THE LEGISLATIVE ASSEMBLY FOR THE AUSTRALIAN CAPITAL TERRITORY

GOVERNMENT SUBMISSION TO THE STANDING COMMITTEE ON PUBLIC ACCOUNTS

IN RESPONSE TO THE AUDITOR-GENERAL'S REPORT NO. 10 OF 2004 "2003-04 FINANCIAL AUDITS"

INTRODUCTION

On 7 December 2004 the Auditor-General's report No. 10 of 2004 – '2003-04 Financial Audits' (the 2003-04 Audited Whole of Government Financial Statements) was presented to the Legislative Assembly.

The Auditor-General's report represents a departure from prior years in that the Auditor-General did not consider it necessary to make recommendations for the Government to consider. Instead the Auditor-General provides a summary of 'significant findings'. The Government has responded to the certain significant findings raised throughout the report.

Overall the Government considers the Auditor-General's report is very positive particularly given that no recommendations resulted from the Auditor General's review, and that, due to the timing of the general election, the unaudited Whole of Government Financial Statements were produced under a considerably shortened timeframe.

The Territory's operating surplus for 2003-04 was $109m, which was an improvement of $92m on the budgeted result of $17m.

GOVERNMENT RESPONSE TO SIGNIFICANT FINDINGS AND EMPHASIS OF MATTER

ACTEW

Audit Qualification at paragraphs 5.8 to 5.11

In previous years, ACTEW has been qualified because it did not equity account for its investment in TransACT in accordance with AASB 16 "Accounting for Investments in Associates". Although ACTEW did apply equity accounting to its TransACT investment in its 2003-04 financial statements, ACTEW's 2003-04 accounts are qualified on the basis that its accounts from 2002-03 should also be altered to reflect this correct treatment.

Government Response

In general terms Accounting Standard AASB 1016 requires a company to equity account another company if the former has 'significant influence' over the latter. The standard describes a number of relevant factors to determining the existence or otherwise of 'significant influence'. In the opinion of the Directors of ACTEW, and of its legal advisor, the application of those factors make it abundantly clear that, for the purpose of the standard, ACTEW did not have and was unable to exert significant influence over TransACT prior to 2003-04.

Changes in the nature of the relationship between ACTEW and TransACT in 2003-04 have meant that, in the opinion of the Directors, equity accounting was appropriate for the 2003-04 financial statements. For these reasons, ACTEW did not alter its treatment of its investment in TransACT for 2002-03 in its 2003-04 financial statements.

Audit Qualification at paragraphs 5.12 to 5.15

ACTEW used TransACT's unaudited financials to equity account its share of TransACT's losses for the year ended 30 June 2004.

Government Response

Unaudited information for TransACT was used in the preparation of statements for the Territory as TransACT has until the end of October to finalise its annual statements (as specified by s315 (1) of the Corporations Act 2001). As the Whole of Government accounts are prepared before this date, audited statements were therefore unavailable.

Audit Qualification at paragraphs 5.16

The audit opinion on ACTEW's financial statements was qualified because there was insufficient evidence available for the Audit Office to reliably assess whether the $40m reported for the TransACT investment at 30 June 2003 reflected fairly the value to be recovered from this investment.

Government Response

At 30 June 2003, it was difficult to make a market assessment of the value of TransACT given the organisation was still in its development phase. Therefore, the determination of a "recoverable amount" for TransACT was a matter of considerable judgement at that time.

Audit Qualification at paragraphs 5.17 to 5.18

Similar to previous years, the Auditor-General has qualified ACTEW's 2003-04 accounts because the ACTEW Board expressed its view in the Directors' Declaration that the accounting treatment of contributed assets is inappropriate. The Auditor-General maintains that the reporting requirements for contributed assets present a "true and fair view".

Government Response

The Government notes the differing opinions of the ACTEW Board and the Auditor-General. While the financial statements of ACTEW adhere to relevant accounting standards, the Directors of ACTEW do not consider that contributions of non-current assets represent revenue. Moreover, the Government accepts that the Directors of ACTEW deemed it appropriate to include in their financial statements a note to this effect, and notes that the financial statements were constructed using the Auditor-General's preferred methodology.

