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. 7 OF 2005 "2004-05 FINANCIAL AUDITS"

INTRODUCTION

On 13 December 2005 the Auditor-General's report No. 7 of 2005: '2004-05 Financial Audits' was tabled in the Legislative Assembly.

Few of the 74 audit opinions issued were qualified. Only 3 qualified audit opinions were issued for non-compliance with AAS.

Seven agencies with unqualified audit opinions contained an 'Emphasis of Matter', all of which related to performance measures.

It is important to note however that the Auditor-General found that most financial statements were satisfactory.

QUALIFICATIONS

A qualified audit opinion was issued on the Territory's Whole of Government Financial Statements. This related to the accounting policy used to account for actuarially assessed movements in the superannuation liability.

The Auditor-General's report presents the Whole of Government results adjusted to reflect the superannuation liability movements as an expense rather than an adjustment to equity. This has resulted in the Auditor-General reporting a deficit of $226m, compared to the $12m deficit reported in the Territory's financial statements.

However, by excluding volatile actuarial variations, the treatment adopted in the Territory's financial statements provides a better measure of the underlying operating result. While there was not a specific Australian Accounting Standard prior to 1 July 2005 addressing movements in superannuation liabilities, guidance will be provided in the future by a new Australian Accounting Standard AASB 119 'Employee Benefits', which will apply from 1 July 2005. This new standard, which will take precedence over the generic Australian Accounting Standards AASB 1018: 'Statement of Financial Performance' and AAS 31: 'Financial Reporting by Governments' that the Auditor-General relied on to qualify the Territory's Financial Statements, allows the treatment adopted by the Territory in its 30 June 2005 financial statements. That is, actuarial movements in superannuation liabilities can be adjusted directly against equity.

Similar to the Whole of Government accounts, a qualified audit opinion was issued on the Superannuation Unit Financial Statements.

ACTEW received a qualification on its financial statements because the past accounting by ACTEW for its TransACT investment affected the reporting of prior year comparatives in ACTEW's results. The other reasons for the qualification were the use of unaudited TransACT numbers and the view expressed by the ACTEW Board in the Directors' Declaration regarding the accounting treatment of contributed assets. Both of these issues have been previously raised by the Audit Office and are ongoing issues.

SIGNIFICANT FINDINGS

The report identifies a number of significant issues. The key issues identified by the Auditor-General and the Government's response to those issues are outlined in the following pages.

GOVERNMENT RESPONSE TO SIGNIFICANT FINDINGS

The Territory's Finances

A qualified audit opinion was issued.

Audit Qualification at paragraph 3.2

The Auditor-General has qualified the Territory's financial statements for the current and recent years (except 2003-04) as a result of non-compliance with Australian Accounting Standards in relation to the Territory's accounting for its superannuation liability.

Government Response

The Territory's 2004-05 financial statements presented a changed accounting treatment for the movement in the superannuation liability resulting from actuarial reviews of the defined superannuation schemes operating for Territory officers, which was recorded directly against equity.

There has been no specific Australian Accounting Standard addressing the accounting requirements for changes in superannuation liabilities for defined benefit plans, resulting from actuarial reviews. Australian Accounting Standards AASB 1018: 'Statement of Financial Performance' and AAS 31: 'Financial Reporting by Governments', on which the Auditor-General relied on to qualify the Territory's financial statements, do not directly address the issue of superannuation accounting. In the absence of a specific Australian accounting standard there has been a lack of clarity regarding the most appropriate accounting treatment. As a result, in recent years the Territory has been refining its accounting treatment for superannuation accounting.

The accounting treatment adopted avoids volatility in the Territory's operating result, both up and down, as a result of the actuarial reviews and provides a more meaningful indication of the Territory's underlying operating position. The accounting treatment adopted during 2004-05, and consistent with the 2005-06 Budget Papers, will be permitted for the 2005-06 financial year under the new standard AASB 119 'Employee Benefits'.

Significant Finding at paragraph 3.2

Given the current deficit and projected results, there is a significant risk that the operating results could continue to be in deficits, in particular, if adverse fluctuations in revenue and expenses occur in future years.

Over recent years, the Territory's long-term financial position has weakened significantly, with most of the decline occurring over the 12 months to 30 June 2005. This decline is primarily due to a substantial rise in the Territory's unfunded superannuation liabilities combined with a large fall in financial assets.

Government Response

Noted. The Government is committed to restoring the budget to surplus and has commissioned a comprehensive Strategic and Functional Review to assist in this process.

When considering the Territory's financial position, the overall strength of the Balance Sheet should be taken into consideration. The recent ratings review by Standard and Poor's assessed the Territory's Balance Sheet as very strong, with a robust financial position capable of absorbing temporary deficit operating results without affecting its AAA credit rating.

