaccurate or unreliable data.

Our review highlighted the importance of entities having a detailed plan in place to guide their actions throughout an asset revaluation process. Those entities with better implementation processes had a deeper understanding of their asset data, which enabled them to provide quality data to the valuer, in a format that could be incorporated into their existing asset systems.

Financial outcomes

The sector generated a combined net result before tax of $543.9 million in 2016–17, a decrease of $173.0 million from the year before. This was largely due to a decline in revenue because of lower consumption—2016–17 was a wetter year than 2015–16—and lower wholesaler revenue in the first year of their new pricing structure.

The sector's total asset base grew by $633.9 million to $46.2 billion, largely due to funds spent on asset works, renewal and replacement. Liabilities grew by $218.5 million to $21.4 billion, from increases in short-term payables and borrowings.

We separately assessed the financial performance, position and risks to financial sustainability of each cohort over the 2016–17 financial reporting period, given each cohort's results are affected by different circumstances.

Recommendations

We recommend that water entities:

1. further refine their financial reporting processes by developing a financial statement preparation plan and preparing quality proforma financial statements (see Section 2.1)
2. continue investing in streamlining their financial statements and better customising their disclosures, including only using model financial statements as a starting point for further streamlining and customisation (see Section 2.1)
3. focus more on the processes and quality of performance reporting, ensuring full compliance with Ministerial Reporting Direction 01 *Performance Reporting* and preparing proforma performance reports prior to year end (see Section 2.2)
4. assess whether any findings related to IT control weaknesses in specific systems reported by audit are relevant to other financial and operational systems, to minimise risk across the organisation (see Section 3.1)
5. address issues raised in audit management letters on a timely basis so that any weaknesses in their control environment are resolved promptly (see Section 3.1)
6. perform a post-revaluation review exercise to identify areas for improvement that could be carried to the next revaluation exercise or used to help prepare for the Asset Management Framework requirements of the *Asset Management Framework*, which supports the Standing Direction Requirement *4.2.3 Asset management accountability* of the Minister for Finance in 2017–18 (see Section 3.3).

We recommend that the Department of Environment, Land, Water and Planning:

7. review the effectiveness of water entities' performance reporting, focusing on whether the performance reports are meeting the overall purpose of Ministerial Reporting Direction 01 *Performance Reporting*, as initially intended (see Section 2.2).

Submissions and comments

We have consulted with DELWP, the 19 water entities, ESC and the Victorian Water Industry Association (VicWater), and we considered their views when preparing this report. As required by section 16(3) of the *Audit Act 1994*, we gave a draft copy of this report to those agencies and asked for their submissions or comments. We also provided a copy of the report to the Department of Premier and Cabinet.

The following is a summary of those responses. The full responses are included in Appendix A.

DELWP provided a response for inclusion in this report, stating that it is committed to conducting a comprehensive review of its performance reporting framework. This review will look at the effectiveness and appropriateness of key performance indicators (KPI) under the current Ministerial Reporting Direction (MRD) 01 *Performance Reporting*.

DELWP also noted its plans to address specific recommendations through water sector forums and VicWater.

Coliban Water provided a response for inclusion in the report, outlining its remediation plans for the high-risk issues that we highlighted and its intention to demonstrate that these issues have been addressed as part of the 2017–18 audit.

1 Audit context

Water entities provide a range of water services, including supplying water and sewerage services. Entities may also manage bulk water storage and specific recreational areas, such as caravan parks. Water entities are standalone businesses responsible for their own management and performance.

Victoria's water sector is made up of 19 water entities and one controlled entity. Since the results of the controlled entity are consolidated into its parent entity, we do not discuss this entity separately in our report. Appendix B includes a list of all 20 entities.

In this report, we use the cohorts defined by DELWP and VicWater—metropolitan, regional urban and rural—to report on the sector. Figure 1A defines these cohorts.

Figure 1A
Cohorts—water entities

Cohort	Description
Metropolitan	Consists of: • a wholesaler, which supplies retail water entities, controls headworks and major sewerage treatment plants, and is responsible for drainage and waterways to the Greater Melbourne area • three retail water entities, which operate the water distribution and sewerage systems for the Melbourne metropolitan area, within a specified geographic region, as well as operating a small number of treatment plants.
Regional urban	Provide water supply and sewerage services to regional urban customers outside the metropolitan zone of Victoria. Two of these water entities also supply rural water services.
Rural	Provide rural water services for irrigation, domestic and stock purposes. These services include water supply, drainage and salinity mitigation. Some also provide bulk water supply services to other water entities in regional Victoria.

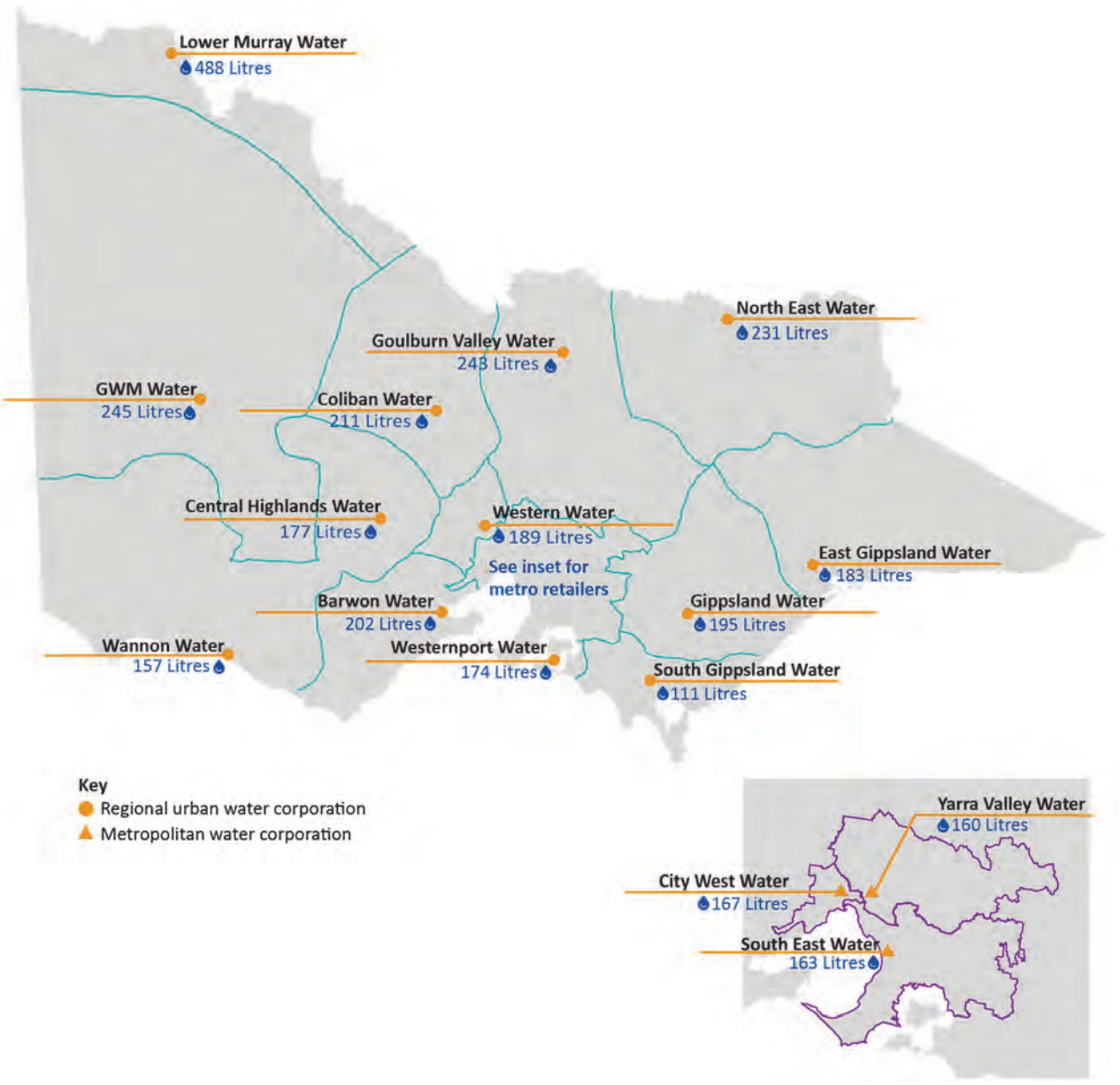
Source: VAGO, based on information provided by DELWP.

A constituted board governs each water entity, responsible for:

- overseeing the entity's strategic direction
- setting objectives and performance targets
- ensuring that the entity complies with legislation and government policy.

Figure 1B shows the areas serviced by Victoria's metropolitan and urban regional water entities and average litres consumed, per person, per day in each specific service area. Areas serviced by the rural water entities can be found in Appendix B.

Figure 1B
Regions serviced by metropolitan and regional urban retailers, includes 2016–17 average litres consumed, per person, per day



Source: VAGO, based on information provided by DELWP.

1.1 What do water entities do?

Metropolitan and regional urban retail services

Water entities manage, maintain and operate reservoirs and water storage within their respective regions to provide water and sewerage services to households, and commercial and industrial businesses.

In Victoria, most water is captured, protected and stored in catchment reservoirs. Collected from various sources—dams, catchments and the desalination plant—water then travels through drains and pipes to water treatment plants. Here, it is treated and tested for quality before it is made available for use.

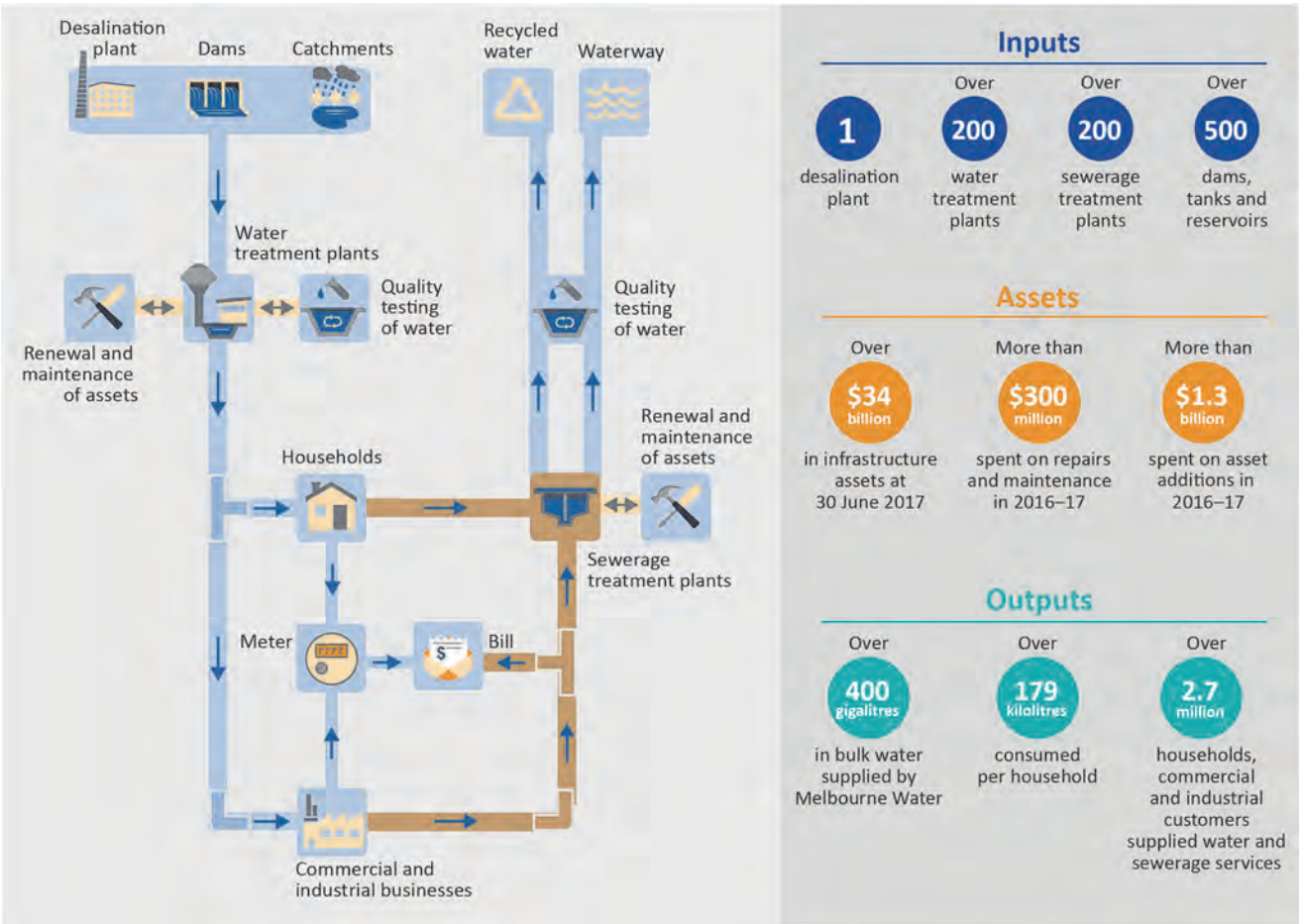
Catchment—an area where water is collected by the natural landscape. In a catchment, rainwater run-off will eventually flow to a creek, river, dam, lake, ocean, or into a groundwater system.

Sewage flows down household and commercial drains to sewerage treatment plants. It undergoes various treatment processes ensuring it can be either recycled or returned to waterways.

Water entities invest significant effort and funds in maintaining, repairing and renewing their assets to ensure availability of quality water and delivery of sewerage services.

Figure 1C details the water cycle, highlighting the key inputs, assets and outputs.

Figure 1C
Operator perspective—inputs, processes and outputs to the water cycle



Source: VAGO.

Rural services

Rural water entities own and maintain dam/reservoir infrastructure assets used to store water on behalf of their customers—typically farmers, graziers and growers.

Rural water customers:

- hold water shares, which represent an ongoing entitlement to a share of water available within a specific water region
- order water from their relevant rural water entity, which is delivered via pipelines and channels—the maximum annual amount of water available is set by their water share.

Rural water entities do not provide sewerage-related services.

1.2 Framework for water regulation

Legislative and regulatory framework

The board of each water entity reports to the Minister for Water through DELWP. In turn, the minister reports to Parliament on the performance of each water entity.

The *Water Act 1989* is the central legislation for Victoria's water industry. Its objectives are to:

- promote the orderly, equitable and efficient use of water resources
- ensure that water resources are conserved and properly managed for sustainable use for the benefit of all Victorians
- maximise community involvement in making and implementing arrangements for using, conserving and managing water resources.

The *Financial Management Act 1994* (FMA) establishes a governance framework mandating governance and accountability for the financial management of organisations in the public sector. The FMA aims to:

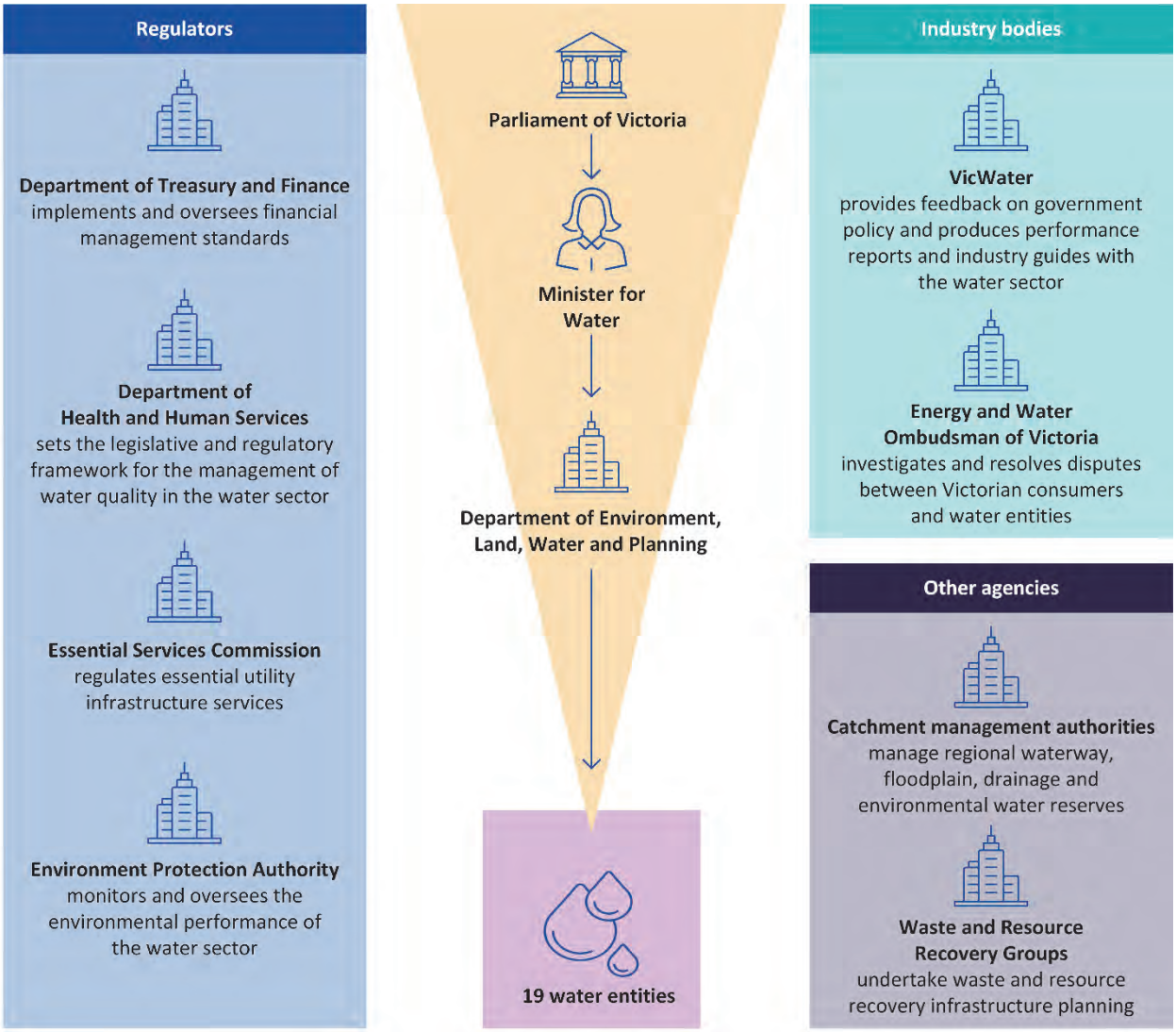
- improve financial administration of the public sector
- make better provision for the accountability of the public sector
- provide for annual reporting to the Parliament by departments and public sector bodies.

In addition to the 19 water entities, Victoria has 10 catchment management authorities (CMA), established under Victoria's *Catchment and Land Protection Act 1994.* CMAs are responsible for coordinated catchment management in their region. The *Water Act 1989* gives them powers to manage regional waterways, floodplains, drainage and environmental water reserves. The *Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2016–17* includes the results for the audits of CMAs for the 2016–17 reporting period.

Figure 1D lists the key agencies involved in regulating the water sector. These agencies are responsible for setting economic, environmental and social obligations within which water entities must operate.

It also highlights key industry bodies, such as the Victorian Water Industry Association, which plays an important advocacy role, providing forums for industry discussions on priority matters and disseminating news and information to key industry stakeholders.

Figure 1D
Victoria's legislative and regulatory framework for the water sector



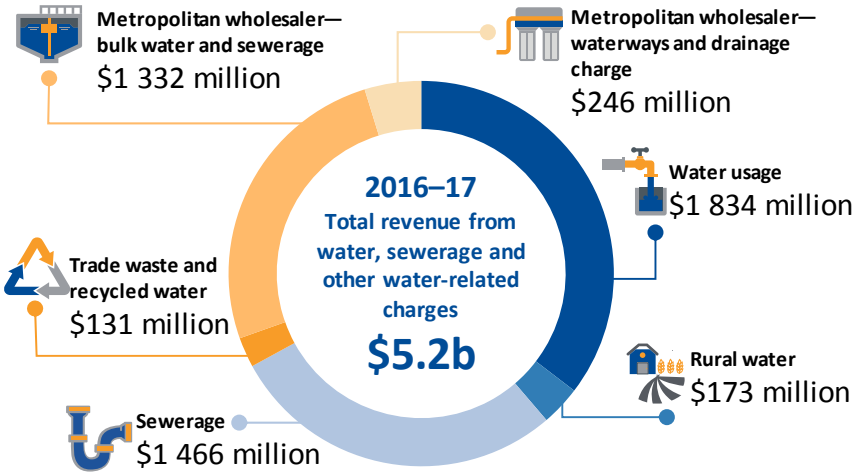
Source: VAGO.

1.3 How water entities fund their operations

Water entities get most of their revenue from charges for water, sewerage and other related activities, collected under the *Water Act 1989* and approved through the sector regulator, ESC.