It should be noted that ACTEW's 2002-03 Annual Report disclosed that legal advice was obtained on its accounting for its investment in TransACT and that this legal advice strongly supported ACTEW's accounting treatment.

The Government notes that, in the opinion of the Directors of ACTEW, if the Financial Statements had been presented without the note within the Director's Declaration, they would not have presented a true and fair view of the Directors as required by section 297 of Corporations Act.

FORESTS

Significant Finding at paragraph 5.34 to 5.37

Forests did not manage its operations to budget due to higher than expected costs resulting from the acceleration of work on the removal of debris and the replantation of forests following the January 2003 bushfire.

Government Response

In November 2003, the Government made decisions on the future use of the burnt plantations and new responsibilities for ACT Forests as a public land manager. The Government also agreed to a review of ACT Forests' base budget by the Departments of Treasury and Urban Services.

In early 2004, cost estimates for a rehabilitation program were prepared on the basis that ACT Forests could internally fund the first six years of that program using the proceeds of the standing timber claim.

With Ministerial approval, ACT Forests commenced delivery of the Government's rehabilitation program and by 30 June 2004 had exceeded the original debris removal target by sixty percent and made considerable progress with preparing sites for replanting.

The completion of these additional works caused the higher than expected costs observed by the Auditor-General. They are, in fact, a measure of the rehabilitation work that has been completed ahead of the original schedule and are fully in accordance with the Government's priority to expediently implement the bushfire recovery program.

ACT HEALTH

Emphasis of matter at paragraphs 5.39 to 5.40

The following performance measures in 'Output 1.1 Health and Community Care: Acute Services (Timeliness)' could not be independently verified.

Percentage of patients in emergency departments seen within standard timeframes:

- **(i) Category 1 (Treated immediately).**
- **(ii) Category 2 (Treated within 10 min).**
- **(iii) Category 3 (Treated within 30 min).**
- **(iv) Category 4 (Treated within 1 hour).**
- **(v) Category 5 (Treated within 2 hours).**

The Audit Office was therefore unable to express an opinion on these measures.

<u>Government Response</u>

The measures used to report timeliness of treatment of emergency department patients are drawn from the system used to record emergency department patient care instances. This system meets the business needs of ACT Health and was developed with a focus on patient data recording rather than strict audit protocols. The Auditor-General recommended systems used by ACT Health to record Emergency Department performance be replaced with a paper-based system;

It is the opinion of ACT Heath that a paper-based reporting system for Emergency Department waiting times, while improving the auditability of this information, would disrupt Emergency Department operations. In this regard, the Government disagrees with the Auditor-General's findings.

A further, general, discussion of systems used to record performance measure data is included below in the Government response to paragraphs 5.39 to 5.40 of the Auditor-General's report.

Emphasis of matter at paragraphs 5.39 to 5.40

The systems used by ACT Health to record and report on its performance measure results were found to need significant improvement and did not provide assurance that its reported results were free from errors or irregularities. These problems were reported to ACT Health.

<u>Government Response</u>

Many of the systems used by ACT Health to provide performance data were developed with a focus on patient data or service delivery rather than strict audit protocols and this can cause some difficulty in meeting the stringent requirements of audit. In 2004-05, ACT Health has adopted a new model for data collection recommended by the Auditor-General's office to deliver improvements in accuracy and reliability of information.

In consultation with the audit team, many of these shortcomings were improved between the 3rd quarter interim audit and the final audit and the Department will continue to work with line areas to overcome these issues.

Significant Findings at paragraphs 5.49 to 5.50

ACT Health's current ratio is low with only $0.86 in current assets to meet each dollar of current liabilities.

ACT Health will need to manage its expenses carefully to avoid the need for unexpected cash injections from the Government to support its operations over the next 12 months"

Government Response

At 30 June 2004, some 59.5 percent of ACT Health's current liabilities were employee benefits. There is virtually no likelihood that ACT Health would need to extinguish all employee benefits at a given point in time.

It is considered that the cash and investments balance held by ACT Health at 30 June 2004, together with receipt of appropriation amounts fortnightly and other budgeted revenues, should be adequate to meet its foreseen emerging liabilities during 2004-05.

HOME LOAN PORTFOLIO

Significant Finding at paragraph 5.52

The 2003-04 operating result (a $3.7m deficit) was significantly less than the budgeted operating surplus of $3.0m because the Home Loan Portfolio did not allow for doubtful debts ($4.8m) and investment losses ($1.8m) in the budget.