The Audit report notes that superannuation liabilities are expected to continue to rise significantly over the next few years and raises questions as to whether the Government's current strategies to manage the unfunded liabilities will be sufficient to prevent them from growing to the point where significant financial difficulties are expected in the long term. The report does, however, acknowledge that the full extent of unfunded superannuation liabilities does not have to be met for some years and that there is no current threat to the Territory's finances (paragraph 1.18, p4).

Over 60% of the Territory's liabilities are superannuation liabilities that will be extinguished over the next 80 to 100 years. The Government remains committed to its strategic financial objectives, including a commitment to a 90% coverage of accrued superannuation liabilities by 2039-40.

The Government also notes that the introduction of the Public Sector Superannuation Accumulation Plan, which is a fully funded scheme, will significantly assist in managing the future growth in superannuation liabilities.

ACTEW

A qualified audit opinion was issued.

Audit Qualification at paragraph 4.6

Prior to 2003-04 ACTEW did not equity account for its investment in TransACT in accordance with AASB 16 'Accounting for investments in Associates'. ACTEW's 2004-05 accounts are qualified on the basis that the reporting of prior year comparatives in ACTEW's results was affected by this non-compliance.

Government Response

In general terms Australian Accounting Standard AASB 1016 requires a company to equity account for its investment in 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.

Audit Qualification at paragraphs 4.7 to 4.10

ACTEW used TransACT's unaudited financials to equity account its share of TransACT's losses for the year ended 30 June 2005.

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. It is notable that TransACT's audited results did not vary significantly from the unaudited financial results.

Audit Qualification at paragraphs 4.11 to 4.12

Similar to previous years, the Auditor-General has qualified ACTEW's 2004-05 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. The Directors of ACTEW consider that contributions of non-current assets represent capital instead of revenue. The assets are not for resale like trading stock but form part of the capital base of ACTEW being fixed plant and equipment. Nevertheless the financial statements of ACTEW have been prepared in compliance with relevant accounting standards.

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.

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.

ACTION

An unqualified audit opinion was issued.

Significant Finding at paragraph 4.25 to 4.27

Operating expenses of ACTION exceeded budget due to higher than expected employee related expenses, bus maintenance expenses and fuel costs. Government contributions thus exceeded budget in order to provide extra funding to meet the higher bus operational costs.

Government Response

ACTION recognises the finding, as it reflects the actual outcome for 2004-05.

ECOWISE (a subsidiary of the ACTEWAGL Joint Venture)

An unqualified audit opinion was issued.

Significant Finding at paragraph 4.35

Controls and accounting practices in several areas need improvement, especially in areas of financial statement preparation processes and corporate governance issues.

Government Response

The Board of ECOWISE notes the areas requiring improvement and has put in place a number of initiatives to address the weaknesses identified. The initiatives will be put in place during 2005-06.

Emergency Services Authority (ESA)

An unqualified audit opinion was issued.

Significant Finding at paragraph 4.42

The corporate governance framework, such as the Audit Committee and Finance Committee, was established in 2004-05 and is still developing. It was therefore in the initial stages of having an impact on the Authority's operations at the time of the audit.

Government Response

ESA continues to strengthen its corporate governance framework with the Audit Committee and the Finance Committee meeting regularly in 2005-06. ESA has appointed Acumen Alliance for its internal audit function. An audit schedule has been developed and is to be endorsed by the Audit Committee at the next meeting, with 2 initial audits having already commenced. The Risk Management Plan has been drafted and is waiting finalisation in the coming weeks.

Significant Finding at paragraph 4.45

ESA did not achieve the budgeted operating surplus. This is because the capital injection funding was not fully drawn down due to the discontinuation of two major projects.

Government Response

The ESA is taking action to ensure it manages within its budget allocation in future years.

The West Belconnen Joint Emergency Services Centre and the Belconnen Joint Emergency Services Centre projects were cancelled, as this concept was no longer seen as suitable. Consequently no capital injection was required.

ACT HEALTH

An unqualified audit opinion was issued.

Significant finding at paragraphs 4.52

ACT Health did not achieve the budgeted operating surplus. This is because the capital injection funding was not fully drawn down due to delays in various capital works projects.

Government Response

ACT Health experienced delays in the implementation of several capital works projects and decisions were taken to not proceed with two projects. The slippage of various projects and the cancellation of the Karralika and Renal Projects were identified in the 2005-06 Budget brought down in May 2005.

The delayed projects were the ANU Medical School, the Building 10 lifts, Orthopaedic Theatre refurbishment, Anatomical Pathology Laboratory and various works at the Imaging Department. The delays were due to a combination of internal planning issues, the need to undertake a value management exercise to control potential cost overruns for the ANU Medical School and a longer than expected timeframe for the design and documentation phase for the ANU Medical School.