Total revenue in 2016–17 for sector service and usage charges was $5.2 billion, 89.7 per cent of the total $5.8 billion revenue generated. Figure 1E shows a breakdown of these regulated revenue streams.

Figure 1E
Service and usage charges by water entities 2016–17



Note: Melbourne Water, as the wholesaler of Melbourne's water supply to the metropolitan retail water entities, is responsible for managing catchments, waterways and major drainage systems, treating water and transferring water to the metropolitan water retailers. The costs incurred by Melbourne Water for these activities are charged to the metropolitan water retailers by way of bulk water and sewerage charges.

Source: VAGO.

ESC is responsible for regulating and approving the maximum prices each water entity charges its customers for supplying water and providing sewerage and other services. This is in accordance with the requirements of the *Essential Services Commission Act 2001*, the *Water Industry Act 1994*, the *Water Industry Regulatory Order* and the Commonwealth Water Charge Infrastructure Rules, where applicable.

ESC has reviewed and approved prices for metropolitan and regional urban businesses since 1 July 2005, and for rural businesses since 1 July 2006.

ESC's approach to price reviews remained largely unchanged until 23 October 2014, when the *Water Industry Regulatory Order 2014* (WIRO 2014) was released in the *Victoria Government Gazette*, following approval from the Governor in Council. The purpose of WIRO 2014 is to provide a framework for economic regulation by ESC for services provided by the water industry. WIRO 2014 revoked the former WIRO 2012.

The revised order provides ESC with greater flexibility in how it delivers efficient pricing and service outcomes for Victorian water and sewerage customers. As a result, following extensive consultation with water entities and key stakeholders, ESC made changes to its framework for water pricing and approach to price reviews.

The new approach is designed to deliver better outcomes for Victorian water customers, with incentives for water entities to put forward quality price submissions that reflect their customers' expectations and offer value for the prices proposed.

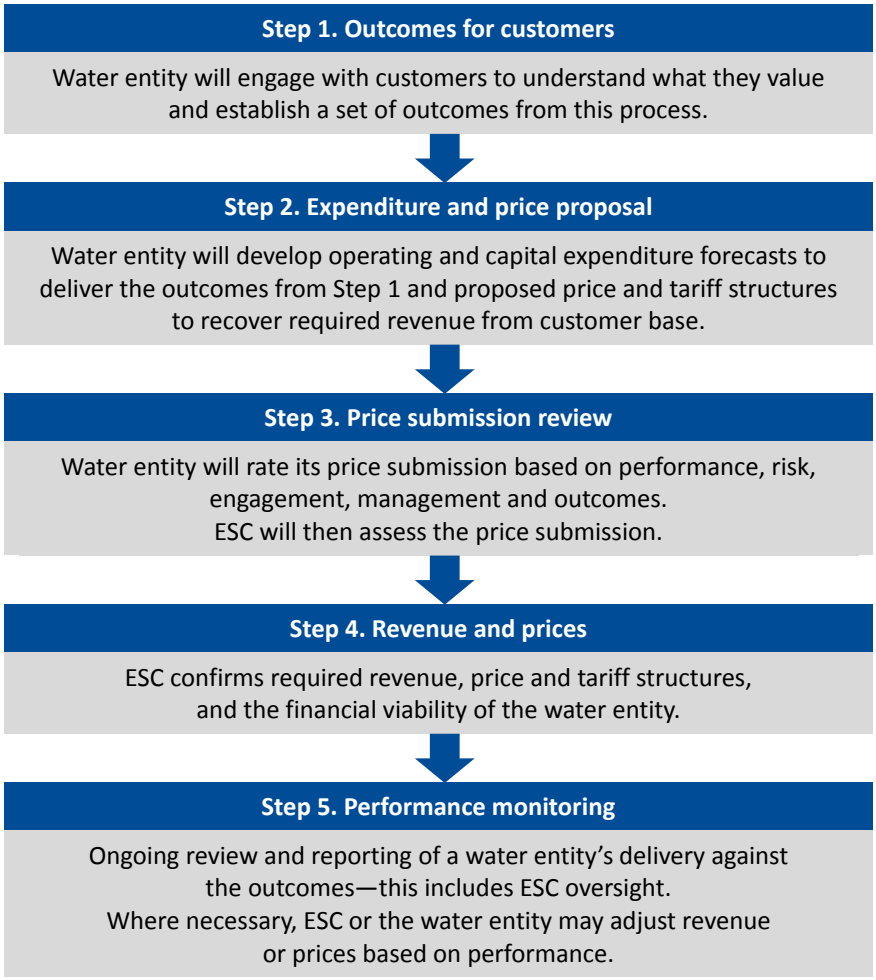
ESC has commenced its review for the regulatory period from 1 July 2018. Figure 1F outlines the timing for this period.

Figure 1F
Timing of the new water pricing review process

Source: ESC, information sheet on proposed water pricing approach for 2018, May 2016.

Figure 1G outlines the new approach for the 2018 price review.

Figure 1G
New pricing approach



Source: VAGO, based on ESC, Water Pricing Framework and Approach, Implementing PREMO from 2018, October 2016.

In the first step, each water entity will engage with its customers and community to inform the outcomes to be delivered in a pricing period.

In the second step, each water entity will develop an estimate of expenditure to deliver the outcomes identified in step 1, and any other obligations imposed by government and regulators. This results in the development of a price submission, including proposed prices and tariff structures.

The third step involves a new approach to the assessment of price submissions which influences the returns allowed in prices for each water entity. The return on equity established at the start of a pricing period could vary for each business, depending on the 'ambition' of its price submission.

In its price submission, a water entity will self-rate the 'ambition' of its submission against PREMO elements—Performance, Risk, Engagement, Management and Outcomes. ESC will also rate the submission against PREMO elements. This assessment process will inform the return on equity to be reflected in revenue and prices, which forms the fourth step.

The final step is the ongoing review of outcomes delivered by water entities.

It is important to note that the water price reviews effective for 1 July 2018 exclude Melbourne Water and Goulburn-Murray Water, as these entities are on a different price review cycle.

Government funding

In contrast to the other cohorts, the two rural water entities receive significant government funding (both state and Commonwealth) for the delivery of key modernisation projects, such as the $2 billion Connections Project currently being delivered by Goulburn-Murray Water.

1.4 Report structure

In this report, we detail the 2016–17 financial audit outcomes of Victoria's 19 water entities. We identify and discuss the key matters arising from our audits, and provide an analysis of information included in water entities' financial and performance reports. Figure 1H outlines the structure of the report.

Figure 1H
Report structure

Part	Description
Part 2—Results of audits	Evaluates the audit opinion results for financial and performance report audits, and the timeliness, accuracy and quality of reporting
Part 3—Internal controls	Assesses the strength of internal controls designed, implemented and maintained by the water entities
Part 4—Financial outcomes	Analyses the financial performance, position and sustainability of the water sector to enhance the accountability and transparency for transactions and events during the year

The financial audits included in this report were undertaken under section 15 of the *Audit Act 1994* and Australian Auditing Standards, and the audited entities pay the cost of these audits. We used the results of these audits in preparing this report. The cost of preparing this report was $185 000, which is funded by Parliament.

2 Results of audits

2.1 Financial report audit opinions

Independent audit opinions add credibility to financial reports by providing reasonable assurance that the information reported is reliable and accurate. A clear audit opinion confirms that the financial report presents fairly the transactions and balances for the reporting period, in keeping with the requirements of relevant Australian Accounting Standards and applicable legislation. We carried out our financial audits of the water entities in accordance with the Australian Auditing Standards.

We issued clear audit opinions for the 19 water entities for the financial year ended 30 June 2017, consistent with our 2015–16 results.

Quality of financial reporting

Entities that adopt effective financial reporting practices throughout the year should be able to produce accurate and reliable financial reports in a timely manner.

The timeliness and accuracy of an entity's financial reports are important attributes. Entities also need to have well-planned and managed processes to enable them to prepare cost-effective and efficient financial reporting.

Overall, the water entities used good-quality processes to prepare their financial reports, and they presented timely and accurate draft reports for audit.

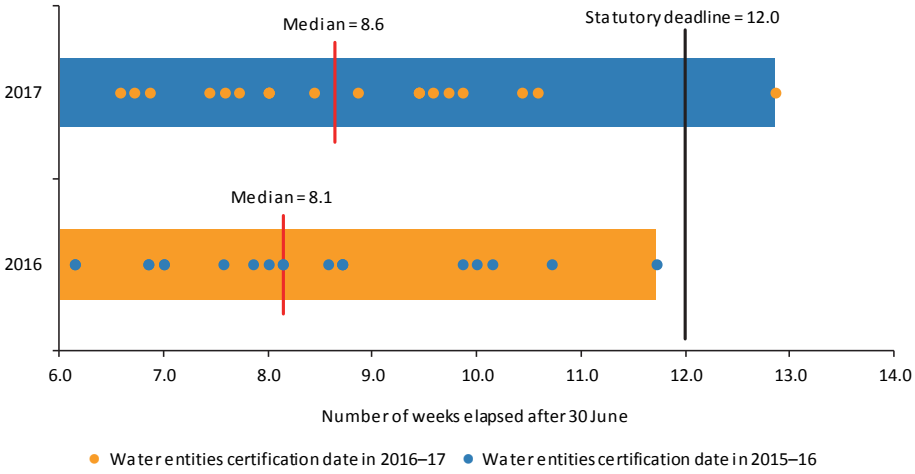
Timeliness

Timely financial reporting is a critical element of entities' accountability to stakeholders and enables informed decision-making. The later reports are produced and published after year end, the less useful they are.

The FMA requires entities to finalise their financial reports within 12 weeks of the end of the financial year. Appendix C sets out the dates on which entities' 2016–17 financial reports were certified and auditor's reports were issued.

As shown in Figure 2A, 18 of the 19 water entities met the legislated time frame for finalising their financial reports after the 2016–17 balance date. In 2015–16, all 19 water entities met the legislated time frame.

Figure 2A
Finalisation dates for water entities' financial reports



Note: Dots may represent more than one entity if the financial reports were finalised on the same day.

Source: VAGO.

Management letter—a letter the auditor writes to the board, the audit committee and management of a water entity, outlining issues identified during the financial audit.

Figure 2A shows that one entity, Westernport Water, took more than 12 weeks to finalise its financial report, beyond the statutory deadline. The delay was partly caused by resourcing challenges, with the entity's chief financial officer departing unexpectedly in July. This led to inadequate preparation for the year-end process and audit, and impacted the quality of financial reporting. We reported this as a high-risk issue in our management letter, which Westernport Water's management team accepted. The entity has now established appropriate remediation plans.

Accuracy

The frequency and size of errors in financial reports are direct measures of the accuracy of draft financial reports submitted for audit.

Ideally, there should be no errors or adjustments required as a result of an audit. If we detect errors in draft financial reports, we raise them with the entity's management, and we expect that entities will adjust all material errors that we identify during an audit. Entities must correct material errors before we can issue a clear audit opinion.

Across the 2016–17 reporting period, we identified a number of significant financial transactions, balances and disclosure adjustments. Figure 2B summarises our findings.

Figure 2B
Significant dollar and disclosure adjustments identified across the 2016–17 reporting period

Dollar adjustments

Significant dollar adjustments that we identified resulted in:

- **a $51.8 million understatement of total assets,** mainly caused by adjustments to the valuation of infrastructure assets under a discounted cashflow model in 2016–17 and depreciation impacts associated with the 2015–16 formal revaluation of non-current physical assets
- **a $13.7 million overstatement of total assets,** mainly driven by overestimation of accrued revenue
- **an $11.6 million overstatement to total revenue,** relating to water and sewerage revenue in connection with the accrued revenue adjustment above.

Disclosure adjustments

Common financial statement disclosure adjustments we identified related to:

- **application of new accounting standards and Financial Reporting Directions (FRD)**, in particular AASB 124 *Related Parties Disclosures* and FRD 21C *Disclosures of responsible persons and executive officers in the financial report*, over*:*
  - determination and disclosure of key management personnel, including the responsible Minister
  - accuracy in calculating the remuneration of responsible persons and key management personnel
  - completeness of related-party disclosures, including government entity related-party transactions
- **formula errors** when transposing data from worksheets into the financial report, most noticeably with commitment and asset movement reconciliation notes
- **fair value disclosure** of non-current physical assets, where enhancements were required to commentary associated with valuation techniques and significant unobservable inputs
- **customising accounting policy disclosures** ensuring relevance to the individual water entity's transactions and balances
- **customising financial instrument disclosures** ensuring relevance to the individual water entity.

Source: VAGO.

We raised three high-risk issues in our management letters surrounding the accuracy of financial reporting in 2016–17:

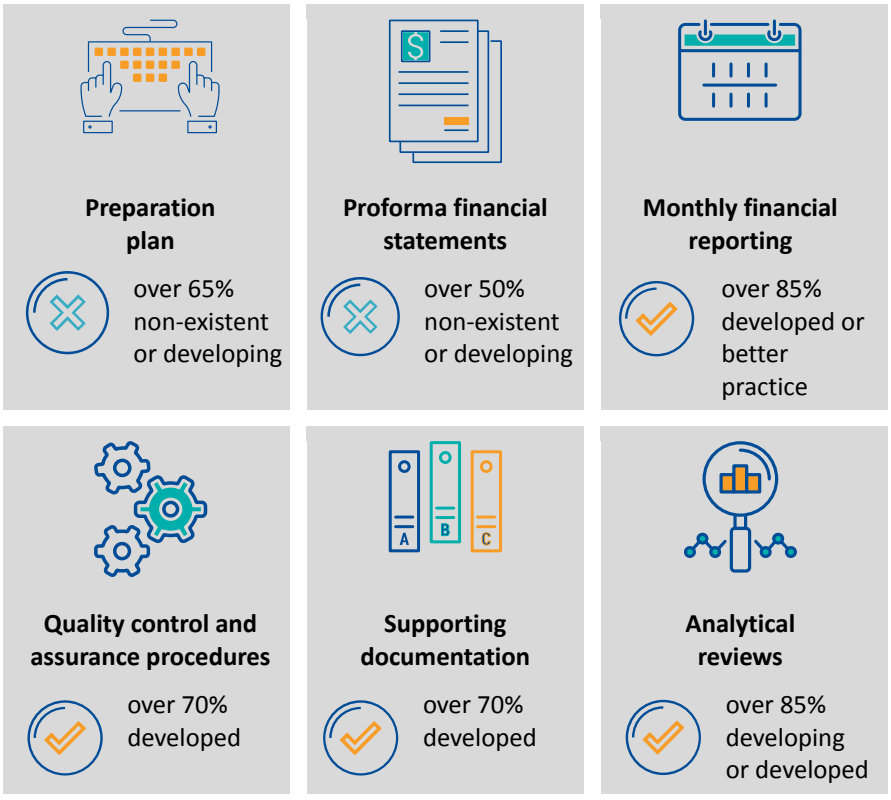
- Gippsland Water—delayed resolution of a 2012–13 prior-period issue relating to untimely capitalisation of assets, which increased the risk of material misstatement in depreciation and asset classifications
- Grampians Wimmera Mallee Water (GWMWater)—omission of a Committee of Management controlled by the entity that needed to be consolidated as per AASB 10 *Consolidated Financial Statements*, however information was not available to adequately value assets and liabilities to allow for adequate consolidation
- Westernport Water—failure to adequately prepare for changes to AASB 124 *Related Parties Disclosures.*

Management accepted our recommendations and established appropriate remediation plans.

Quality of the financial report preparation process

We assessed the quality of financial reporting processes against better practice criteria, detailed in Appendix F. Overall, the financial report preparation processes of most of the water entities were sound, as summarised in Figure 2C.

Figure 2C
Assessment of financial report preparation processes against better practice criteria



Note: Appendix F2 includes a detailed breakdown of the sector results of financial report preparation processes against better practice elements.

Source: VAGO.

Proforma financial statements—a set of financial statements prepared by management prior to balance date to assist with planning the structure and contents of the actual financial statements.

As shown in Figure 2C, two areas that entities need to address are:

- the preparation and quality of proforma financial statements
- the development of financial report preparation plans, including the entity's approach to streamlining the financial report and materiality determination.

The quality of the financial report preparation process was a particular concern at Westernport Water and Lower Murray Water, leading to significant delays and extensive reworking over key financial reporting and accounting standard changes, which also influenced their ability to achieve internal and external deadlines. Staff resourcing challenges around balance date further compounded these issues.

Streamlining financial reports

The International Accounting Standards Board (IASB) identified a 'disclosure problem' in the information that entities disclose in its financial reports. IASB observed three main disclosure concerns:

- not enough relevant information
- irrelevant information
- ineffective communication of the information provided.

IASB is focusing on projects that will improve communication in financial reporting—a strategic theme of IASB's work plans for 2017–21.

While IASB develop and finalise their response to disclosure concerns, the accounting profession has begun to address them by streamlining their financial reports.

The objectives of streamlining financial reports are to:

- maintain compliance with accounting standards and other relevant requirements
- present only relevant information by removing disclosures that are immaterial and including only entity-specific commentary
- communicate financial information in a manner that aligns with the objectives, service delivery, financial performance and financial position of the entity
- enhance the readability of the financial report and making it more user-friendly.

VAGO, the Department of Treasury and Finance and DELWP strongly encouraged water entities to streamline their financial reports, although it is not a mandatory accounting requirement.

As a result, the water sector worked proactively with its industry body, VicWater, to develop a streamlined financial statement model to assist water entities to prepare their financial reports for the 2016–17 reporting period. We commend the sector for its commitment to this streamlining process.

In the first year of this approach, we observed positive results and further areas for improvement—see Figure 2D.

Figure 2D
Key outcomes from streamlining financial reports in the water sector for 2016–17

Positive outcomes:

- restructured and regrouped notes, aligned with like areas
- accounting policies and commentary grouped directly to transactions and balances, making documents more understandable and user-friendly
- structures aligned with like transactions and balances.

Areas for improvement:

- remove immaterial disclosures in the context of the individual water entity's financial statements
- remove generic disclosures that have been taken from the financial statement model, that are not material, or that are irrelevant to the water entity
- customise structure and disclosures in the context of the individual water entity's objectives, service delivery and operations
- improve disclosures to enhance readability—remove technical language and streamline commentary where possible.

Source: VAGO.

Materiality—in the context of financial reporting, information is material if its omission, misstatement or non-disclosure has the potential to affect the economic decisions of users of the financial report, or the discharge of accountability by management or those charged with governance.

The size, value and nature of the information and the circumstances of its omission or misstatement help in deciding how material it is.

Although we were pleased that water entities took the opportunity to streamline their financial reporting processes to realign and refresh their structure and content, a number of entities continued to only use the model financial statements without modification. This resulted in immaterial and irrelevant financial report disclosures.

We encourage the sector to continue their streamlining investment, including only using the model financial statements as a starting point for further streamlining and customisation.

A detailed financial reporting preparation plan can help entities to streamline their financial reports and decide what note disclosures should stay in the financial statements, and what should be reworked, regrouped or removed. Materiality has a significant impact on this plan, to ensure entities include the information that will help users of the financial report understand the entity's financial performance and position.

Entities should document materiality assessments in the plan and then communicate to key stakeholders, such as audit committees and auditors, for input.

Further, by preparing early proforma financial statements, water entities can provide the proposed document to key stakeholders such as boards, audit committees and audit well before the balance date for review and input. This helps avoid inefficiencies and reworking when it comes to the preparation of draft financial reports closer to or after balance date.

2.2 Performance report audit opinions

FRD 27C *Presentation and Reporting of Performance Information* requires all water entities to annually prepare a report on their performance and have it audited.

The Minister for Water updated MRD 01 *Performance Reporting* on 11 April 2017 under section 51 of the FMA. This update supports the requirement under FRD 27C and specifies the format, content and KPIs that water entities must include in their performance reports.

DELWP require water entities to reflect the agreed KPIs as per MRD 01 in their corporate plans, which are submitted annually for review and noting. The corporate plans must contain all KPIs, along with targets for all indicators. Appendix F provides further detail on the financial and non-financial indicators for each entity type.

We issued clear audit opinions on all 19 performance reports, consistent with the 2015–16 reporting period. A clear audit opinion confirms that the actual results reported on the performance report were fairly presented and complied with MRD 01.

We do not form an opinion on the relevance or appropriateness of the reported KPIs, as these are set by the minister. We carried out these audits in accordance with the Australian Auditing Standards.

Quality and timeliness of performance reporting

Generally, water entities prepare and finalise their performance reports concurrently with their financial reports. Our audit of the 2016–17 performance reports resulted in a number of audit adjustments. Common themes included:

- **poor quality explanatory notes** to support significant variances, providing limited information or purpose to the reader
- **compliance issues** with explanatory notes, where detailing steps taken or plans to reduce unfavourable variances in the future were not initially disclosed in performance reports, as required by MRD 01
- **calculation errors** in deriving variance figures, as required by MRD 01.