<u>Government Response</u>

The provision for doubtful debt was increased by $4.8m based on the recommendation of external consultant KPMG, that the appropriate level of provision for doubtful debt should be $12.5m. The result of the recommendation could not have been anticipated during the budget process because the:

- Home Loan Portfolio had already increased the provision for doubtful debt by $4.8m in 2002-03; and
- review by the consultant did not commence until after the 2003-04 Budget process was completed.

It is proposed that an external review will be undertaken in the future to determine the appropriate level of the provision for doubtful debt and the basis for determining future provisions.

The investment loss of $1.8m relates mainly to a lower than expected return on fixed interest investments. The return of these investments is subject to the vagaries of the market. The actual outcome reflects a reduction in the value of bonds resulting from increases in market interest rates over 2003-04. These losses were partially offset by improvements in earnings on cash investments

INSURANCE AUTHORITY

Significant Finding at paragraph 5.59

The Authority did not have enough assets to meet its liabilities at 30 June 2004 and that its ability to meet long term liabilities and any unexpected losses has deteriorated in recent years.

Government Response

The position as at 30 June 2004 was addressed by a capital injection of $10m by the Government in the first quarter of the financial year 2004-05. The longer term liabilities are currently being considered in the context of the 2005-06 Budget process.

LEGISLATIVE ASSEMBLY SECRETARIAT

Significant Finding at paragraphs 5.62 to 5.64

Significant weaknesses in controls (mostly in relation to payments) were found and reported to the Secretariat. The cumulative effect of these weaknesses is that the Secretariat is at particular risk of errors and irregularities (including fraud).

Government Response

The significant weaknesses in controls identified by the Audit-General are of concern to the Secretariat and the Government. In many respects, they arise due to the relatively small structure in the Corporate Services Office and the difficulties in segregating duties. Since the audit was undertaken, an independent review of the staff structure has been completed and it has been proposed that recommendations related to this issue be adopted. However, there are budgetary implications and it is understood the Speaker will address this in his approach to the Treasurer in respect of the Secretariat's 2005-06 Budget.

Significant Finding at paragraphs 5.65 to 5.67

The Secretariat's operating results have deteriorated significantly in recent years, due largely to wage increases and higher leave entitlement liabilities

Government Response

The leave liabilities for Secretariat staff were reviewed during the year ended June 2004 (following a recommendation from the June 2003 audit) and the review identified that those liabilities had been understated. This contributed significantly to the deterioration in the operating result.

Significant Finding at paragraphs 5.68 to 5.69

For the first time in recent years, the Secretariat did not have sufficient current assets to meet current liabilities at 30 June 2004

Government Response

The Secretariat's low level of current assets in relation to current liabilities was largely due to higher than budgeted expenditure in the year ended June 2004. The Secretariat was aware, during 2003-04, that certain unexpected and unavoidable expenditure was being incurred and that these expenses were likely to result in an operating deficit for the year. The Secretariat has addressed the main causes of that operating deficit and continues to closely monitor expenditure to ensure, to the greatest extent practicable, it is maintained within budgeted levels and that there are adequate reserves to meet the future liabilities of the Secretariat.

SUPERANNUATION UNIT

Significant Finding at paragraph 5.74

The Superannuation Unit was unable to achieve the budgeted operating result because the significant increase in superannuation expenses far outweighed the above budget investment returns.

Government Response

The Superannuation Unit has limited managerial control over the assets, liabilities and thus the operating result of the Superannuation Provision Account (SPA).

The capacity of the Territory to service its superannuation liabilities is dependent upon the responsible management of assets set aside to offset/augment the level of annual call on budget. An investment return objective has been agreed and funds are invested in a manner that intends to achieve this objective over the long term.

The investment assets of the SPA are subject to global financial market forces. It is important to note that these financial assets are invested with a long-term time horizon. Over the short term, asset valuations (and thus earnings) will be volatile, but over the long term estimated investment asset valuations and earnings will prove more predictable. The Superannuation Unit budgets for investment earnings using the estimated long-term return on the total portfolio reflecting the established strategic asset allocation.