Our past reports have highlighted that the water sector's performance reporting processes are not as mature as those used for financial reporting. This was again apparent for the 2016–17 reporting period, where entities prioritise financial reporting over performance reporting.

Water entities need to focus more on the processes for performance reporting and its quality, ensuring their performance reports comply with MRD 01. Preparing proforma performance reports, including draft variance explanations, prior to year end can help entities to reduce the number of disclosure deficiencies in their draft performance reports and improve the efficiency of the year-end reporting process.

We also encourage the sector to shift its mindset when preparing annual performance reports—rather than being seen as a compliance document, they can help to communicate key financial and non-financial results to water entities' customers.

In light of both the quality issues we identified with entities' performance reporting, and the sector having applied a consistent performance reporting approach for four years, we recommend that DELWP review the effectiveness of water entities' performance reporting. This review should consider whether the process and final performance reporting outputs are meeting the overall purpose of MRD 01, as initially intended.

3 Internal controls

3.1 Context

Effective internal controls help entities meet their objectives reliably and cost-effectively. Entities require strong internal controls to deliver reliable, accurate and timely external and internal financial reports.

In our annual financial audits, we consider the internal controls relevant to financial reporting and assess whether entities have managed the risk that their financial reports may not be complete and accurate. Poor internal controls make it more difficult for entities to comply with relevant legislation and increase the risk of fraud and error.

Water entity boards are responsible for establishing and maintaining internal controls that help to:

- prepare and maintain accurate financial records
- report promptly and reliably, externally and internally
- appropriately safeguard assets
- prevent and detect errors and other irregularities.

The *Standing Directions of the Minister for Finance* require each entity's management to build effective internal control structures.

In this section, we discuss:

- internal control weaknesses common with the 19 water entities in 2016–17
- the status of control weaknesses identified in prior years' audits.

We also discuss results of our assessment on how well entities input their asset revaluation results from the 2015–16 asset revaluation into their internal systems.

3.2 Assessment of internal controls

As part of our audit, we assess the design and implementation of water entities' controls and, where we identify controls that we intend to rely on, we test how effectively these controls are operating. If we assess an entity's internal controls as not being well designed, not operating as intended or missing controls that should be in place, the Australian Auditing Standards require us to communicate those deficiencies to the entity's management and audit committee.

To the extent that we test water entities' internal controls, we found them adequate for ensuring reliable financial reporting. However, we found instances where entities need to strengthen their key internal controls.

During our 2016–17 audits, we identified 83 internal control weaknesses across the 19 water entities. Figure 3A shows the number of issues identified by risk rating, excluding 43 low-risk issues and four business improvement opportunities that we reported directly to the entity. These are normally minor control weaknesses or opportunities to improve existing processes or internal controls. See Appendix D for definitions of our risk ratings.

Figure 3A
Reported internal control weaknesses by area and risk rating

	Risk rating		
Area of issue	**High**	**Medium**	**Total**
IT controls	9	15	24
Infrastructure assets, property, plant and equipment	2	1	3
Expenses and payables	–	3	3
Revenue and receivables	–	2	2
Employee benefits	–	2	2
Other	–	2	2
Total	**11**	**25**	**36**

Source: VAGO.

Common high- and medium-risk issues

Across our 2016–17 audits, we identified several common high- and medium-risk control weaknesses that require improvement:

- IT controls, which are needed to protect computer applications, infrastructure and information assets from threats to security and access
- the monitoring and maintenance of infrastructure assets, property, plant and equipment records and data.

Information technology

IT controls protect computer applications, infrastructure and information assets from a wide range of security and access threats. They also promote business continuity, minimise business risk, reduce the risk of fraud and error, and help meet business objectives.

The water sector relies on IT in its operations and financial management processes. IT systems are regularly upgraded and replaced across the sector. The need to upgrade and maintain existing systems, and the vigilance needed from increasing external IT security threats, means the sector needs to maintain a strong focus on this part of the business.

Patch—an additional piece of software designed to fix new or emerging security vulnerabilities or operational issues. Periodic patching reduces the risk of security vulnerabilities in systems and enhances the overall security of the IT infrastructure.

User access management controls—can help ensure systems are appropriately secured to prevent unauthorised access, disclosure and loss of data. Inappropriate and excessive user access rights assigned to systems may result in unauthorised access to data and programs, leading to potential errors, financial fraud and reputational loss.

IT disaster recovery plan (DRP)—a documented process or set of procedures to assist in the recovery of a water entity's IT infrastructure in the event of a disaster. Periodic review and update of the DRP is critical to ensuring it can be used to adequately recover critical systems within required business timeframes.

Consistent with our prior-year findings, we have again identified issues related to user access management controls, patch management, and periodic review and testing of IT disaster recovery plans (DRP).

Nine of the high-risk issues we identified in this area relate to three water entities:

- **Weak user access management controls** for both the finance and revenue systems were identified at Coliban Water and Melbourne Water, where several accounts held super-user access. This level of access was not required, and the entities had not performed periodic user access reviews in line with internal procedure documents for the operational system during 2016–17.
- **A number of cumulative patches had not been applied** to either revenue, finance and/or operating systems at Coliban Water and Yarra Valley Water. The entities had not conducted, documented or formally approved an assessment of the decision to not implement these patches. Further, patches were not applied in a timely manner to servers for operating and finance systems and the domain controller of Melbourne Water.
- **IT DRPs were outdated** at Coliban Water and Melbourne Water. We found shortfalls where the DRPs were not commensurate with the current system environment or lacked specific, detailed end-to-end processes. The entities had not performed required annual disaster recovery testing.
- **Weak change management controls** were in place at Coliban Water—we found numerous instances where changes to the finance and revenue systems were not actioned through the internal change management system and no evidence of testing was available.
- **Password management controls were not in line with policy** for both the finance and revenue systems at Coliban Water.

We reported these high-risk issues and they were accepted by the entities' management. The entities have established appropriate remediation plans.

We continue to identify these significant IT issues each year—however, they relate to varying key financial and operational systems within the water entities, depending on which systems we actually test. For example, in one audit cycle, we may raise issues relating to untimely patches or inappropriate user access relating to a finance system and, in a subsequent cycle, we may test controls over an operational system, such as a billings system, where patching and unauthorised access issues are again identified for that specific system.

This indicates that water entity management teams are not taking the lessons learnt from audit issues reported against particular key systems and applying them to other relevant systems to minimise risks across the organisation.

Monitoring, maintenance and accounting for infrastructure assets, property, plant and equipment

In 2016–17, the 19 water entities controlled more than $44.2 billion of physical assets. Entities need to appropriately record and maintain these assets, and monitor their condition and use, so that decisions can be made about whether they are appropriately valued and when they need to be replaced. Inadequate recording and monitoring of assets can lead to poor asset management or may trigger material misstatements in financial reports.

Capitalisation—the recognition of the cost of an asset, rather than an expense. This approach is used when a cost is not expected to be entirely consumed in a current period, rather over an extended period and will generate economic benefit for an entity.

We found several common issues:

- poor records management over asset data
- untimely capitalisation of work in progress and developer-contributed assets
- inappropriate capitalisation of labour costs
- failure to upload asset valuation data into the fixed-asset ledger following the asset valuation in 2015–16.

The high-risk issues we identified in this area related to two water entities:

- At Goulburn-Murray Water, poor project management and lack of supporting documentation led to a backlog of decommissioned assets during the 2016–17 reporting period and contributed to a further $16.8 million impairment of assets.
- At Gippsland Water, asset valuation results from the 2015–16 scheduled valuation were not processed in the fixed-asset ledger until April 2017. As a result of this delay, the fixed asset module for the 2016–17 financial year was not activated until April 2017, impacting asset accounting across the reporting period.

Status of matters raised in previous audits

As part of the financial audit process, we monitor internal control weaknesses identified in previous audits to ensure that entities resolve them promptly. We provide information to management and their respective audit committees about the status of these issues.

Figure 3B shows the number of internal control weaknesses raised in previous audits, with the resolution status by risk rating.

Figure 3B
Prior-year issues by resolution status and risk rating

	Risk rating		
Status of prior year issues	**High**	**Medium**	**Total**
Unresolved issues	2	7	9
Resolved issues	7	23	30
Total	**9**	**30**	**39**

Source: VAGO.

Thirty-nine control weakness issues remained open at the start of 2016–17. Encouragingly, 77 per cent of these matters were resolved during 2016–17.

However, two high-risk and seven medium-risk issues raised in previous years remain unresolved. The two unresolved high-risk issues were both in relation to the 2015–16 asset revaluation exercise:

- Lower Murray Water did not have a formal asset valuation policy to establish its valuation methodologies and accounting requirements. In addition, the independent valuer reported issues with the quality of asset data provided for valuation.
- Gippsland Water initially provided incomplete asset data to the Valuer-General Victoria (VGV). Data that the entity subsequently provided to resolve this issue did not contain sufficient detail for the VGV to perform a valuation. This resulted in management conducting a desktop valuation exercise in 2016–17, noting that the majority of this balance related to assets placed in service in the preceding 12–36 months.

Failure to resolve these issues reduces the effectiveness of the internal control environment. This could lead to water entities being unable to achieve their process objectives, comply with relevant legislation or identify material misstatements.

Appendix D includes information about time lines for resolution.

3.3 Post asset revaluation implementation

Each year, we select one internal control area and perform a more detailed review of the controls and related operating environment. For our 2016–17 audits, we focused on how well water entities input their asset revaluation results from the 2015–16 asset revaluation into their internal systems.

Comprehensive, accurate and up-to-date information on assets is vital for entities to effectively manage their assets, particularly for asset-intensive organisations such as water entities. Such information allows entities to make informed decisions about the physical and financial performance of assets they control. If entities do not have ready access to the necessary information, they cannot make these decisions effectively.

The upcoming Asset Management Accountability Framework (AMAF) requirements imposed under the Standing Direction 4.2.3 *Asset management accountability* raise the importance of quality asset information. Beginning with the 2017–18 financial year, water entities must attest in their annual report that they comply with AMAF requirements.

In 2015–16, the 19 water entities undertook an asset revaluation process in accordance with the requirements of FRD 103F *Non-Current Physical Assets*. In our report *Water Entities: 2015–16 Audit Snapshot*, we commented that the planning and preparation of the 2015–16 revaluation was much more effective than the previous valuation process in 2010–11, as key stakeholders acted early and managed to better scrutinise their valuation results. Despite the improvements, we highlighted that water entities needed to further enhance the quality of their asset data.

For most entities last year, the results of the 2015–16 asset revaluation were processed directly to the balance sheet and not reflected in entities' supporting systems. The tight timing of the revaluation process and the statutory financial reporting deadlines did not allow for a direct upload of the revaluation results.

We expected water entities to have uploaded the valuation data to supporting systems early in the 2016–17 year. Revaluation planning processes should have included a post revaluation result phase, to implement the revaluation results into key systems.

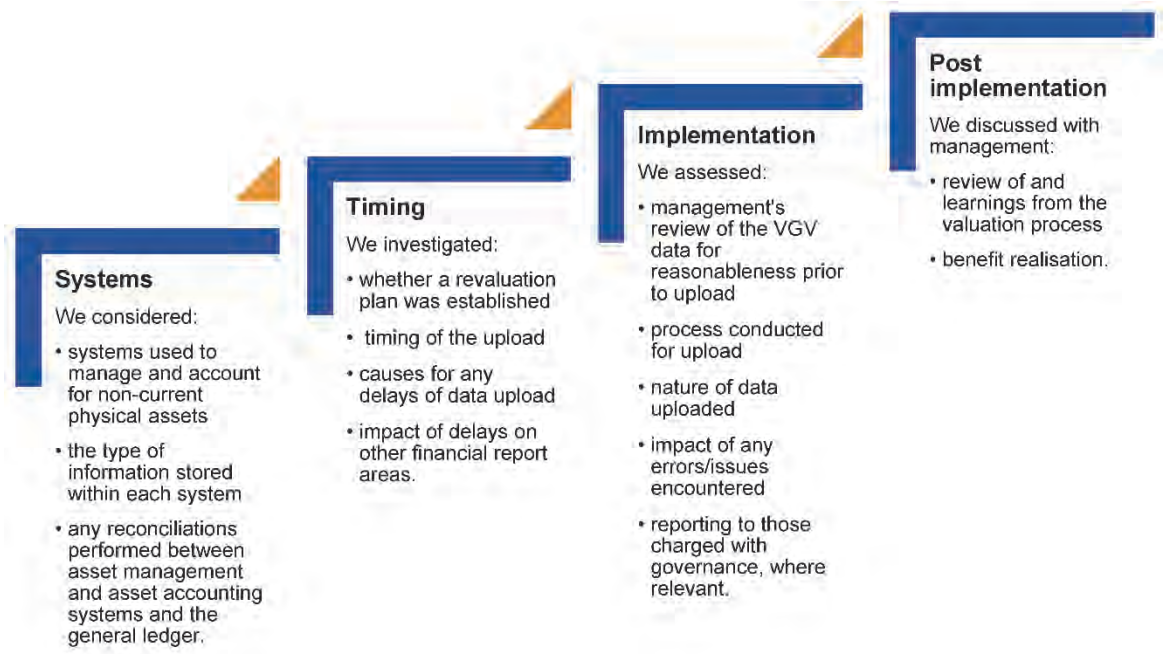
Information management and record keeping requirements

The AMAF, which supports Standing Direction 4.2.3 *Asset management accountability,* addresses the importance of information management and record keeping over assets. To meet operational needs and to satisfy relevant accounting standards and disclosure requirements, managing directors of water entities must establish appropriate record keeping processes.

Assessment of the post asset revaluation implementation

Figure 3C shows our approach for reviewing the post asset revaluation implementation into asset accounting systems.

Figure 3C
Our approach to reviewing post asset revaluation implementation into asset accounting systems



Source: VAGO.

Regional and rural water corporations determine the fair value of their assets based on the cost of replacing them, adjusted for accumulated depreciation. Known as a depreciated replacement cost method, it is applied to all not-for-profit water entities. Results of the full asset revaluation exercise are generally reflected in the water entities' fixed asset sub-ledger (FASL) and asset information management system (AIMS) via updates to each individual asset.

Income approach—a discounted cash-flow valuation method that requires the determination of an appropriate discount rate and the projection of future cash flows. Each year, an independent valuer assists the metropolitan water corporations to perform this valuation.

Metropolitan water entities, which are 'for-profit' businesses, use an income approach as the fair value methodology for their infrastructure assets, which does not assign values to individual assets. In contrast to the regional and rural water entities, metropolitan water entities do not perform the valuation exercise at the level of individual assets. Therefore, metropolitan water entities did not update their individual infrastructure assets within their FASL and AIMS.

Due to the different valuation methodology adopted by the metropolitan water entities and the rest of the sector, our comments below relate solely to the regional urban and rural water entities.

Our assessment showed mixed results.

Best performance

We assessed entities as having the best post asset revaluation processes if they uploaded their revaluation results within the first quarter of 2016–17 and experienced only insignificant issues with the upload process.

We found common traits of entities with best performance:

- prior to providing data to the VGV for revaluation in 2015–16, they prepared data in a format consistent with their internal systems, which meant that, upon receipt of revaluation results, the data was in a format that could be easily uploaded
- they had an integrated system for AIMS and FASL
- they had a detailed revaluation plan that identified the key steps of the revaluation process (from commencement to upload), responsible individuals, accountabilities and time lines
- they scrutinised in detail the VGV results prior to uploading the data—two entities formed specific working groups to manage this process, to verify unit rates, unusual rates and significant differences between existing data.

We also acknowledge Coliban Water's establishment of a post asset valuation group—its purpose was to reflect on lessons learnt from the revaluation exercise, establish new data templates and assess compliance against the requirements of the AMAF in preparation for 2017–18.

Better performance

Compared to the best performing entities, this group generally:

- had no—or a less detailed—revaluation plan in place
- did not have integrated systems for AIMS and FASL
- experienced some data mismatches between the AIMS and FASL
- provided incomplete or inaccurate data to the VGV for valuation
- provided data to the VGV that was not in a suitable format to be uploaded into their FASL—as a result, revaluation results returned from the VGV required further manipulation or formatting before they could be uploaded.

Basic performance

These entities experienced significant delays or were yet to upload valuation results to their FASL and AIMS by 30 June 2017. They also encountered significant issues which not only impacted the timing of implementation, but also indicated poor-quality asset data and highlighted a general lack of preparedness for the overall revaluation exercise. These entities generally:

- lacked a detailed revaluation plan
- had resourcing constraints
- did not perform reconciliations between the AIMS and FASL
- experienced significant data mismatches between the AIMS and FASL, which were only identified toward the end of the revaluation process—for example, once the VGV issued the revaluation results to the water entity
- encountered errors with the initial asset data provided to the VGV for valuation
- failed to consider the complexities and resources required to perform the data upload into the AIMS and FASL.

The delays and issues with the upload of asset data had a number of consequences:

- manual maintenance of fixed assets transactions and balances occurred outside of the FASL across the 2016–17 reporting period
- controls that would have normally existed, such as reconciliation of the FASL to the general ledger, did not exist, increasing the risk that asset data was not complete and accurate
- project managers lacked visibility of the actual status of work in progress
- depreciation impact of asset additions, disposals and write-offs for the year was required to be manually calculated
- lack of up-to-date asset information resulted in suboptimal reporting to those charged with governance.

Benefits

The best-performing entities reported that the improved quality of their asset data allowed them to make better asset-related decisions across the business. Opportunities included:

- improved condition assessments, resulting in more accurate asset life-cycle planning and costing
- forming a post-revaluation review group to reflect on lessons learnt and to assist with preparing for the AMAF requirements
- increased reliability of asset data used across the overall business, including by engineers
- having an extremely detailed understanding of their asset base and reliable data to allow for a full revaluation exercise to be conducted in-house on an annual basis
- enhanced costing of future capital projects.

In contrast, entities that were unable to update their asset systems with revaluation data in a timely fashion are at an increased risk that business decisions are based upon inaccurate or unreliable data.

Our review highlights the importance of having a detailed plan in place to guide the asset revaluation process. Entities with better performing implementation processes had a deeper understanding of their asset data which enabled them to provide quality data to the valuer, in a format that could be readily incorporated into their existing systems.

However, we noted that the majority of entities are yet to perform a formal post revaluation review exercise, to consider lessons learnt and identify areas for improvement that could be carried for the next revaluation exercise or to assist in preparing for AMAF requirements in 2017–18.

4

Financial outcomes

We consider an entity to be financially sustainable if it can maintain operations over the long term based on existing revenue and expenditure policies. It must also be able to absorb short-term fluctuations in income and expenditure from reasonably foreseeable internal and external factors.

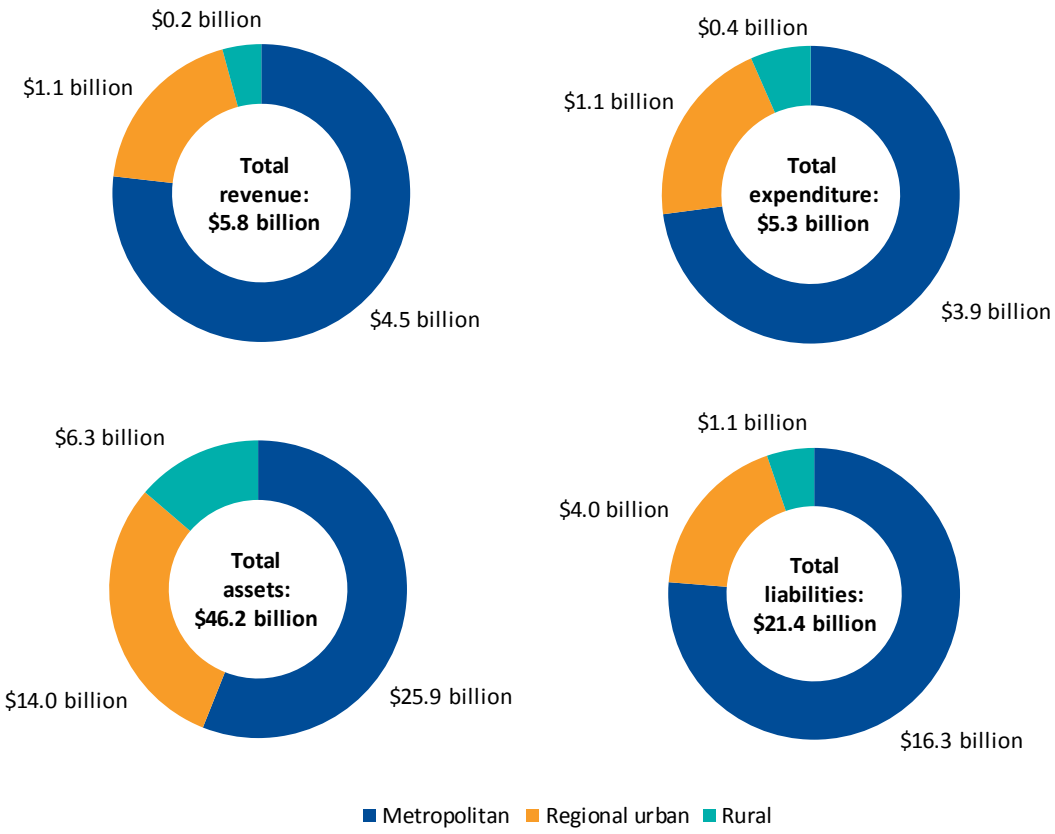
We separately assess the financial performance and position of each cohort over the 2016–17 financial reporting period, because their results are affected by varying circumstances.

We analyse financial data for the past five years, and consider whether water entities generate enough surpluses from operations to provide services, maintain or renew assets and repay debt. Their ability to do so is subject to the regulatory environment in which they operate and their ability to minimise costs and maximise revenue. We also consider forecast data, where appropriate, for the next five years based on data obtained from the water entities' most recent 2017–18 corporate plans.

4.1 Overview of the sector's financial results

Figure 4A provides an overview of the financial results of the Victorian water sector for 2016–17, by cohort—metropolitan, regional urban and rural.

Figure 4A
Financial performance and financial position for the sector



Source: VAGO.

The metropolitan water cohort—comprising the metropolitan wholesaler and three metropolitan retail water entities—contributes to a significant proportion of the sector's transactions and balances, followed by the 13 regional urban water entities, and the two rural water entities.

Appendix E includes the detailed data and calculations that underpin our analysis. This appendix lists our financial sustainability risk indicators and results against each indicator for the 19 water entities over the last five financial years 2012–13 to 2016–17.

The indicators highlight potential risks to ongoing financial sustainability in either the short or longer term. However, forming a definitive view of any entity's financial sustainability requires an analysis that moves beyond historical financial considerations to include the entity's financial forecasts, strategic plans, operations and environment, including the regulatory environment.

4.2 Metropolitan water entities

Understanding financial performance

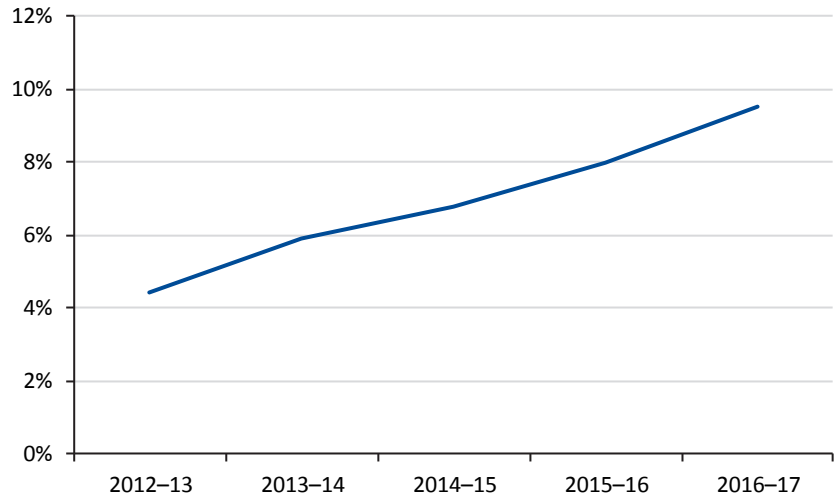
The four metropolitan water entities generated a combined net result after income tax of $416.6 million for 2016–17, an increase of $42.1 million, or 11.2 per cent, on 2015–16.

Average net result

The average net result margin is calculated based on the net result after tax, as a percentage of an entity's total revenue. Figure 4B shows the average net result margin of the cohort for a five-year period. Since 2012–13, the increase in the average net result margin for this cohort aligns with upward trends in revenue and net result after tax, indicating strong historical financial performance. This continued in 2016–17.

Figure 4B
Average net result margin for the metropolitan cohort

Average net result margin—shows how much of each dollar collected by the metropolitan cohort translates into operating profit.



Source: VAGO.

We analyse the key drivers behind the financial performance results of the metropolitan cohort below.

Events affecting revenue

In 2016–17, the four metropolitan water entities generated total revenue of $4.5 billion. Figure 4C shows the key revenue components for the metropolitan cohort.

Figure 4C
Key revenue components for metropolitan water entities in 2016–17

Source: VAGO.

The metropolitan water entities' combined revenue decreased by $109.6 million (2.4 per cent) in 2015–16, due to a significant decrease of $174.8 million in Melbourne Water's bulk water and sewage services, and revenue from waterways and drainage charges.

Government Water Rebate initiative (from the retailer perspective)—a rebate back to customers provided by the metropolitan retailer on behalf of the state government on water bills of residential water customers. It was first issued in 2014–15 on the first quarter bill (July, August, September) and is due to be provided each year until 2017–18.

Effective from 1 July 2016, Melbourne Water commenced the first year of its four-year ESC price determination. The new price determination decreased bulk water and sewage tariff rates, incorporating efficiency savings from the Government Water Rebate initiative, which was previously provided to the metropolitan retailers as a separate rebate.

The decline in revenue is further compounded by a reduction in water supplied to the metropolitan retailers due to:

- lower consumption by metropolitan households, commercial and industrial businesses across the 2016–17 reporting period
- the metropolitan region experiencing higher-than-average rainfalls compared to the prior year.

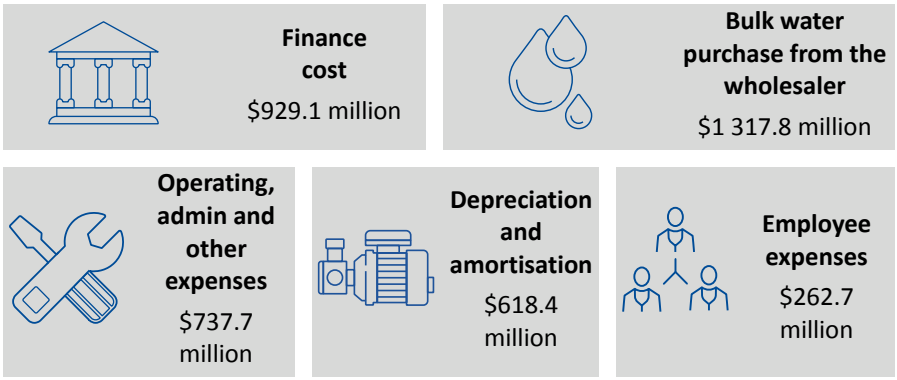
Both of these factors have resulted in a decline in service and usage charge revenue of the metropolitan retailers.

The decline in total revenue was offset by developer contributions increasing by $36.0 million from 2015–16, reflecting the continual expansion of services in Melbourne's outer suburbs and growth corridors.

Events affecting expenditure

In 2016–17, the four metropolitan water entities incurred $3.9 billion in total expenditure, a decrease of $71.4 million (1.8 per cent) from the prior year. Figure 4D shows the metropolitan cohort's key expenses.

Figure 4D
Key expenditure components for metropolitan water entities in 2016–17



Source: VAGO.

The main factor affecting the cohorts' expenditure is the bulk water charges paid by the metropolitan retailers to Melbourne Water, which decreased by approximately $91.7 million. This is due to the reduction in tariff rates and water consumption, in line with Melbourne Water's revenue movement explained in our revenue analysis.

Further, total finance costs for the cohort decreased by $15.3 million, or 1.6 per cent. This decline is largely a result of Melbourne Water experiencing lower interest expenses of $10.9 million due to repaying some debt and refinancing maturing debt at lower interest rates in 2015–16. There was also a reduction in finance costs associated with the Victorian Desalination Plant of $8.6 million, due to refinancing savings.

While Melbourne Water's finance costs decreased by $19.5 million, this was offset by the metropolitan retailers—their finance costs increased by a combined $4.1 million, due to a $177.8 million increase in borrowings held.

Other movements in expenditure items include:

- depreciation and amortisation increasing by $12.6 million (2.1 per cent), driven by a net revaluation increment of $217.2 million for the metropolitan water entities' physical assets from prior year's formal valuation exercise
- employee benefits increasing by $14.1 million (5.7 per cent), due to an increase in the overall full-time equivalent (FTE) base of 3.9 per cent for the cohort and increases in salaries and wages in line with enterprise bargaining agreements.

National Tax Equivalent Regime (NTER)—an administrative arrangement that results in government-owned enterprises paying a tax equivalent to the state government.

Events affecting income tax expense

The metropolitan water entities are subject to the National Tax Equivalent Regime (NTER), administered by the Australian Taxation Office.

Total income tax expense for the 2016–17 reporting period was $207.7 million. This represents a decline of $77.3 million, largely driven by a reduction in income tax payable by Melbourne Water, resulting from a change in the income tax treatment associated with the Victorian Desalination Plant.

Understanding financial position

Assets

Property, plant, equipment and infrastructure assets represented **95.6 per cent** of the total asset base in the metropolitan cohort.

At 30 June 2017, the four metropolitan water entities had assets of $25.9 billion, an increase of $491.8 million, or 1.9 per cent, compared to the prior year. The cohort's most significant assets are property, plant, equipment and infrastructure (PPEI) worth $24.7 billion.

PPEI assets grew by $437.6 million in 2016–17. The key drivers affecting this growth are:

- a $19.3 million net revaluation increase in infrastructure assets, comprising:
  - Yarra Valley Water and City West Water's increments of $41.0 million and $36.4 million respectively
  - South East Water's decrement of $58.1 million.
- additions to infrastructure assets across all four water entities of $418.3 million relating to asset renewal and replacement across the Melbourne metropolitan network.

Asset management is a key area that impacts the long-term financial sustainability of a water entity. A key financial challenge is how well water entities plan and carry out asset renewal and replacement. To understand this challenge, we analyse a longer-term indicator—capital replacement.

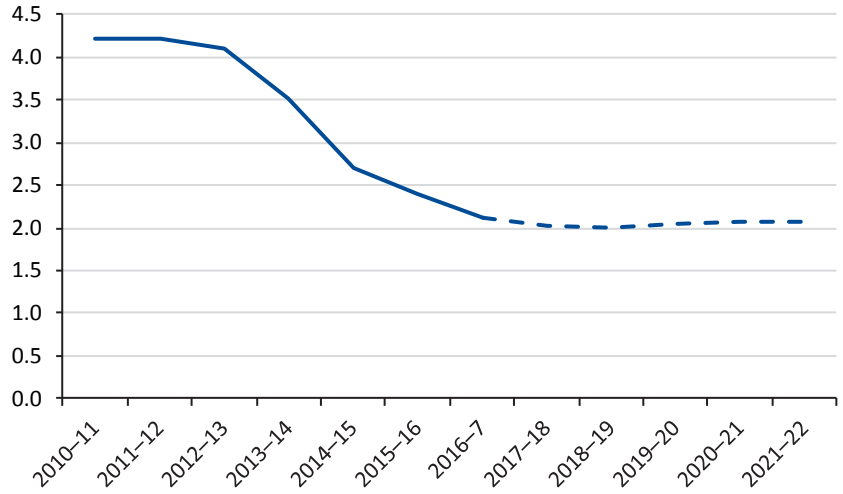
Capital replacement

Capital replacement ratio—in 2016–17, for every $1 of depreciation expense incurred, entities have spent on average $2.12 on infrastructure, property, plant and equipment.

The capital replacement ratio illustrates whether water entities are spending more on replacing or renewing assets each year compared with their depreciation expense—depreciation being considered an indicator of consumption.

We calculate this ratio based on a five-year rolling average, as can be seen in Figure 4E. The five-year rolling average allows for better phasing of asset spending by the four metropolitan water entities, as it closely aligns to their water pricing cycle.

Figure 4E
Five-year rolling average of the capital replacement ratio of the metropolitan cohort



Note: The information used in this figure comes from water entities' audited financial reports from 2005–06 to 2016–17 and 2017–18 corporate plans, which contain forward estimates for the 2017–18 to 2021–22 financial years. Dashed lines represent unaudited data taken from the water entities' corporate plans.

Source: VAGO.

Figure 4E indicates that the level of capital spending on asset renewal or replacement has kept pace with the consumption of assets, as it has remained above 1.0, however over time the trend has declined.

The downward trend was significantly impacted by increases in the values of PPEI assets since 2009–10. In 2009–10, metropolitan water entities revalued their infrastructure assets to fair value for the first time. Because this revaluation significantly increased asset values, depreciation expenses increased significantly from 2010–11 onwards.

The corporate plan forecast to 2021–22 indicates stabilisation at around 2.0, assuming a consistent trend across the cohort. However, when we look more closely at individual entity results within the cohort, this average is distorted. Melbourne Water experiences a declining trend in contrast to the upward trend of the three metropolitan retailers.

Liabilities

At 30 June 2017, the four metropolitan water entities had combined liabilities of $16.3 billion, an increase of $140.6 million (0.9 per cent) on 2015–16. This is due to an increase in borrowings of $257.5 million to meet working capital requirements, fund capital expenditure programs and fund statutory obligations.

This increase is offset by:

- a reduction of $46.3 million in the annual finance lease payments by Melbourne Water for the Victorian Desalination Plant
- a decrease of $81.7 million in Melbourne Water's current tax liability from the prior year, because of a change in income tax status for the Victorian Desalination Plant.

Figure 4F shows the key types of liability balances for the metropolitan cohort.

Figure 4F
Total liabilities for metropolitan waters entities by nature at 30 June 2017

Source: VAGO.

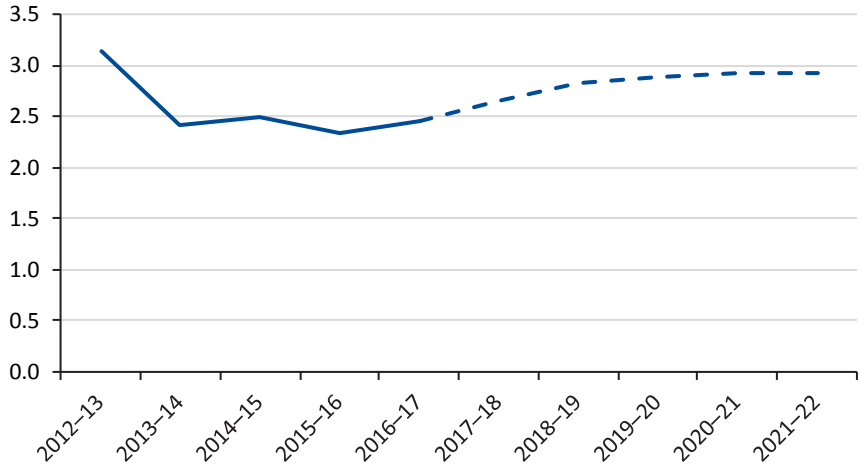
Gross debt to revenue

At 30 June 2017, the metropolitan water entities collectively held $8.7 billion in borrowings. The loans held are secured by guarantees from the state—meaning that the state holds the risk of entities not paying the principal and interest on loans.

In the metropolitan cohort, there has been and continues to be significant dependency on debt to finance capital projects, as these entities do not hold sufficient reserves or generate sufficient funds from operations to fund this investment.

The gross debt to revenue ratio assesses an entity's ability to pay the principal and interest on borrowings from the funds that the entity generates. Figure 4G shows the ratio for the past five years and the forecast ratio to 2021–22.

Figure 4G
Gross debt to revenue



Note: The information from this figure comes from water entities' audited financial statements from 2005–06 to 2016–17 and entities' 2017–18 corporate plans, which contain forward estimates for the 2017–18 to 2021–22 financial years. Dashed lines represent unaudited data taken from the water entities' corporate plans.

Source: VAGO.

Historically, debt levels are approximately 2.5 times total revenue—meaning the metropolitan water entities require at least three years' worth of total revenue generated to pay off the cohort's debt. When analysing the 2017–18 corporate plans, the level of borrowings for the metropolitan cohort are forecast to increase by $2.8 billion (22.0 per cent) over the period to 2021–22. This will result in a gross debt to revenue ratio trending upward to 3.0 times total revenue.

Our analysis of revenue generated by the entities shows that, after meeting operational and statutory obligations, only a small surplus remains at the end of each year to invest in either capital replacement or pay down debt. This indicates that the metropolitan cohort has little capacity to pay down debt from the revenue generated.

The entities have the power under the *Borrowing and Investment Powers Act 1987,* to rollover (refinance) their maturing debt and, in recent years, they have done so. All four entities intend to refinance their maturing debt to 2021–22.

Funding capital projects from debt is appropriate, particularly when the funds are used to construct larger-scale assets with extended useful lives, as costs associated with the assets are spread across future years. However, longer-term financial risks exist for the cohort if maturing debt continues to be rolled over without any plan for repayment.

Cash interest cover—measures an entity's ability to meet ongoing interest payments and ability to service debt.

As shown in Appendix E, the metropolitan water entities maintain strong cash interest cover, indicating that this cohort has the ability to service its debt by having sufficient funds to cover interest and financial accommodation levy payments.

4.3 Regional urban water entities

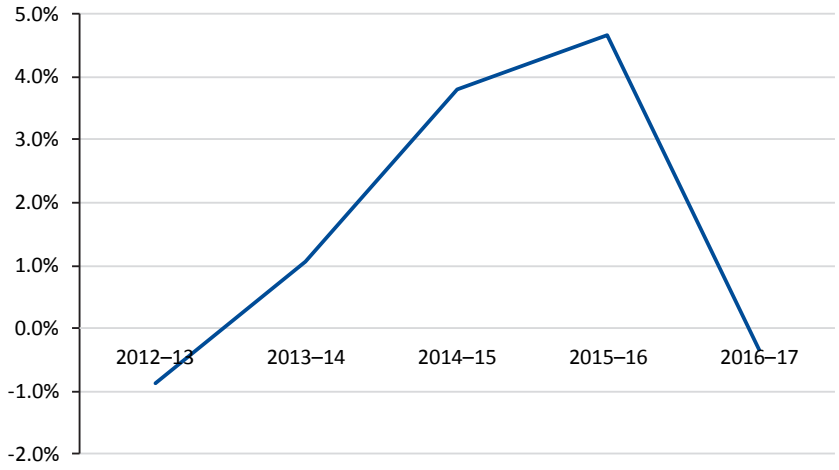
Understanding financial performance

The 13 regional urban water entities generated a combined net profit after income tax of $13.9 million for 2016–17, a decrease of $53.1 million (79.3 per cent) on 2015–16.

Average net result

The regional urban cohort's average net result margin has fluctuated over the five-year period, peaking in 2015–16 before a significant decline in the 2016–17 reporting period, falling below zero. Figure 4H shows the average net result margin of the cohort for a five-year period.

Figure 4H
Average net result margin for the regional urban cohort



Source: VAGO.

The decline in the average net result margin illustrates a weakening in the financial performance of the cohort, caused by 11 of the 13 regional urban entities experiencing a decline in their performance from 2015–16.

The average negative result in 2016–17 occurred because of the three water entities that generated the largest net losses for the year—GWMWater, Lower Murray Water and South Gippsland Water.

GWMWater's net deficit for the 2016–17 reporting period was due predominantly to an increase in depreciation expenditure as a result of the prior year revaluation exercise and the completion of two large infrastructure projects; and lower water consumption and developer contribution revenue.

Lower Murray Water continued to report a net loss as a result of an increase in repair and maintenance costs caused by flood damage, an increase in employee expenses and lower water consumption revenue.

South Gippsland Water's net loss was less in the prior year due to revenue received for a one-off capital project.

Service and usage charges $932.0m

Developer contributions $118.4m

Depreciation and amortisation $343.6m

Employee expenses $236.0m

Finance costs $131.3m

Operating, admin and other expenses $378.3m

Events affecting revenue

In 2016–17, the regional urban cohort generated revenue of $1.1 billion, a decrease of $25.3 million (2.23 per cent) on 2015–16. This was largely due to a decrease of $25.0 million in water and sewerage service revenue from lower water consumption by their customers, as regional Victoria experienced higher-than-average rainfall.

The decline was slightly offset by an increase in developer contributions of $9.3 million from 2015–16, with growth across key regional areas covered by Barwon Water, Coliban Water, Central Highlands Water and Goulburn Valley Water.

Events affecting expenditure

In 2016–17, the regional urban cohort incurred $1.1 billion in total expenditure, an increase of $30.8 million (2.9 per cent) from the prior year.

This increase in expenditure for 2016–17 was driven by:

- depreciation and amortisation increasing by $14.2 million (4.3 per cent), due to the significant revaluation increments on the water entities' physical assets from the prior year's formal valuation exercise, which had a full year's impact in 2016–17
- employee benefits increasing by $9.8 million (4.3 per cent), due to a 2.1 per cent increase in workforce FTE and increases in employee rates in line with enterprise bargaining agreements
- operating, administrative and other expenses increasing by $11.2 million (3.1 per cent), across a number of regional urban entities
- finance costs decreasing by $4.4 million (3.2 per cent), due to entities refinancing maturing loans at lower interest rates in the prior year and partially impacted by repayment in borrowings across 2016–17.