Table A below outlines actual investment earnings versus the original budget estimates. The variations between budget estimates and actuals are substantial when viewed on an annual basis, but over the period 1 July 1999 to 30 June 2004 actual investment earnings have totalled approximately $201 million compared to the budget estimate of $234m – a deficit of $33. A good investment year during 2004-05 would see this deficit reduce further.

Table A: SPA Investment Earnings ($millions)

	1999-00	**2000-01**	**2001-02**	**2002-03**	**2003-04**
Budget	25.70	10.13	61.76	77.58	59.06
Actual	73.96	37.98	-43.07	3.65	128.88

The superannuation liabilities of the SPA are actuarially determined using certain underlying financial and demographic assumptions, such as constant staffing numbers, length of service, level of employee contribution, inflation, real salary increases, percentage of final benefits paid as pensions versus lump sum and mortality rates.

As the Superannuation Unit conducts annual actuarial reviews, any differences with actual experience versus the actuarial assumptions will cause variations to the estimated liabilities. Government employment policies have a direct impact on the liability estimates and these outcomes are reflected by the SPA through the annual actuarial reviews.

Due to the size of both the SPA investment portfolio and the Territory's unfunded superannuation liabilities, a small percentage variation to the original budget assumptions will cause significant variations to original budget estimates for the SPA.

Significant Findings at paragraph 5.80 to 5.85

The Superannuation Unit have insufficient investments set aside to meet superannuation liabilities. Ratio of investments to superannuation liabilities has declined steadily in recent years from $0.75 in 2001 to $0.59 in 2004 in investments for each dollar of superannuation liabilities.

Government Response

The steady decline in the ratio of investments to superannuation liabilities from $0.75 in 2001 to $0.59 in 2003-04 is due to the combined impact of poor investment returns during 2001-02 and 2002-03, with falls on global equity markets, and the large actuarially determined increase in the estimated unfunded superannuation liabilities of the Territory of $232 million during 2003-04.

The Territory currently extinguishes superannuation liabilities through annual cash payments, referred to as emerging costs, to the Commonwealth via ComSuper. These cash payments are currently of a size that is manageable through recurrent revenue by the ACT. However, these payments are estimated to increase rapidly in the future and, if not managed prudently, will cause significant budget resources to be diverted to meet ongoing liabilities.

The SPA has a liability funding plan in place, which is reviewed annually following the actuarial reviews, and allows for fully funding current accruing liabilities, through a combination of employer contributions and investment earnings, as well as a "catch up" component. This cost is then spread evenly over future budgets in real terms.

The ACT has made significant progress in the funding of defined benefit superannuation liabilities. The ratio of investments to superannuation liabilities was $0.29 per dollar of liabilities at 30 June 1999. Even with significant increases in the estimated superannuation liabilities, from approximately $1.2 billion in 1999 to $2.1 billion in 2004, and two years of poor investment returns, the Territory has doubled liability coverage to $0.59 per dollar of liabilities by 30 June 2004. The ACT is in a much stronger financial position as compared to most other States and, in particular, the Commonwealth, in relation to the funding of public sector defined benefit superannuation liabilities.

TOTALCARE

Significant Finding at paragraphs 5.87 to 5.88

Totalcare recognised a liability of $17.3m for the estimated amount of superannuation contributions owing in respect of its employees due to incorrect payment of employees' superannuation contributions over several years. The exact amount of this liability will not be known for some time

Government Response

A working party of staff from the ACT Department of Treasury has been established to carry out a two-part program to rectify the situation. This will be done by firstly, identifying all past and present staff who were eligible to be a member of ComSuper, and secondly, calculating the amount of superannuation contributions owing to ComSuper for each eligible employee.

The Australian Government Solicitor's office has completed reviewing nearly 2,000 files to determine which employees were eligible for ComSuper membership. They have identified around 1,200 employees that will require further action. The Treasury team are now reviewing each eligible employee's file to collect the data required and then calculate the amount of contribution owing. It is expected to take 8-12 months to complete gathering the data and performing calculations.

A provision has been raised in the financial statements for the estimated amount of superannuation contributions outstanding. As the individual data collection process will take some months, the amount of the provision has been estimated based on a number of averages such as average salary and average length of service. This is a management estimate based on the best information available at the time. The final liability may vary from the estimated amount.