We explore the regional urban cohort's debt position further below.

Understanding financial position

Assets

At 30 June 2017, the regional urban cohort had assets of $14.0 billion, an increase of $68.7 million (0.5 per cent) compared to the prior year.

Work-in-progress at 30 June 2017 $334.0m

Similar to the metropolitan cohort, PPEI assets represent 96.3 per cent of the cohort's total asset base, which grew by $76.9 million to $13.5 billion at 30 June 2017.

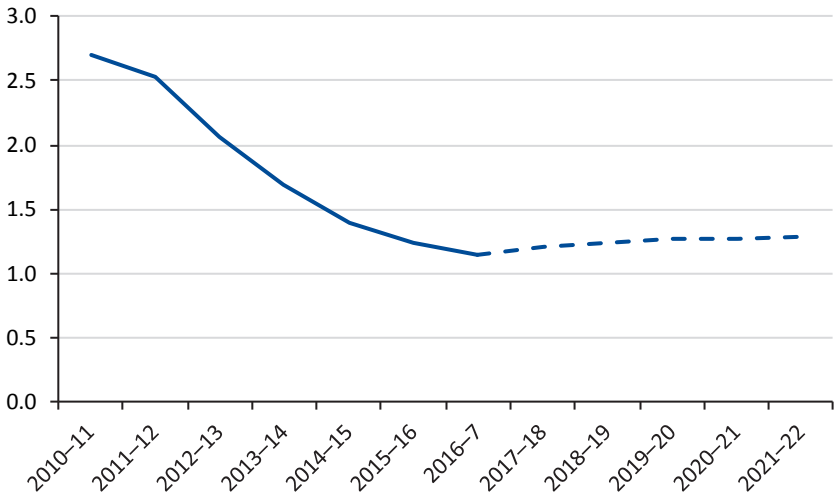
This growth in PPEI for 2016–17 is due to asset additions resulting from asset renewal and replacement, and new assets to service growth, predominantly for Barwon Water, Goulburn Valley Water and Western Water.

Capital replacement

We calculate the capital replacement ratio for the regional urban cohort on a five-year rolling average, over a period of 16 years, as can be seen in Figure 4I.

Figure 4I
Five-year rolling average of the capital replacement ratio for the regional urban cohort

Capital replacement ratio—in 2016–17, for every $1 of depreciation expense incurred, entities have spent on average $1.15 on infrastructure, property, plant and equipment.



Note: The information used in this figure comes from water entities' audited financial reports from 2005–06 to 2016–17 and 2017–18 corporate plans, which contain forward estimates for the 2017–18 to 2021–22 financial years. Dashed lines represent unaudited data taken from the water entities' corporate plans.

Source: VAGO.

Figure 4I indicates that the level of capital spending for asset renewal or replacement has kept pace with the consumption of assets, as it has remained above 1.0. However, over time the trend has declined.

The downward trend was significantly impacted by changes in the valuation of PPEI assets since 2010–11. In 2010–11, infrastructure assets across the regional urban entities were revalued to fair value for the first time and again in 2015−16, causing the depreciation expense to increase significantly across the period as a result of the higher asset values.

The corporate plan forecasts indicate a slight upward trend for the cohort. However, we note this average trend is significantly distorted by the forecast for Barwon Water and GWMWater, which both show a declining trend, with a capital replacement ratio of equal or less than 0.5 by 2021–22.

A further five regional urban entities are also at greater risk relative to the cohort, with an average below 1.0 in their capital replacement ratio over the next five years. Refer to Appendix E for breakdowns of the individual entities' results for the last five years.

Regional urban water entities need to recognise declining trends and assess the longer-term risks to their capacity to replace assets at a pace that matches their consumption. Entities with long-lived infrastructure assets require comprehensive asset renewal strategies to support the long-term replacement of core assets.

Liabilities

At 30 June 2017, the regional urban cohort had combined liabilities of $4.0 billion, an increase of $39.2 million, or 1.0 per cent on 2015–16, as a result of an increase in borrowing levels of $33.8 million for the cohort.

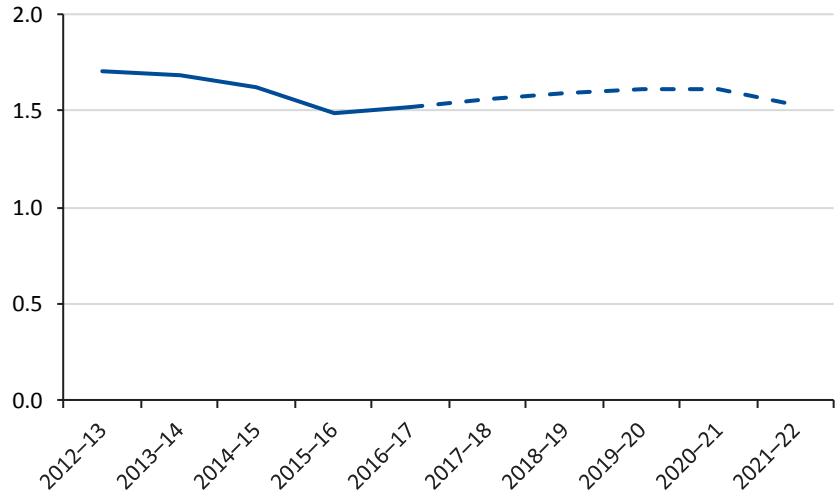
This result is significantly impacted by three regional urban water entities—Barwon Water, Goulburn Valley Water and Western Water—whose total borrowings increased by $69.3 million to support key capital projects, as highlighted earlier in this section. In contrast, nine of the 13 regional urban water entities repaid borrowings during the 2016–17 reporting period, reducing their total borrowings by $35.5 million.

Gross debt to revenue

Borrowings at 30 June 2017
$2.0b

With the exception of the 2016–17 results, Figure 4J shows a downward trend in the debt to revenue ratio over the last five years, indicating that the cohort has improved its ability to pay down debt from the revenue generated. This is consistent with the fact that a number of regional urban water entities have commenced repaying debt, as noted in our liability analysis.

Figure 4J
Gross debt to revenue



Note: The information used in this figure comes from water entities' audited financial reports from 2005–06 to 2016–17 and 2017–18 corporate plans, which contain forward estimates for the 2017–18 to 2021–22 financial years. Dashed lines represent unaudited data taken from the water entities' corporate plan.

Source: VAGO.

The corporate plan forecasts illustrate an average gross debt to revenue ratio of around 1.5 to 2021–22, with a planned increase in borrowings of $383.0 million (17.9 per cent), over the period to 2021–22. Both the historical and forecast trends indicate that the cohort still requires at least two years' worth of total revenue to pay off its debt. This would indicate that, on average, the cohort does not have the ability to pay down its debt from the revenue generated each year.

Five of the 13 regional urban water entities intend to fully fund their future capital expenditure program using internal funds generated from operating cash surpluses, as well as repaying borrowings, reducing their overall debt balance over the five-year forecast period.

4.4 Rural water entities

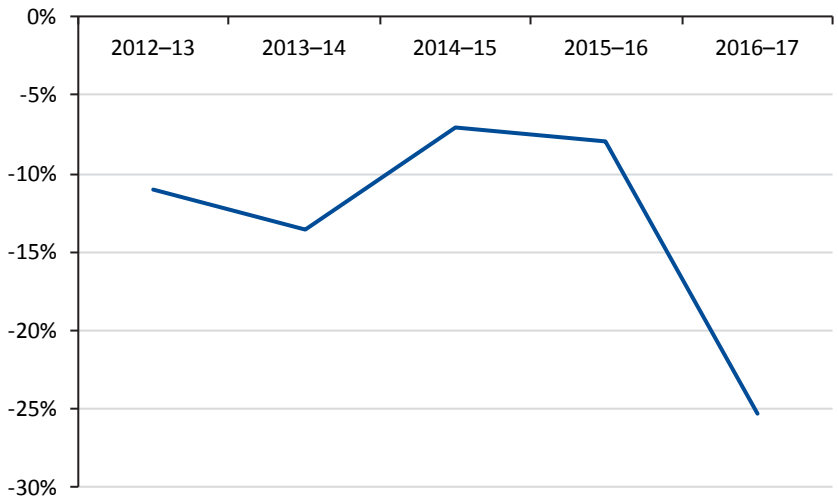
Understanding financial performance

The two rural water entities recorded a combined net deficit after tax of $66.3 million for 2016–17, a decrease of $51.6 million (350.5 per cent), on 2015–16.

Average net result

The rural cohort's average net result margin has fluctuated over the five-year period but has remained in a net deficit position. Figure 4K shows the average net result margin of the cohort for a five-year period.

Figure 4K
Average net result margin for the rural cohort



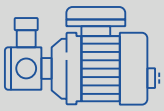
Source: VAGO.

Government funding
$71.4m

Events affecting revenue

In 2016–17, the two rural cohort entities generated revenue of $246.3 million, a decrease of $47.6 million (16.2 per cent) on 2015–16. The decline related to Goulburn Murray Water, where:

- government funding recognised as revenue was lower by $33.9 million, due to the reset of the Connections Project by government
- service and usage charges decreased by $8.0 million, due to lower water orders given higher average rainfall across the 2016–17 reporting period.



Depreciation and amortisation
$343.6m

Events affecting expenditure

In 2016–17, the two rural water entities incurred $348.1 million in total expenditure, an increase of $34.0 million (10.8 per cent) from the prior year. This decline was due to the depreciation expense increasing by $36.0 million (43.8 per cent).

The increase was expected given the significant revaluation increment experienced in 2015–16, adding $621.6 million into the value of the cohort's physical asset base—Goulburn Murray Water had an increment of $586.5 million and Southern Rural Water had an increment of $35.1 million.

Earnings before interest, tax, depreciation and amortisation (EBITDA) margin—measures an entity's ability to fund financing charges, tax obligations and asset renewal—the higher the EBITDA margin, the greater availability of funds for this purpose.

Average net result margin and EBITDA margin comparison

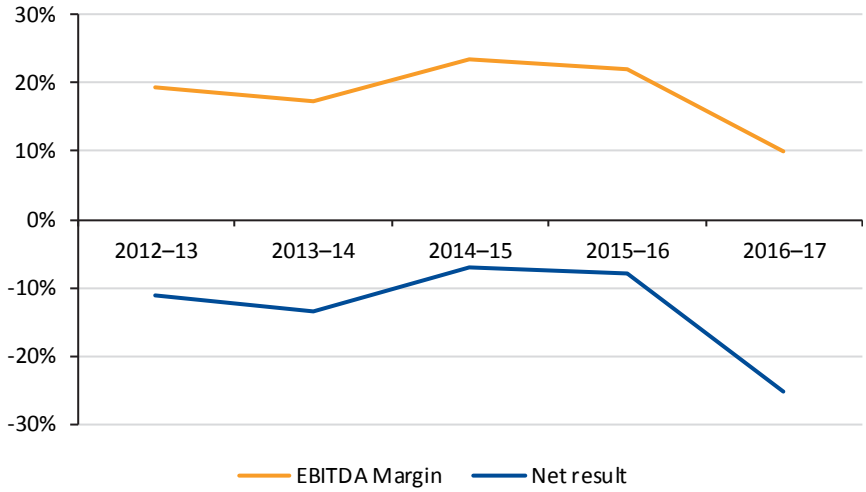
Figure 4K highlights that rural water entities have experienced significant net deficits over the five-year period. Operating losses are amplified for rural entities due to:

- the regulatory asset values set by the former Minister for Water, being at 0 to 2 per cent of the total asset values as at 1 July 2004
- these entities being responsible for the delivery and construction of significant capital programs, largely funded by state and Commonwealth governments.

Both these factors mean that the regulatory asset base used by ESC to set prices for these entities is substantially lower than the value of assets in their financial reports. As a result, these entities recover less through the prices they levy in comparison to the depreciation expense in their financial reports, leading to the operating losses reported.

Another indicator used to consider short-term financial sustainability risks is the EBITDA margin. Figure 4L shows the difference between the average net result margin and the EBITDA margin for the rural entities over the review period.

Figure 4L
Average net result margin and EBITDA margin comparison



Source: VAGO.

When removing the effect of interest, tax, depreciation and amortisation, the rural water entities achieve a positive result, indicating their ability to meet financial obligations in the short term. Despite the downward trend in 2016–17, a positive EBITDA result still does not indicate short term financial sustainability concerns.

Understanding performance position

Assets

At 30 June 2017, the two rural water entities had assets of $6.3 billion, an increase of $77.3 million (1.2 per cent) compared to the prior year. This cohort has historically held large amounts of cash and cash equivalents at balance date, due to funding received from government for the delivery of significant capital projects. As at 30 June 2017, Goulburn Murray Water held $283.1 million in cash and cash equivalents.

Similar to the other two cohorts, PPEI assets represented 94.6 per cent of the cohort's total asset base.

Cash and cash equivalents at 30 June 2017
$290.6m

The increase in total assets for the period relate to:

- a significant cash injection in late June 2017 for Goulburn Murray Water's Connections Project, increasing the total cash and cash equivalent balance for the cohort by $164.2 million at 30 June 2017
- a decrease in the infrastructure asset base of $87.7 million as both rural water entities turn over their aged assets through their major modernisation projects, which require both entities to dispose of their aged infrastructure assets and replace them with modern irrigation asset networks in their service areas. This resulted in the following:
  - assets written-off by Goulburn Murray Water of $21.1 million and Southern Rural Water of $3.8 million
  - assets impaired by Goulburn Murray Water of $16.8 million and Southern Rural Water of $36.0 million, where these physical assets no longer had any service potential at 30 June 2017.

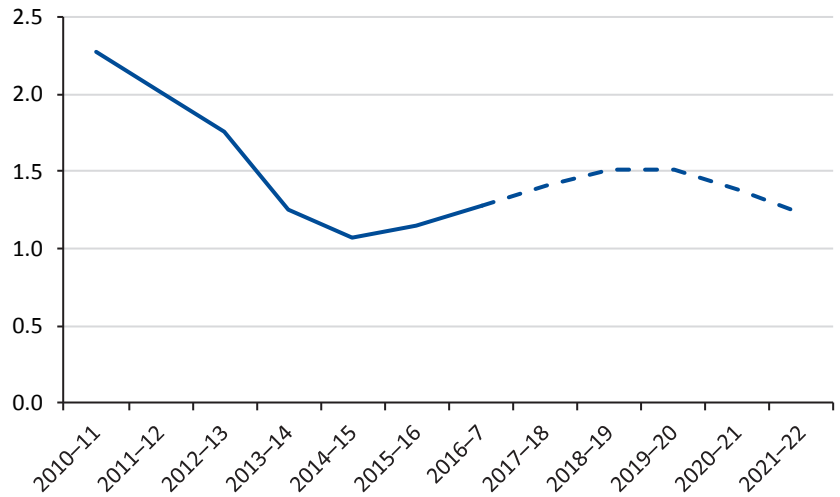
Infrastructure assets at 30 June 2017
$5 598.0m

Capital replacement

Figure 4M shows a historical downward trend for the rural cohort's capital replacement ratio. However, the results remain above 1.0, indicating the level of capital spending for asset renewal or replacement has just kept pace with consumption of assets.

Capital replacement ratio—In 2016–17, for every $1 of depreciation expense incurred, entities have spent on average $1.29 on infrastructure, property, plant and equipment.

Figure 4M
Five year rolling average of the capital replacement ratio



Note: The information used in this figure comes from water entities' audited financial reports from 2005–06 to 2016–17 and 2017–18 corporate plans, which contain forward estimates for the 2017–18 to 2021–22 financial years. Dashed lines represent unaudited data taken from the water entities' corporate plans.

Source: VAGO.

The impact of the revaluation of their infrastructure assets in 2010–11 to fair value—where the depreciation expense increased in the year following the revaluations—reflects the decline across the following five-year average period from 2011–12.

Unlike the other two cohorts, the rolling average of the capital replacement ratio for the two rural entities has been on the incline since 2014–15 and we expect this to continue until 2019–20, based on corporate plan forecasts. This period of growth in the ratio aligns to the significant capital expenditure by both rural entities planning for their respective modernisation projects, which are funded by state and Commonwealth governments. These current injections of cash are for new infrastructure assets only.

The consumption of these assets will increase the depreciation charge and further widen the gap of the rural cohort's net result and EBITDA margin, as detailed above. The challenge will arise in the longer term, when these entities will be required to replace and renew their significant infrastructure assets. Further support from the state and/or Commonwealth governments may again be required.

Liabilities

At 30 June 2017, the two rural entities had combined liabilities of $1.1 billion, an increase of $42.5 million (4.0 per cent) on 2015–16. This is mainly due to an increase in unearned revenue for Goulburn Murray Water, relating to their Connections Project of $113.1 million.

The movement in unearned revenue was offset by a decrease in deferred tax liabilities of $59.6 million—a direct result of the decrease to the infrastructure asset balance resulting from decommissioning and impairments highlighted above.

Appendix A
Audit Act 1994 section 16—submissions and comments

We have consulted with all water entities, DELWP, ESC and VicWater throughout the course of the audit. As required by section 16(3) of the *Audit Act 1994*, we gave a draft copy of this report, or relevant extracts, to those entities and asked for their submissions and comments. We also provided a copy of the report to the Department of Premier and Cabinet.

Responsibility for the accuracy, fairness and balance of those comments rests solely with the entity head.

Responses were received as follows:

DELWP 58

Coliban Water 59

RESPONSE provided by the Secretary, DELWP

Department of Environment, Land, Water and Planning

PO Box 500, East Melbourne,
Victoria 8002 Australia
delwp.vic.gov.au

Mr Andrew Greaves
Auditor-General
Level 31 / 35 Collins Street
MELBOURNE VIC 3000

Ref: SEC013212

Dear Mr ~~Greaves~~ Andrew,

PROPOSED REPORT ON THE RESULTS OF AUDITS 2016-17: WATER ENTITIES

Thank you for your letter dated 27 October 2017 about the proposed report on the *Results of Audits 2016-17: Water Entities*. I appreciate the opportunity to comment.

I note that all 19 water entities received clear audit opinions on their financial and performance reports for 2016-17.

I am pleased to note your findings that the report has assessed the industry as being financially sustainable with no immediate short-term risks. However, I also note that in the longer term, some water entities will need to consider the risks associated with their ability to renew/replace assets and repay debt.

The report's recommendations are noted, including the recommendation pertaining to the Department of Environment, Land, Water and Planning (DELWP). In this regard, DELWP has already initiated a process to engage with the water industry through workshops and water industry forums to address issues with performance reporting under the Minister for Water's Letter of Expectations 2017-18 to the water entities.

As part of this process, DELWP will, during 2017-18, comprehensively review performance reporting by the water entities with regards to the effectiveness and appropriateness of key performance indicators under the current Ministerial Reporting Direction 01 – *Performance Reporting* and key performance indicators under the Letter of Expectations.

DELWP will also actively engage with the water industry through opportunities at water industry forums and the peak Victorian Water Industry Association to bring recommendations in the report that are actionable by the water entities to their attention for continuous improvement.

I thank you again for the opportunity to comment on the proposed audit report.

Yours sincerely

John Bradley
Secretary

9 / 11 / 2017

VICTORIA State Government

RESPONSE provided by the Managing Director, Coliban Water

Coliban WATER

Our ref: **Contact:** Peter Leersen **Your ref:** File No 32537

8 November 2017

Victorian Auditor-General's Office
Auditor-General, Andrew Greaves
Level 31, 35 Collins Street
Melbourne VIC 3000

Dear Andrew

Response to Proposed Report on the *Results of Audits 2016-17: Water Entities*

Coliban Water is pleased to submit to the Victorian Auditor-General's Office (VAGO) this response to provisional information provided by VAGO that is to form part of the content to be contained in Chapter 3 of the *Results of Audits 2016-17: Water Entities* report to be tabled in the near future in the Victorian Parliament.

The provisional information sighted by Coliban Water details VAGO's findings from the 2016-17 financial audit of the corporation in relation to information technology (IT) system controls, with VAGO identifying and reporting five issues that were assessed during audit as being high risk.

Coliban Water has accepted these findings and the corporation has committed to a series of remediation strategies and actions to mitigate the high risk situation as assessed during audit. The provisional information from VAGO acknowledges the establishment of appropriate remediation measures.

The following table reports on the progress to date in respect of those measures.

Information Technology Risk Issues	Time Frame	Status	Remediation Actions and Strategies
1. Weak user access management controls	Aug 2017	Closed	Inappropriate users have been removed, an online workflow system for adding, changing and removing users has been implemented, and a scheduled job in the IT Service Desk application has been created to ensure a full periodic review is undertaken.
2. Patches not applied	Sep 2017	Closed	A minor change to the automatic patch system has rectified the issue and SQL Server patches are now applying correctly.
3. Out-of-date IT DRPs	Mar 2018	In Progress	The Disaster Recovery Plan has been updated and procedures are being developed, taking into account input from a recent independent enterprise-wide business continuity review.

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VICTORIA State Government

Coliban WATER

Information Technology Risk Issues	Time Frame	Status	Remediation Actions and Strategies
4. Weak change management controls	Mar 2018	In Progress	A full review of the change management process has commenced with the intent of introducing a new IT system to support this process. The process review is expected to be completed by Dec 2017 with the tool implementation by Mar 2018. Additionally, a scheduled job in the IT Service Desk application has been created to ensure periodic reviews are undertaken.
5. Password management controls not in line with policy	Sep 2018	Closed	Password management controls now align to the IT Policy, including minimum password age settings.

It is Coliban Water's intention to demonstrate to VAGO that the high risk IT issues identified and reported have all been addressed as part of the 2017-18 financial audit of the corporation.

If you require any further information or clarification of any details contained in this letter, please contact the corporation's Chief Financial Officer, Mr Peter Leersen.

Yours faithfully

Jeff Rigby
Managing Director

37–45 Bridge Street
Bendigo Victoria 3550
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BENDIGO DC VIC 3554
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VICTORIA State Government

Appendix B
Water entities

Figure B1 lists the legal and trading names of the 20 entities, including one controlled entity, that form part of the Victorian water industry.

Figure B1
Water entities and controlled entity

Legal name	Trading name
Metropolitan cohort	
Wholesaler	
Melbourne Water Corporation	Melbourne Water
Retailers	
City West Water Corporation	City West Water
South East Water Corporation	South East Water
Yarra Valley Water Corporation	Yarra Valley Water
* iota Services Pty Ltd (subsidiary of South East Water Corporation)	iota
Regional urban cohort	
Barwon Region Water Corporation	Barwon Water
Central Gippsland Region Water Corporation	Gippsland Water
Central Highlands Region Water Corporation	Central Highlands Water
Coliban Region Water Corporation	Coliban Water
East Gippsland Region Water Corporation	East Gippsland Water
Goulburn Valley Region Water Corporation	Goulburn Valley Water
Grampians Wimmera Mallee Water Corporation	GWMWater
Lower Murray Urban and Rural Water Corporation	Lower Murray Water
North East Region Water Corporation	North East Water
South Gippsland Region Water Corporation	South Gippsland Water
Wannon Region Water Corporation	Wannon Water
Western Region Water Corporation	Western Water
Westernport Region Water Corporation	Westernport Water
Rural cohort	
Gippsland and Southern Rural Water Corporation	Southern Rural Water
Goulburn-Murray Rural Water Corporation	Goulburn-Murray Water

Source: VAGO.

Controlled entity

iota Services Pty Ltd (iota) is a wholly-owned subsidiary of South East Water, incorporated on 29 October 2014 under the *Corporations Act 2001* and it commenced trading on 1 January 2015. The then Minister for Water approved the establishment of iota under the provisions of the *Water Act 1989*. iota is responsible for the profitable commercialisation of South East Water's innovations, products and services.

The entity is consolidated into the financial report of South East Water, as per the requirements of AASB 10 *Consolidated Financial Statements*. As the entity is consolidated, the results of that audit are addressed throughout this report as part of the South East Water results.

Rural service areas

Four of the water entities provide rural water services, which comprise water supply, drainage, and salinity mitigation services for irrigation and domestic and stock purposes. These are:

- Southern Rural Water
- Goulburn-Murray Water
- GWMWater
- Lower Murray Water.

Southern Rural Water, Goulburn-Murray Water and GWMWater also provide bulk water supply services to other water entities in regional Victoria. See Figure 2B for rural service areas.

Figure B2
Rural service areas

Source: VAGO.

Appendix C
Acquittal of audits

Figure C1 shows the dates when entities' 2016–17 financial and performance reports were certified and auditor's reports were issued.

Figure C1
Acquittal of audits

Entity	Audit types		Financial report			Timeliness of audited financial report completion		Performance report			Timeliness of audited performance report completion	
	FMA	Non-FMA	Clear opinion issued	Certification date	Auditor-General's report signed	Within 12 weeks	More than 12 weeks	Clear opinion issued	Certification date	Auditor-General's report signed	Within 12 weeks	More than 12 weeks
Completed audits with 30 June 2017 balance dates												
Metropolitan												
Wholesaler												
Melbourne Water	✓		✓	25-Aug	31-Aug	●		✓	25-Aug	31-Aug	●	
Retailers												
City West Water	✓		✓	22-Aug	29-Aug	●		✓	22-Aug	29-Aug	●	
South East Water	✓		✓	4-Sep	5-Sep	●		✓	4-Sep	5-Sep	●	
iota Services Pty Ltd		✓	✓	4-Sep	5-Sep	●		NA	NA	NA	NA	
Yarra Valley Water	✓		✓	25-Aug	31-Aug	●		✓	25-Aug	31-Aug	●	
Regional urban												
Barwon Water	✓		✓	17-Aug	22-Aug	●		✓	17-Aug	22-Aug	●	
Central Highlands Water	✓		✓	4-Sep	5-Sep	●		✓	4-Sep	5-Sep	●	
Coliban Water	✓		✓	28-Aug	1-Sep	●		✓	28-Aug	1-Sep	●	
East Gippsland Water	✓		✓	6-Sep	7-Sep	●		✓	6-Sep	7-Sep	●	
Gippsland Water	✓		✓	25-Aug	4-Sep	●		✓	25-Aug	4-Sep	●	
Goulburn Valley Water	✓		✓	23-Aug	25-Aug	●		✓	23-Aug	25-Aug	●	
GWM Water	✓		✓	21-Aug	23-Aug	●		✓	21-Aug	23-Aug	●	
Lower Murray Water	✓		✓	11-Sep	12-Sep	●		✓	11-Sep	12-Sep	●	
North East Water	✓		✓	15-Aug	22-Aug	●		✓	15-Aug	22-Aug	●	
South Gippsland Water	✓		✓	12-Sep	13-Sep	●		✓	12-Sep	13-Sep	●	
Wannon Water	✓		✓	31-Aug	1-Sep	●		✓	31-Aug	1-Sep	●	
Western Water	✓		✓	7-Sep	8-Sep	●		✓	7-Sep	8-Sep	●	
Westernport Water	✓		✓	28-Sep	10-Oct		●	✓	28-Sep	10-Oct		●
Rural												
Southern Rural Water	✓		✓	5-Sep	7-Sep	●		✓	5-Sep	7-Sep	●	
Goulburn-Murray Water	✓		✓	16-Aug	28-Aug	●		✓	16-Aug	28-Aug	●	
2016–17 total	**19**	**1**				**95%**	**5%**				**95%**	**5%**
2015–16 total	**19**	**1**				**100%**	**-**				**100%**	**-**

Note: FMA—*Financial Management Act 1994*.

Source: VAGO.

Appendix D
Management letter risk ratings

Figure D1 shows the risk ratings applied to management letter points raised during an audit.

Figure D1
Risk definitions applied to issues reported in audit management letters

Rating	Definition	Management action required
Extreme	The issue represents: • 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: • 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: • 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: • 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: VAGO.

Appendix E
Financial sustainability risk indicators and summaries

Appendix E sets out the definitions we use for the current and prior years that assist us in assessing and reporting on financial sustainability risks across the water sector.

However, these financial sustainability indicators are only indicative, highlighting financial sustainability risks at a cohort level—metropolitan, regional urban and rural—looking at each entity relative to the cohort against a five-year average.

It is important to note that a more definitive view of financial sustainability requires a more holistic analysis beyond historical financial reporting to also include forward looking financial forecasts and plans, operations and an entity's environment, particularly the regulatory environment within which these water entities must operate.

Figure E1 shows the indicators used to assess the financial sustainability risks of entities covered by this report. These indicators should be considered collectively, and are more useful when assessed over time as part of trend analysis.

Figure E1
Financial sustainability indicator definitions and formulas

Indicator	Definition	Formula
Short-term financial sustainability indicators		
Cash interest cover (ratio)	This measures an entity's ability to meet ongoing interest payments and ability to service debt. The higher the ratio, the better the ability for the entity to meet its interest payments from borrowings.	Net operating cash flows before net interest and tax payments / Net interest payments
Internal financing (%)	This measures an entity's ability to finance capital works using cash generated by the entity's operating cash flows. The higher the percentage, the greater the ability for the entity to finance capital works from their own funds.	Net operating cash flows less dividends / Net capital expenditure
Current ratio	This measures an entity's ability to pay existing liabilities in the next 12 months. A ratio greater than 1.0 means there are more cash and liquid assets than short-term liabilities.	Current assets / Current liabilities (excluding long-term employee provisions and revenue in advance)
EBITDA margin (%)	This is a measure of an entity's ability to generate surplus to fund its operations. This measure is generally used for entities with significant fixed assets and/or debt financing. The larger the EBITDA margin, the stronger the result.	Earnings before interest, tax, depreciation and amortisation / Total revenue
Net result margin (%)	This measures how much of each dollar collected as revenue translates to net result. A positive result indicates a surplus, and the larger the percentage, the stronger the result.	Net result after tax / Total revenue
Long-term financial sustainability indicators		
Gearing ratio (%)	This is a longer-term measure that compares all current and non-current interest bearing liabilities to total assets. It complements the current ratio, which is a short-term measure. A lower ratio indicates lesser reliance on debt to finance the entity's assets.	Total debt (including finance leases) / Total assets
Return on assets (ROA) (%)	This ratio shows the percentage of profit the entity earns in relation to its overall resources. A positive result indicates the entity's resources are generating a surplus, and the larger the percentage, the stronger the result.	Earnings before net interest and tax / Average total assets

Indicator	Definition	Formula
Return on equity (ROE) (%)	This is a measure of profitability that calculates how many dollars of profit an entity generates with each dollar of equity. A positive result indicates the entity is generating a surplus with each dollar of the shareholders' equity, and the larger the percentage, the stronger the result.	Net profit after tax / Average total equity
Capital replacement ratio	This compares the rate of spending on infrastructure, property, plant and equipment and intangibles with its depreciation and amortisation. This is a long-term indicator, as capital expenditure can differ in the short term if there are insufficient funds available from operations, and borrowing is not an option. A ratio less than 1.0 means the spending on capital works has not kept pace with consumption of assets.	Cash outflows for property, plant and equipment / Depreciation
Gross debt to revenue (ratio)	This assesses an entity's ability to pay the principal and interest on borrowings, as and when they fall due, from the funds that the entity generates. The lower the ratio, the less amount of revenue generated by the entity is required to repay down its total debt.	Total interest bearing liabilities (including finance lease) / Total revenue
Net debt to revenue (ratio)	This assesses an entity's ability to pay the principal and interest on borrowings, as and when they fall due, from the funds they generate. The lower the ratio, the less amount of revenue generated by the entity is required to repay down its total debt.	Total interest bearing liabilities (including finance lease) less cash and cash equivalent / Total revenue

Source: VAGO.

The financial sustainability risks for each water entity, for the financial years ended 30 June 2012–13 to 2016–17 are shown in Figures E2 to E20.

Metropolitan cohort—wholesaler

Figure E2
Melbourne Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	1.5	1.8	1.6	2.1	2.0	1.8	2.4
Internal financing ratio	56.4%	166.7%	103.4%	135.3%	89.0%	110.2%	60.5%
Current ratio	0.4	0.3	0.2	0.1	0.1	0.2	0.6
EBITDA margin	63.8%	70.3%	70.5%	74.2%	71.4%	70.0%	39.7%
Net result	-3.2%	5.2%	6.6%	8.2%	8.4%	5.1%	6.9%
Long-term financial sustainability indicators							
Gearing ratio	58.4%	57.5%	55.9%	53.6%	53.6%	55.8%	46.4%
Return on assets	4.0%	5.9%	6.0%	6.9%	6.0%	5.8%	5.5%
Return on equity	-0.9%	2.0%	2.5%	3.1%	2.9%	1.9%	4.1%
Capital replacement ratio	1.2	0.7	0.9	1.0	1.2	1.0	2.1
Gross debt to revenue	6.7	4.8	4.6	4.2	4.5	5.0	2.6
Net debt to revenue	6.6	4.7	4.6	4.2	4.5	4.9	2.6
Summary							
Shorter-term indicators of cash interest cover and current ratio are weaker than the average cohort results, however this has arisen from the corporation's liquidity strategy to utilise any excess cash to reduce outstanding debt or manage working capital, and is not an indicator of immediate liquidity concerns. The entity has experienced mixed profitability results for ROA, ROE, EBITDA margin and net result relative to the cohort average, however all results still remain positive and highlight surpluses are being consistently generated. Other longer-term indicators present weaker results against the cohort average. Debt to revenue ratios are comparatively weaker, showing the entity requires on average, more than four years' worth of its total revenue generated to pay off debt. The comparatively higher debt levels are also reflected in the weaker gearing ratio. The capital replacement ratio shows a five-year average of one indicating that spending on asset renewal is just keeping pace with asset consumption.							

Source: VAGO.

Metropolitan cohort—retailers

Figure E3
City West Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	2.3	1.7	2.2	2.3	2.6	2.2	2.4
Internal financing ratio	13.9%	9.6%	58.6%	57.9%	73.0%	42.6%	60.5%
Current ratio	0.7	0.5	0.8	1.2	1.3	0.9	0.6
EBITDA margin	28.5%	22.3%	25.6%	26.4%	32.4%	27.0%	39.7%
Net result	7.2%	4.1%	6.1%	6.5%	10.8%	6.9%	6.9%
Long-term financial sustainability indicators							
Gearing ratio	47.5%	49.2%	48.9%	50.4%	48.3%	48.9%	46.4%
Return on assets	4.9%	4.8%	5.2%	6.0%	7.8%	5.7%	5.5%
Return on equity	4.5%	3.6%	5.0%	5.9%	9.3%	5.7%	4.1%
Capital replacement ratio	4.4	3.8	1.9	1.8	1.7	2.7	2.1
Gross debt to revenue	2.0	1.7	1.8	1.6	1.6	1.7	2.6
Net debt to revenue	1.9	1.7	1.8	1.6	1.6	1.7	2.6
Summary							
The weaker current ratio across the cohort is driven by financial and debt management strategies, rather than being an indicator of immediate liquidity concerns. Despite the cash interest cover and internal financing ratio being less than the cohort average, results still indicate that the entity is generating sufficient operating cash to fund required capital spend and to service debt. The entity has experienced mixed profitability results for ROA, ROE, EBITDA margin and net result relative to the cohort average, however all results still remain positive. Surpluses are being consistently generated. Other longer-term indicators present mixed results against the cohort. Debt to revenue ratios are comparatively stronger, showing the entity requires on average, less than two years' worth of its total revenue generated to pay off debt. Despite declining results across the last five years, the capital replacement ratio still indicates that spending on asset renewal is keeping ahead of the pace of asset consumption.							

Source: VAGO.

Figure E4
South East Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	3.2	2.8	3.4	3.1	3.4	3.2	2.4
Internal financing ratio	30.1%	38.5%	32.6%	65.2%	54.0%	44.1%	60.5%
Current ratio	0.7	0.6	0.9	0.9	1.1	0.8	0.6
EBITDA margin	29.7%	28.0%	30.1%	33.1%	35.2%	31.2%	39.7%
Net result	7.5%	9.6%	9.0%	11.6%	13.0%	10.2%	6.9%
Long-term financial sustainability indicators							
Gearing ratio	31.7%	33.1%	34.9%	35.8%	36.6%	34.4%	46.4%
Return on assets	4.2%	5.8%	5.4%	6.6%	6.9%	5.8%	5.5%
Return on equity	3.3%	5.7%	4.8%	6.7%	7.2%	5.5%	4.1%
Capital replacement ratio	2.4	2.6	2.9	1.8	1.8	2.3	2.1
Gross debt to revenue	1.5	1.2	1.4	1.3	1.4	1.4	2.6
Net debt to revenue	1.5	1.2	1.4	1.3	1.4	1.4	2.6
Summary							
Shorter-term indicators of cash interest cover and current ratio have recorded positive results relative to the five-year average for the cohort. Despite the internal financing ratio being less than the cohort average, results still indicate that the entity is generating sufficient operating cash to fund required capital spend. The entity has experienced mixed profitability results for ROA, ROE, EBITDA margin and net result relative to the cohort average, however all results remain positive. Surpluses are being consistently generated. Other longer-term indicators present positive results against the cohort. This is highlighted by relatively stronger gearing and debt to revenue ratios, showing the entity requires on average, less than 1.5 years' worth of its total revenue generated to pay off debt. Despite weaker results in the latest two years, the average capital replacement ratio is comparatively stronger, indicating that spending on asset renewal is keeping ahead of the pace of asset consumption.							

Source: VAGO.

Figure E5
Yarra Valley Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	2.2	2.0	2.4	2.2	2.5	2.2	2.4
Internal financing ratio	26.1%	37.3%	65.0%	38.6%	59.4%	45.3%	60.5%
Current ratio	0.5	0.5	0.5	0.6	0.5	0.5	0.6
EBITDA margin	32.9%	27.5%	31.0%	29.8%	31.3%	30.5%	39.7%
Net result	6.1%	4.6%	5.4%	5.6%	5.9%	5.5%	6.9%
Long-term financial sustainability indicators							
Gearing ratio	45.5%	45.0%	46.1%	47.8%	47.8%	46.5%	46.4%
Return on assets	4.5%	4.5%	4.5%	4.6%	4.6%	4.5%	5.5%
Return on equity	3.4%	3.1%	3.3%	3.7%	3.7%	3.4%	4.1%
Capital replacement ratio	2.9	2.3	2.0	2.6	2.4	2.4	2.1
Gross debt to revenue	2.4	2.0	2.2	2.1	2.3	2.2	2.6
Net debt to revenue	2.4	2.0	2.2	2.1	2.3	2.2	2.6
Summary							
The weak current ratio across the cohort is driven by financial and debt management strategies, rather than being an indicator of immediate liquidity concerns. Despite the cash interest cover and internal financing ratio being less than the cohort average, results still indicate that the entity is generating sufficient operating cash to fund required capital spend and to service debt. The entity has experienced lower profitability results for ROA, ROE, EBITDA margin and net result relative to the cohort average, however all results still remain positive. Surpluses are being consistently generated. Other longer-term indicators present results largely consistent with the cohort averages. This includes a strong capital replacement ratio indicating that spending on asset renewal is keeping ahead of the pace of asset consumption, and debt to revenue ratios showing the entity requires, on average, just over two years' worth of revenue generated to pay off debt.							

Source: VAGO.

Regional urban cohort

Figure E6
Barwon Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	3.0	3.1	3.2	3.4	2.4	3.0	7.3
Internal financing ratio	36.9%	68.7%	118.8%	102.8%	60.3%	77.5%	96.3%
Current ratio	0.6	0.6	0.9	0.9	1.0	0.8	1.1
EBITDA margin	58.2%	56.0%	58.8%	60.6%	55.4%	57.8%	43.0%
Net result	9.7%	4.1%	5.9%	8.1%	1.8%	5.9%	1.7%
Long-term financial sustainability indicators							
Gearing ratio	24.1%	24.7%	25.2%	21.7%	22.5%	23.6%	14.0%
Return on assets	2.8%	2.2%	2.4%	2.6%	1.6%	2.3%	1.2%
Return on equity	1.4%	0.6%	0.8%	1.1%	0.2%	0.8%	0.4%
Capital replacement ratio	2.9	1.7	1.0	1.2	1.1	1.6	1.2
Gross debt to revenue	2.7	2.9	2.8	2.7	2.9	2.8	1.6
Net debt to revenue	2.6	2.8	2.7	2.5	2.8	2.7	1.5
Summary							
Shorter-term indicators of cash interest cover, internal financing and current ratio have recorded positive results, however fall below the five-year average for the cohort. The entity has also experienced positive profitability results for ROA, ROE, EBITDA margin and net result, relative to the cohort average. Other longer-term indicators present mixed results against the cohort. Debt to revenue ratios are comparatively lower, meaning the entity requires on average, almost three years' worth of its total revenue generated to pay off debt. The capital replacement ratio is comparatively stronger, however their declining result indicates spending on asset renewal in the future may not keep pace with asset consumption.							

Source: VAGO.

Figure E7
Central Highland Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	2.2	2.9	3.1	3.2	3.8	3.0	7.3
Internal financing ratio	77.0%	164.0%	140.7%	167.6%	130.5%	136.0%	96.3%
Current ratio	1.1	0.8	0.9	1.2	1.0	1.0	1.1
EBITDA margin	44.4%	45.5%	47.9%	46.7%	45.0%	45.9%	43.0%
Net result	4.3%	7.7%	10.4%	10.1%	8.3%	8.2%	1.7%
Long-term financial sustainability indicators							
Gearing ratio	18.9%	17.9%	16.9%	12.7%	12.1%	15.7%	14.0%
Return on assets	1.9%	2.4%	2.7%	2.3%	1.8%	2.2%	1.2%
Return on equity	0.5%	1.0%	1.3%	1.2%	0.9%	1.0%	0.4%
Capital replacement ratio	0.9	0.8	0.9	0.8	0.9	0.9	1.2
Gross debt to revenue	2.0	1.8	1.7	1.5	1.5	1.7	1.6
Net debt to revenue	1.9	1.7	1.6	1.5	1.4	1.6	1.5
Summary							
Shorter-term indicators of cash interest cover, internal financing and current ratio have recorded positive results, however both the cash interest cover and current ratio fall below the five-year average for the cohort. The entity has also experienced positive profitability results for ROA, ROE, EBITDA margin and net result, relative to the cohort average. Other longer-term indicators present mixed results against the cohort. Debt to revenue ratios are consistent with the cohort average, however the capital replacement ratio is comparatively lower, with a result of less than one, indicating that spending on asset renewal is currently not keeping pace with asset consumption.							

Source: VAGO.

Figure E8
Coliban Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	1.1	1.7	1.8	2.0	2.3	1.8	7.3
Internal financing ratio	7.3%	49.7%	85.3%	62.3%	133.6%	67.6%	96.3%
Current ratio	1.4	1.4	1.8	1.3	1.3	1.4	1.1
EBITDA margin	43.5%	50.6%	54.5%	51.5%	52.2%	50.5%	43.0%
Net result	-15.3%	-4.1%	3.9%	3.0%	4.0%	-1.7%	1.7%
Long-term financial sustainability indicators							
Gearing ratio	32.2%	33.3%	33.9%	28.4%	27.9%	31.1%	14.0%
Return on assets	0.6%	1.9%	2.7%	2.4%	2.3%	2.0%	1.2%
Return on equity	-1.8%	-0.6%	0.6%	0.4%	0.5%	-0.2%	0.4%
Capital replacement ratio	1.0	1.2	0.9	1.5	1.0	1.1	1.2
Gross debt to revenue	4.4	3.9	3.6	3.5	3.5	3.8	1.6
Net debt to revenue	4.3	3.9	3.6	3.5	3.4	3.7	1.5
Summary							
Shorter-term indicators of cash interest cover, internal financing and current ratio have recorded positive results, however both the cash interest cover and internal financing ratio fall below the five-year average for the cohort. The entity has also experienced positive profitability results for ROA and EBITDA margin, relative to the cohort average. This is in contrast to the net result and ROE indicators which fall below the cohort average. However, we note the improved net result and ROE indicators over the last three years, indicating improved financial performance. Other longer-term indicators show weaker results against the cohort. Debt to revenue ratios are comparatively lower, meaning the entity requires on average, more than three years' worth of its total revenue generated to pay off debt. The capital replacement ratio is only slightly weaker than the cohort average, however the five-year average of approximately one indicates that spending on asset renewal is just keeping pace with asset consumption.							

Source: VAGO.

Figure E9
East Gippsland Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	7.3	7.8	11.1	11.8	16.2	10.8	7.3
Internal financing ratio	176.0%	121.4%	150.5%	154.3%	126.5%	145.7%	96.3%
Current ratio	0.7	1.0	1.3	1.7	0.9	1.1	1.1
EBITDA margin	48.2%	47.0%	47.4%	39.7%	41.9%	44.8%	43.0%
Net result	8.6%	8.5%	9.0%	4.3%	3.5%	6.8%	1.7%
Long-term financial sustainability indicators							
Gearing ratio	8.7%	7.6%	5.9%	3.9%	3.2%	5.9%	14.0%
Return on assets	1.7%	1.7%	1.7%	0.8%	0.6%	1.3%	1.2%
Return on equity	1.1%	1.1%	1.2%	0.4%	0.3%	0.8%	0.4%
Capital replacement ratio	0.7	1.0	1.0	0.7	1.0	0.9	1.2
Gross debt to revenue	0.9	0.8	0.6	0.6	0.4	0.7	1.6
Net debt to revenue	0.8	0.7	0.5	0.4	0.3	0.5	1.5
Summary							
Shorter-term indicators of cash interest cover, internal financing and current ratio have recorded positive results. However, the current ratio is relatively lower in 2016–17 compared to the entity's historical performance. The entity has also experienced positive profitability results for EBITDA margin and net result, relative to the cohort average. Longer-term indicators present mixed results against the cohort. Debt to revenue ratios across the five-year period are relatively stronger against the average cohort results, where the entity on average will only require less than one year worth of its total revenue generated to pay down its debt. In contrast, the capital replacement ratio is comparatively lower, with the entity's average results falling below 1.0 and further behind the average cohort, indicating that spending on asset renewal is not keeping pace with asset consumption.							

Source: VAGO.

Figure E10
Gippsland Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	2.3	3.9	3.2	4.2	3.3	3.4	7.3
Internal financing ratio	29.7%	76.7%	56.7%	93.0%	110.0%	73.2%	96.3%
Current ratio	0.5	0.4	0.4	0.4	0.5	0.4	1.1
EBITDA margin	36.4%	39.5%	40.0%	44.4%	41.2%	40.3%	43.0%
Net result	2.4%	2.5%	0.3%	6.4%	1.5%	2.6%	1.7%
Long-term financial sustainability indicators							
Gearing ratio	21.2%	21.7%	23.6%	23.1%	23.1%	22.5%	14.0%
Return on assets	1.6%	1.7%	1.5%	2.2%	1.4%	1.7%	1.2%
Return on equity	0.4%	0.5%	0.1%	1.2%	0.3%	0.5%	0.4%
Capital replacement ratio	2.0	1.8	1.7	1.4	0.8	1.6	1.2
Gross debt to revenue	1.9	1.9	2.2	2.0	2.1	2.0	1.6
Net debt to revenue	1.8	1.9	2.1	1.9	2.0	1.9	1.5
Summary							
Shorter-term indicators of cash interest cover and internal financing have recorded positive results, however both fall below the five-year average for the cohort. Whilst the entity has experienced positive profitability results for EBITDA margin and net result, relatively consistent to the cohort average, the current ratio across the five-year period remains consistently below the five-year average for the cohort. Longer-term indicators present mixed results against the cohort. Debt to revenue ratios across the five year period are relatively weaker against the average cohort results, where the entity on average will only require about two years' worth of its total revenue generated to pay down its debt. In contrast, the capital replacement ratio is comparatively higher, with the entity's average results indicating that spending on asset renewal is keeping ahead of the pace of asset consumption.							

Source: VAGO.

Figure E11
Goulburn Valley Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	4.3	4.8	6.2	5.8	5.7	5.4	7.3
Internal financing ratio	105.8%	113.2%	97.4%	108.1%	77.8%	100.5%	96.3%
Current ratio	1.3	0.9	0.9	1.5	1.0	1.1	1.1
EBITDA margin	43.8%	43.7%	46.0%	43.4%	39.5%	43.3%	43.0%
Net result	2.4%	2.3%	7.7%	4.5%	3.8%	4.1%	1.7%
Long-term financial sustainability indicators							
Gearing ratio	12.8%	11.5%	11.7%	10.5%	11.1%	11.5%	14.0%
Return on assets	1.1%	1.1%	1.6%	1.3%	1.1%	1.2%	1.2%
Return on equity	0.3%	0.3%	1.0%	0.6%	0.5%	0.5%	0.4%
Capital replacement ratio	0.8	0.8	1.3	1.0	1.4	1.1	1.2
Gross debt to revenue	1.4	1.2	1.2	1.1	1.2	1.2	1.6
Net debt to revenue	1.2	1.2	1.1	1.1	1.2	1.1	1.5
Summary							
The entity's short term indicators are broadly consistent with the cohort average, with slightly more positive profitability results for EBITDA margin and net result, relative to the cohort average. Shorter-term indicators of cash interest cover, internal financing and current ratio have also recorded positive results, where only cash interest cover fall below the five-year average for the cohort. Longer-term indicators present results that are fairly consistent with the cohort. Debt to revenue ratios have remained around the five-year average, which is slightly stronger than the cohort average. The capital replacement ratio has historically fluctuated over the five-year period with the average result just below the cohort result. This indicates that spending on asset renewal is just keeping pace with asset consumption.							

Source: VAGO.

Figure E12
GWMWater

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	2.2	2.8	3.4	3.9	3.2	3.1	7.3
Internal financing ratio	51.4%	63.8%	127.0%	120.2%	92.8%	91.0%	96.3%
Current ratio	1.0	0.6	1.1	1.2	1.7	1.1	1.1
EBITDA margin	38.1%	42.9%	49.5%	50.0%	44.6%	45.0%	43.0%
Net result	-42.6%	-16.9%	-9.8%	10.0%	-16.0%	-15.0%	1.7%
Long-term financial sustainability indicators							
Gearing ratio	7.2%	7.3%	7.3%	6.6%	6.4%	7.0%	14.0%
Return on assets	-1.3%	-0.3%	0.0%	0.1%	-0.3%	-0.4%	1.2%
Return on equity	-1.5%	-0.7%	-0.4%	0.4%	-0.6%	-0.6%	0.4%
Capital replacement ratio	0.4	0.8	0.5	0.7	0.6	0.6	1.2
Gross debt to revenue	2.4	2.2	2.1	1.9	2.0	2.1	1.6
Net debt to revenue	2.3	2.2	2.0	1.9	1.9	2.1	1.5
Summary							
Shorter-term indicators of cash interest cover, internal financing and current ratio have recorded positive results, however both cash interest cover and internal financing fall below the five-year average for the cohort. Although the entity has experienced negative profitability results to ROA, ROE and net result over the five-year period, EBITDA margin has remained positive and above the cohort average indicating the entity's ability to continue to meet short term financial obligations. Other longer-term indicators highlight a relatively weaker result against the cohort, where the debt to revenue ratios indicate the entity requires on average, two years' worth of its total revenue generated to pay off debt. The capital replacement ratio is generating results below 1.0 indicating that spending on asset renewal is not keeping pace with asset consumption.							

Source: VAGO.

Figure E13
Lower Murray Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	6.7	6.9	7.3	8.8	4.8	6.9	7.3
Internal financing ratio	87.7%	99.5%	41.0%	32.2%	55.4%	63.1%	96.3%
Current ratio	1.7	2.8	2.8	2.0	1.7	2.2	1.1
EBITDA margin	35.0%	38.1%	30.0%	27.0%	26.2%	31.3%	43.0%
Net result	-4.7%	-4.0%	-8.7%	-12.4%	-12.7%	-8.5%	1.7%
Long-term financial sustainability indicators							
Gearing ratio	7.7%	8.0%	6.9%	5.7%	5.6%	6.8%	14.0%
Return on assets	-0.1%	0.0%	-0.7%	-1.1%	-1.0%	-0.6%	1.2%
Return on equity	-0.5%	-0.4%	-0.9%	-1.2%	-1.1%	-0.8%	0.4%
Capital replacement ratio	0.9	0.9	1.7	2.4	0.8	1.3	1.2
Gross debt to revenue	1.0	1.0	0.9	0.8	0.8	0.9	1.6
Net debt to revenue	0.9	0.4	0.1	0.5	0.6	0.5	1.5
Summary							
Shorter-term indicators of cash interest cover, internal financing and current ratio have recorded positive results, however both cash interest cover and internal financing fall below the five-year average for the cohort. Although the entity has experienced negative profitability results to ROA, ROE and net result over the five-year period, the EBITDA margin has remained positive, indicating the entity's ability to continue to meet short-term obligations. Longer-term indicators present mixed results against the cohort. Debt to revenue ratios are comparatively stronger against the cohort, indicating the entity requires on average, less than one year worth of its total revenue generated to pay off debt. The capital replacement ratio peaked in 2015-16, however the current year results have returned to the similar levels at the beginning of the five-year period, with a result below 1.0 indicating that spending on asset renewal may not be keeping pace with asset consumption.							

Source: VAGO.

Figure E14
North East Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	16.3	13.6	14.0	18.7	16.8	15.9	7.3
Internal financing ratio	55.6%	82.8%	161.6%	150.0%	135.3%	117.0%	96.3%
Current ratio	1.0	0.6	1.2	1.6	1.9	1.3	1.1
EBITDA margin	45.6%	43.5%	39.8%	42.0%	33.1%	40.8%	43.0%
Net result	8.7%	6.1%	2.9%	6.7%	-1.8%	4.5%	1.7%
Long-term financial sustainability indicators							
Gearing ratio	5.5%	6.2%	4.8%	3.7%	3.2%	4.7%	14.0%
Return on assets	1.3%	1.0%	0.6%	1.0%	0.0%	0.8%	1.2%
Return on equity	1.2%	0.7%	0.3%	0.8%	-0.2%	0.5%	0.4%
Capital replacement ratio	2.0	1.4	0.7	0.8	0.6	1.1	1.2
Gross debt to revenue	0.6	0.7	0.6	0.4	0.4	0.5	1.6
Net debt to revenue	0.6	0.7	0.6	0.4	0.3	0.5	1.5
Summary							
Shorter-term indicators of cash interest cover, internal financing and current ratio have recorded results above the five-year average for the cohort. Despite the negative net result and ROE in 2016-17, the entity's five-year average profitability results remain positive. Longer-term indicators present mixed results against the cohort. Debt to revenue ratios across the five-year period are relatively stronger against the average cohort results, where the entity on average will require less than one year worth of its total revenue generated to pay down its debt. In contrast, the capital replacement ratio is comparatively weaker, with the entity's results declining to below 1.0 from 2014–15 and falling behind the cohort average. This indicates that spending on asset renewal may not be keeping pace with asset consumption.							

Source: VAGO.

Figure E15
South Gippsland Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	3.6	4.6	3.9	2.8	3.9	3.8	7.3
Internal financing ratio	74.6%	68.6%	38.4%	71.9%	81.5%	67.0%	96.3%
Current ratio	1.0	0.6	1.1	1.3	1.2	1.1	1.1
EBITDA margin	40.5%	41.1%	42.5%	35.4%	31.0%	38.1%	43.0%
Net result	-1.0%	-0.9%	1.5%	-3.1%	-14.3%	-3.6%	1.7%
Long-term financial sustainability indicators							
Gearing ratio	12.8%	12.5%	15.8%	13.3%	12.7%	13.4%	14.0%
Return on assets	0.6%	0.6%	0.9%	0.3%	-0.6%	0.4%	1.2%
Return on equity	-0.1%	-0.1%	0.2%	-0.4%	-1.4%	-0.4%	0.4%
Capital replacement ratio	1.0	1.3	2.0	0.9	0.9	1.2	1.2
Gross debt to revenue	1.4	1.5	1.9	1.9	1.9	1.7	1.6
Net debt to revenue	1.2	1.4	1.7	1.8	1.7	1.6	1.5
Summary							
Shorter-term indicators of cash interest cover, internal financing and current ratio have recorded positive results, however both cash interest cover and internal financing fall below the five-year average for the cohort. The entity's five-year average profitability results for EBITDA and ROA remain positive, showing the entity has the ability to continue to meet short-term needs, despite generating a negative five-year average net result. Longer-term indicator results are relatively consistent with the cohort. Debt to revenue ratios across the five-year period are slightly weaker than the average cohort, where the entity, on average, will require just over 1.5 years' worth of its total revenue generated to pay down its debt. Whilst the capital replacement ratio is equal to the cohort, results falling below 1.0 over the last two years indicate that spending on asset renewal may not be keeping pace with asset consumption.							

Source: VAGO.

Figure E16
Wannon Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	6.5	6.7	8.2	10.6	10.4	8.5	7.3
Internal financing ratio	113.0%	130.5%	177.0%	202.7%	113.4%	147.3%	96.3%
Current ratio	1.1	1.0	1.2	1.3	1.0	1.1	1.1
EBITDA margin	48.1%	42.3%	41.5%	43.6%	36.9%	42.5%	43.0%
Net result	8.6%	2.0%	6.9%	7.1%	2.9%	5.5%	1.7%
Long-term financial sustainability indicators							
Gearing ratio	14.8%	13.3%	11.5%	7.0%	5.8%	10.5%	14.0%
Return on assets	2.3%	1.2%	1.5%	1.7%	0.7%	1.5%	1.2%
Return on equity	1.4%	0.3%	1.1%	1.0%	0.4%	0.8%	0.4%
Capital replacement ratio	1.0	0.8	0.7	0.8	1.0	0.9	1.2
Gross debt to revenue	1.2	1.1	0.9	0.7	0.6	0.9	1.6
Net debt to revenue	1.1	1.1	0.9	0.6	0.6	0.8	1.5
Summary							
Shorter-term indicators of cash interest cover, internal financing and current ratio have recorded better or equal results relative to the five-year average for the cohort. Positive average profitability results for ROA, ROE, EBITDA margin and net result, relative to the cohort average are also evident. Other longer-term indicators present mixed results against the cohort. Debt to revenue ratios across the five-year period are relatively stronger against the average cohort results, where the entity on average, requires less than one year worth of its total revenue generated to pay down debt. In contrast, the capital replacement ratio is comparatively lower, with the entity's average results falling below 1.0 indicating that spending on asset renewal may not be keeping pace with asset consumption.							

Source: VAGO.

Figure E17
Western Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	1.5	2.2	2.9	2.8	2.8	2.4	7.3
Internal financing ratio	20.5%	61.2%	118.0%	59.1%	27.5%	57.3%	96.3%
Current ratio	0.7	0.5	1.1	1.1	0.5	0.8	1.1
EBITDA margin	36.5%	38.4%	49.6%	47.3%	48.1%	44.0%	43.0%
Net result	3.5%	1.4%	10.0%	12.7%	10.4%	7.6%	1.7%
Long-term financial sustainability indicators							
Gearing ratio	24.3%	24.6%	25.1%	22.3%	24.6%	24.2%	14.0%
Return on assets	2.1%	1.8%	3.1%	3.8%	3.2%	2.8%	1.2%
Return on equity	0.7%	0.3%	1.9%	2.7%	2.1%	1.5%	0.4%
Capital replacement ratio	1.7	1.1	0.9	1.7	2.6	1.6	1.2
Gross debt to revenue	2.1	2.3	2.2	1.8	2.1	2.1	1.6
Net debt to revenue	1.9	2.1	2.0	1.7	2.1	2.0	1.5
Summary							
Shorter-term indicators of cash interest cover and internal financing have recorded positive results, however fall below the five-year average for the cohort. The current ratio is relatively lower in 2016–17 compared to the entity's historical performance. The entity has experienced positive profitability results for ROA, ROE, EBITDA margin and net result, relative to the cohort average. Other longer-term indicators present mixed results against the cohort. Debt to revenue ratios are comparatively weaker, meaning the entity requires on average, at least two years' worth of its total revenue generated to pay off debt. The capital replacement ratio has improved in recent years after a drop in 2014–15 to return results comparatively higher than the cohort average.							

Source: VAGO.

Figure E18
Westernport Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	61.2	10.0	16.9	21.0	23.0	26.4	7.3
Internal financing ratio	78.2%	47.6%	127.1%	139.0%	153.9%	109.2%	96.3%
Current ratio	0.3	0.8	0.9	1.1	1.2	0.9	1.1
EBITDA margin	31.0%	36.0%	40.0%	30.0%	35.0%	34.4%	43.0%
Net result	4.0%	5.1%	9.6%	3.1%	4.2%	5.2%	1.7%
Long-term financial sustainability indicators							
Gearing ratio	3.6%	6.6%	5.5%	4.3%	3.9%	4.8%	14.0%
Return on assets	0.8%	1.1%	1.5%	0.1%	0.6%	0.8%	1.2%
Return on equity	0.6%	0.7%	1.4%	0.4%	0.6%	0.7%	0.4%
Capital replacement ratio	1.7	1.7	0.9	0.8	0.7	1.2	1.2
Gross debt to revenue	0.3	0.6	0.5	0.4	0.4	0.4	1.6
Net debt to revenue	0.3	0.5	0.4	0.3	0.2	0.4	1.5
Summary							
Shorter-term indicators of cash interest cover and internal financing have produced strong results relative to the five-year average for the cohort. The entity's current ratio position has improved across the five-year period, where 2016–17 is above the cohort's average. Positive profitability results for ROA, ROE, EBITDA margin and net result have occurred, even though three of the four indicators fall below the cohort average. Longer-term indicators present a mixed result against the cohort. Despite lower gearing against the cohort average, the result continues to be favourable given the entity's large asset base and low debt levels. Debt to revenue ratios are relatively stronger compared to the cohort average, where the entity requires on average, less than one year worth of its total revenue generated to pay off debt. The entity's capital replacement ratio is on par with the cohort average, however their declining result indicates spending on asset renewal in the future may not keep pace with asset consumption.						

Source: VAGO.

Rural cohort

Figure E19
Goulburn Murray Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	0.0	22.4	12.9	2.4	23.9	12.3	17.1
Internal financing ratio	-6.0%	157.0%	89.2%	5.3%	115.2%	72.1%	61.2%
Current ratio	2.9	5.1	3.8	2.3	5.5	3.9	2.6
EBITDA margin	13.0%	10.0%	23.7%	23.4%	9.0%	15.8%	18.4%
Net result	-13.8%	-16.7%	-5.1%	-4.1%	-27.6%	-13.4%	-13.0%
Long-term financial sustainability indicators							
Gearing ratio	3.0%	3.0%	2.7%	2.2%	2.1%	2.6%	2.1%
Return on assets	-1.0%	-1.0%	-0.3%	-0.2%	-1.7%	-0.8%	-0.6%
Return on equity	-1.0%	-1.0%	-0.3%	-0.3%	-1.4%	-0.8%	-0.6%
Capital replacement ratio	1.3	1.1	1.2	1.9	1.1	1.3	1.3
Gross debt to revenue	0.5	0.6	0.5	0.4	0.5	0.5	0.6
Net debt to revenue	0.3	-0.2	-0.2	0.0	-0.8	-0.2	0.1
Summary							
Whilst the cash interest cover and current ratio present mixed results against the cohort average, both show positive results indicating no risks. The entity's internal financing ratio has experienced significant fluctuations over the last five years, however the average result indicates that cash generated from operations is sufficient to meet asset funding requirements. These results are impacted by the timing and receipt of government funding for the Connections Project. Profitability results for ROA, ROE, EBITDA margin and net result are largely consistent with the cohort averages. Whilst results fluctuate year to year, the net result indicator has remained negative, driven by depreciation levels. This is evident from the significant disparity between EBITDA margin and net result. This is explained further in Part 4 of our report. Other longer-term indicators present results in line with the cohort average. Gearing and debt to revenue ratios indicate no risks with the entity's long-term ability to repay debt. However, capital replacement results close to one represent that spending on asset renewal in the future may not keep pace with asset consumption.							

Source: VAGO.

Figure E20
Southern Rural Water

Indicator	2012–13	2013–14	2014–15	2015–16	2016–17	Five-year average	
						Entity	Cohort
Short-term financial sustainability indicators							
Cash interest cover	60.5	10.2	16.5	11.4	10.9	21.9	17.1
Internal financing ratio	59.2%	42.3%	67.3%	45.5%	37.1%	50.3%	61.2%
Current ratio	1.8	1.0	1.4	1.1	0.9	1.2	2.6
EBITDA margin	25.6%	24.5%	23.2%	20.5%	10.8%	20.9%	18.4%
Net result	-8.1%	-10.5%	-9.2%	-11.9%	-22.9%	-12.5%	-13.0%
Long-term financial sustainability indicators							
Gearing ratio	1.7%	1.4%	1.3%	1.5%	1.8%	1.5%	2.1%
Return on assets	-0.3%	-0.3%	-0.3%	-0.4%	-0.9%	-0.5%	-0.6%
Return on equity	-0.3%	-0.3%	-0.3%	-0.4%	-0.8%	-0.4%	-0.6%
Capital replacement ratio	1.2	1.5	1.1	1.1	1.3	1.3	1.3
Gross debt to revenue	0.7	0.6	0.5	0.6	0.6	0.6	0.6
Net debt to revenue	0.2	0.4	0.3	0.3	0.4	0.3	0.1

Summary

Whilst the cash interest cover and current ratio present mixed results against the cohort average, both show positive results indicating no risk.

Despite being below the cohort average, results of the internal financing ratio over the last five years has consistently shown that cash generated from operations is sufficient to meet asset funding requirements. These results are impacted by the timing and receipt of government funding for modernisation projects.

Profitability results for ROA, ROE, EBITDA margin and net result are largely consistent with the cohort averages. Whilst results fluctuate year to year, the net result indicator has remained negative, driven by depreciation levels. This is evident from the significant disparity between the EBITDA margin and net result. This is explained further in Part 4 of our report.

Other longer-term indicators present results in line with the cohort average. Gearing and debt to revenue ratios indicate no risks with the entity's long-term ability to repay debt. However, capital replacement results close to one represent that spending on asset renewal in the future may not keep pace with asset consumption.

Source: VAGO.

Appendix F
Financial and performance reporting framework

Financial reporting better practice elements

Our assessment of financial reporting performance against better practice was based on elements outlined in Figure F1.

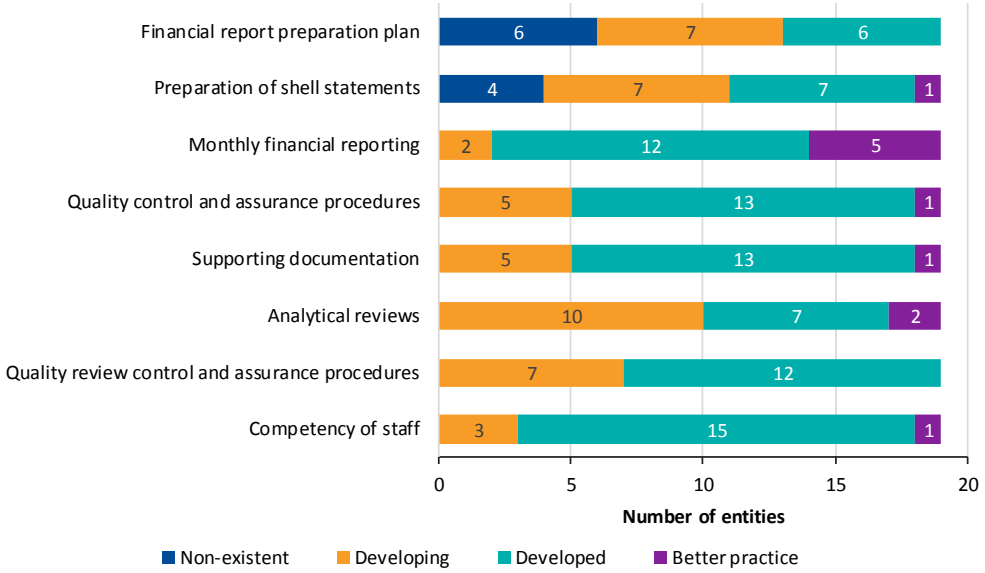
Figure F1
Better practice elements to financial report preparation

Key area	Better practice
Financial report preparation plan	Develop a 'financial report preparation plan' incorporating: • a materiality determination from both a qualitative and quantitative perspective when preparing their financial statements • their approach to streamlining the financial statements • materiality and the plan were reported to relevant stakeholders such as boards, audit committees and audit for consideration.
Preparation of proforma statements	Provide quality proforma statements to audit within agreed timeframes.
Monthly financial reporting	Prepare full accrual monthly financial reports.
Quality control and assurance procedures	Require rigorous quality control and assurance procedures surrounding the compilation, preparation and presentation of their financial statements.
Supporting documentation	Prepare high quality documentation supporting and validating balances in the financial statements.
Analytical reviews	Undertake rigorous analytical review procedures during the financial report preparation process to help with the accuracy and completeness of disclosures.
Quality review control and assurance procedures	Establish sufficiently robust quality review control and assurance processes that provide assurance over the accuracy and completeness of the financial report.
Competency of staff	Require sufficient number of qualified staff, with relevant knowledge and competencies, to assist in the preparation of quality financial statements.

Source: VAGO and Australian National Audit Office, Better Practice Guide: Preparation of Financial Statements by Public Sector Entities.

Figure F2 shows a detailed breakdown of the sector results.

Figure F2
Water sector results of 2016–17 financial report processes assessed against better practice elements



Source: VAGO.

Performance reporting framework

Financial indicators

Figure F3
Financial indicators

Indicator		Metropolitan wholesaler	Metropolitan retailer	Regional urban	Rural
F1	**Cash interest cover** Net operating cash flows before net interest and tax / net interest payments	✓	✓	✓	✓
F2	**Gearing ratio** Total debt (including finance leases) / total assets × 100	✓	✓	✓	✓
F3	**Internal financing ratio** Net operating cash flow less dividends / net capital expenditure × 100	✓	✓	✓	✓

Indicator		Metropolitan wholesaler	Metropolitan retailer	Regional urban	Rural
F4	**Current ratio** Current assets / current liabilities (excluding long-term employee provisions and revenue in advance)	✓	✓	✓	✓
F5	**Return on assets** Earnings before net interest and tax / average assets × 100	✓	✓	✓	✓
F6	**Return on equity** Net profit after tax / average total equity × 100	✓	✓	✓	✓
F7	**EBITDA margin** Earnings before interest, tax, depreciation and amortisation / total revenue × 100	✓	✓	✓	✓
	Total	**7**	**7**	**7**	**7**

Note: ✓ Performance indicator included in the performance report.

Source: VAGO.

Non-financial indicators

Figure F4
Non-financial indicators

Indicator		Metropolitan wholesaler	Metropolitan retailer	Regional urban	Rural
WS1	**Unplanned water supply interruptions** No. of customers receiving (x) unplanned interruptions in the year / total number of water (domestic and non-domestic) customers × 100		✓	✓	
WS2	**Interruption time** Average duration of unplanned water supply interruptions		✓	✓	
WS3	**Restoration of unplanned water supply** Unplanned water supply interruptions restored within (x) hours / total unplanned water supply interruptions × 100		✓	✓	

Indicator		Metropolitan wholesaler	Metropolitan retailer	Regional urban	Rural
WSR1	**Rural water supply deliveries** Number of orders delivered / total number of orders × 100				✓
WSR2	**Unavailability of Domestic and Stock supply** Duration that domestic and stock service is unavailable in excess of on-property storage requirement / length of water season × 100				✓
WSR3	**Groundwater supply** Number of transfers processed within target period / total number of transfers processed × 100				✓
SS1	**Containment of sewer spills** Sewer spills from reticulation and branch sewers contained within (x) hours / total sewer spills from reticulation and branch sewers × 100		✓	✓	
SS2	**Sewer spills interruptions** No. of residential sewerage customers affected by sewerage interruptions restored within (x) hours		✓	✓	
WQ1	**Water quality** Compliance with BWSA: Microbiological Standards —E. coli	✓			
WQ2	**Water quality** Compliance with BWSA: Aesthetics—Turbidity	✓			
CRM1	**Customer responsiveness** Complaints referred to EWOV responded to within EWOV established time	✓			
EM1	**Non-compliance with EPA Victoria Corporate License and SEPP parameters—Sewerage system failure** Zero spills due to sewerage system failure	✓			

Indicator		Metropolitan wholesaler	Metropolitan retailer	Regional urban	Rural
EM2.1	**Compliance with EPA Victoria discharge licence requirements—Western Treatment Plant**	✓			
EM2.2	**Compliance with EPA Victoria discharge licence requirements—Eastern Treatment Plant**	✓			
WW1	**Waterways—drainage and flood protection** 15% reduction in flood effects achieved by projects in delivery by Melbourne Water	✓			
WW2	**Waterways condition** Achievement of Water Plan implementation targets set out in the Healthy Waterways Strategy	✓			
RW1.1	**Recycled water—WTP recycled water schemes—volume demands** WTP recycled water schemes fully compliant with regulatory obligations and their contractual requirements, as outlined in the relevant BRWSAs	✓			
RW1.2	**Recycled water—WTP recycled water schemes—reliability** Refer RW1.1	✓			
RW1.3	**Recycled water—WTP recycled water schemes—quality** Refer RW1.1	✓			
RW2.1	**Recycled water—ETP recycled water schemes—volume demands** ETP recycled water schemes fully compliant with regulatory obligations and their contractual requirements, as outlined in the relevant BRWSAs	✓			

Indicator		Metropolitan wholesaler	Metropolitan retailer	Regional urban	Rural
RW2.2	**Recycled water—ETP recycled water schemes—reliability** Refer RW2.1	✓			
RW2.3	**Recycled water—ETP recycled water schemes—quality** Refer RW2.1	✓			
	Total water and sewerage services	**14**	**5**	**5**	**3**

Note: ✓—Performance indicator included in the performance report.

Note:
BWSA—Bulk Water Supply Agreement
BRWSA—Bulk Recycled Water Service Agreement
EPA—Environment Protection Authority
ETP—Eastern Treatment Plant
EWOV—Energy and Water Ombudsman of Victoria
SEPP—State Environment Protection Policy
WTP—Western Treatment Plant.

Source: VAGO.

Figure F5
Non-financial indicator—Customer responsiveness

Indicator		Metropolitan wholesaler	Metropolitan retailer	Regional urban	Rural
CR1	**Water quality complaints** No. of complaints per 100 customers for colour, turbidity, taste and odour and other		✓	✓	
CR2	**Sewerage service quality complaints** No. of complaints per 100 customers		✓	✓	
CR3	**Sewage odour complaints** No. of complaints per 100 customers		✓	✓	
CR4	**Billing complaints** No. of complaints per 100 customers		✓	✓	✓
	Total customer responsiveness	**0**	**4**	**4**	**1**

Note: ✓ Performance indicator included in the performance report.

Source: VAGO.

Figure F6
Non-financial indicator—Environmental

Indicator		Metropolitan wholesaler	Metropolitan retailer	Regional urban	Rural
E1	**Effluent re-use volume (end use)** Percentage recycled for each category urban and industrial, agricultural, environmental flows and other uses.		✓	✓	
E2	**Total net CO_2 emissions** Net tonnes CO_2 equivalent		✓	✓	✓
	Total environmental	**0**	**2**	**2**	**1**

Note: ✓ Performance indicator included in the performance report.

Source: VAGO.

Appendix G
Glossary

Accountability

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

Amortisation

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

Asset

An item or resource controlled by an entity that will be used to generate future economic benefits.

Asset valuation

The fair value of a non-current asset on a specified date.

Audit Act 1994

Victorian legislation establishing the Auditor-General's operating powers and responsibilities and detailing the nature and scope of audits that the Auditor-General may carry out.

Audit committee

Helps a governing board to fulfil its governance and oversight responsibilities and strengthen accountability of senior management.

Audit opinion

A written expression, within a specified framework, indicating the auditor's overall conclusion about a financial (or performance) report based on audit evidence.

Capital expenditure

Money an entity spends on:

- new physical assets, including property, infrastructure, plant and equipment
- renewing existing physical assets to extend their service potential or life.

Carrying value

The original cost of an asset, less the accumulated amount of any depreciation or amortisation, less the accumulated amount of any asset impairment.

Catchment management authority

A body established under the *Catchment and Land Protection Act 1994* that has management powers over regional waterways, floodplains, drainage and other water to maintain the health of rivers and wetlands.

Change management

IT change management involves the policies and processes to ensure that changes to an IT environment are appropriate and preserve the integrity of underlying programs and data.

Clear audit opinion—financial report

A positive written expression provided when the financial report has been prepared and presents fairly the transactions and balances for the reporting period in keeping with the requirements of the relevant legislation and Australian Accounting Standards—also referred to as an unqualified audit opinion.

Clear audit opinion—performance report

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

Control environment

Processes within an entity's governance and management structure that provide reasonable assurance about the achievement of an entity's objectives in reliability of financial reporting, effectiveness and efficiency of operations, and compliance with applicable laws and regulations.

Corporations Act 2001

Commonwealth legislation governing corporations, including their financial reporting framework.

Corporate Plan

A form of strategic document communicated to all stakeholders that specifies the entity's purpose, activities, strategies and performance goals over the next five years.

Current asset

An asset that will be sold or realised within 12 months of the end of the financial year being reported on, such as term deposits maturing in three months or stock items available for sale.

Current liability

A liability that will be settled within 12 months of the end of the financial year being reported on, such as payment of a creditor for services provided to the entity.

Debt

Money owed by one party to another party.

Deficit

When total expenditure is more than total revenue.

Depreciated replacement cost

Current replacement cost less accumulated depreciation to reflect the economic benefits of the assets that have been consumed.

Depreciation

Systematic allocation of the value of an asset over its expected useful life, recorded as an expense.

Domain controller

A server which supports authentication management and administering security policies within the Active Directory (AD) domain.

Entity

A corporate or unincorporated body 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 its liabilities have been deducted.

Expense

The outflow of assets or the depletion of assets an entity controls during the financial year, including expenditure and the depreciation of physical assets. An expense can also be the incurrence of liabilities during the financial year, such as increases to a provision.

Fair value

The price that would be received if an asset was sold or the price paid to transfer a liability in the course of an orderly transaction between market participants at the measurement date.

Financial accommodation levy

Applied to government-owned entities declared to be leviable authorities under the Finan*cial Management Act 1994.*

The purpose of the levy is to remove the market advantage government entities may experience in borrowing, as a result of their sovereign status, thereby ensuring that borrowings are valued appropriately in financing decisions for capital projects.

The levy can be payable where borrowings are greater than $5 million.

Financial Management Act 1994

Victorian legislation governing the financial management of public sector entities, as determined by the Minister of Finance, including their financial reporting framework.

Financial report

A document reporting the financial outcome and position of an entity for a financial year, which contains financial statements including a comprehensive income statement, a balance sheet, a cash flow statement, a comprehensive statement of equity, and notes.

Financial Reporting Directions

Issued by the Minister of Finance for entities reporting under the *Financial Management Act 1994*, with the aim of:

- achieving consistency and improved disclosure in financial reporting for Victorian public entities by eliminating or reducing divergence in accounting practices
- prescribing the accounting treatment and disclosure of financial transactions in circumstances where there are choices in accounting treatment, or where existing accounting procurements have no guidance or requirements.

Financial sustainability

An entity's ability to manage financial resources so it can meet its current and future spending commitments, while maintaining assets in the condition required to provide services.

Financial year

A period of 12 months for which a financial report is prepared, which may be a different period to the calendar year.

Governance

The control arrangements used to govern and monitor an entity's activities to achieve its strategic and operational goals.

Headworks

An engineering term for any structure at the head or diversion point of a waterway. It is used to divert water from a river into a canal or from a large canal into a smaller canal.

Impairment (loss)

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

Income

The inflow of assets or decrease of liabilities during the financial year, including receipt of cash and the reduction of a provision.

Income approach

A valuation technique that converts future amounts, such as cash flows or income and expenses, to a single current (discounted) amount. The fair value of those future amounts is measured as an indication of current market expectations.

Intangible asset

An identifiable non-financial asset, controlled by an entity, that cannot be physically seen, such as software licences or a patent.

Internal control

A method of directing, monitoring and measuring an entity's resources and processes to prevent and detect error and fraud.

Investment

Public or private sector expenditure for the development and/or use of infrastructure assets, intended to result in medium- to long-term service and/or financial benefits.

Issues

Weaknesses or other concerns in the governance structure of an entity identified during a financial audit, which are reported to them in a management letter.

Liability

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

Management letter

A letter the auditor writes to the governing body, the audit committee and the management of an entity outlining 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

Information is material if its omission, misstatement or non-disclosure has the potential to affect the economic decisions of users of the financial report, or the discharge of accountability by management or those charged with governance. The size, value and nature of the information and the circumstances of its omission or misstatement help in deciding how material it is.

Net result

The value that an entity has earned or lost over the stated period—usually a financial year—calculated by subtracting an entity's total expenses from its total revenue for that period.

Non-current asset

An asset that will be sold or realised later than 12 months after the end of the financial year being reported on, such as investments with a maturity date of two years or physical assets the entity holds for long-term use.

Non-current liability

A liability that will be settled later than 12 months after the end of the financial year being reported on, such as repayments on a five-year loan that are not due in the next 12 months.

Performance report

A statement detailing an entity's predetermined performance indicators and targets for the financial year, and the actual results achieved, along with explanations for any significant variations between the actual result and the target.

Physical asset

A non-financial asset that is a tangible item an entity controls, and that will be used by the entity for more than 12 months to generate profit or provide services, such as building, equipment or land.

Regulatory period

A statutory defined period that reflects all of the financial/operational activities that took place during that time.

Revaluation

The restatement of a value of non-current assets at a particular point in time.

Revenue

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

Risk

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

Rollover

Prior to or at maturity of a loan, the parties of the loan agreement continue to carry over the loan for another successive period of time.

Super-user

An account assigned with full access to a system and is generally used for system administration.

Auditor-General's reports tabled during 2017–18

Report title	Date tabled
V/Line Passenger Services (2017–18:1)	August 2017
Internal Audit Performance (2017–18:2)	August 2017
Effectively Planning for Population Growth (2017–18:3)	August 2017
Victorian Public Hospital Operating Theatre Efficiency (2017–18:4)	October 2017
Auditor-General's Report on the Annual Financial Report of the State of Victoria, 2016–17 (2017–18:5)	November 2017

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