The Karralika project was cancelled and may be the subject of future capital works project funding consideration and the Renal project was also cancelled as ACT Health was able to secure a service based on a price per treatment that included the cost of the facility.

Significant finding at paragraphs 4.57

ACT Health's current assets are not sufficient to meet its current liabilities. ACT Health will need to manage its expenditure very carefully to avoid unexpected cash injections being required from the Government over the next 12 months.

Government Response

A large component of ACT Health's current liabilities is employee benefits and it is considered likely that ACT Health will end the 2005-06 year with a similar level of liabilities. It is unlikely that any cash injections would be needed from Government in order to manage this over the next 12 months and ongoing cash flow monitoring and management is performed by ACT Health.

INSURANCE AUTHORITY (ACTIA)

An unqualified audit opinion was issued.

Significant Finding at paragraph 4.65

The Authority did not have enough assets to meet its liabilities at 30 June 2005 and that its ability to meet long term liabilities and any unexpected losses has deteriorated in recent years.

Government Response

The Government provided ACTIA with an additional cash injection of $23m in the 2005-06 Budget to address the increase in insurance liabilities.

In addition, the reinsurance program will be reviewed in 2006. ACTIA is also taking steps to improve the risk management practices within government to reduce the number of insurance claims.

Significant Finding at paragraph 4.61

There were factors outside direct control of the Authority that affected the Authority's operations within the overall budget. These factors include rise in court awarded settlements for medical malpractice claims and the further identification of outstanding matters by agencies.

Government Response

The Government agrees that the Authority's budget is heavily influenced by factors outside its direct control.

Land Development Agency (LDA) - including the Gold Creek Country Club, Kingston Stage 1A and other Joint Ventures

An unqualified audit opinion was issued.

Significant Finding at paragraph 4.69 and 4.80

The Gold Creek Country Club (GCCC) operated at a loss and relied upon Government financial support to continue operations in 2004-05.

Government Response

GCCC has been operating at a loss and has required Government financial support for a number of years. In October 2005 the LDA exchanged contracts with a purchaser for the sale of the GCCC assets and operations. Settlement of the sale will be completed by May 2006, at which time the ACT will no longer be responsible for financial support of the GCCC.

Significant Finding at paragraph 4.69 and 4.77 to 4.78

Internal controls and accounting practices can be improved in several areas.
The Club identified an instance of alleged fraud of three free annual memberships by a staff member during 2004-05. Following a consultant's examination of the Club's current fraud management policies and operation procedures, it was advised that the Club did not have effective controls with respect to recording and management of memberships.

Government Response

In noting the instance of alleged fraud, the auditors also indicated that the GCCC had moved to update its fraud management policies and operational procedures through the advice of independent consultants. No further instances of alleged fraudulent activity have been identified.

SUPERANNUATION UNIT

A qualified audit opinion was issued

Audit Qualification at paragraph 4.94 to 4.96

The Superannuation Unit's 2004-05 financial statements did not comply with Australian Accounting Standards AASB 1018: 'Statement of Financial Performance' and AAS 29: 'Financial Reporting by Government Departments'.

Government Response

For the 2004-05 financial statements, the Superannuation Unit changed the accounting treatment for the movement in the superannuation liability resulting from actuarial reviews of the defined superannuation schemes operating for Territory officers.

There has been no specific Australian Accounting Standard addressing the accounting requirements for changes in superannuation liabilities for defined benefit plans, resulting from actuarial reviews. Australian Accounting Standards AASB 1018: 'Statement of Financial Performance' and AAS 29: 'Financial Reporting by Government Departments', on which the Auditor-General relied on to qualify the Unit's financial statements, do not directly address the issue of superannuation accounting. In the absence of a specific Australian accounting standard there has been a lack of clarity regarding the most appropriate accounting treatment. As a result, in recent years the Territory has been refining its accounting treatment for superannuation accounting.

The accounting treatment adopted avoids volatility in the Territory's operating result, both up and down, as a result of the actuarial reviews and provides a more meaningful indication of the Territory's underlying operating position. The accounting treatment adopted during 2004-05, and consistent with the 2005-06 Budget Papers, will be permitted for the 2005-06 financial year under the new standard AASB 119 'Employee Benefits'.

Audit Qualification at paragraph 4.101

The Superannuation Unit continues to be unable to achieve the budgeted operating result because the significant increase in superannuation expenses substantially exceeded the investment returns.

Government Response

The Superannuation Unit has limited managerial control over the investment assets and recorded revenues, the defined benefit superannuation liabilities and recorded expenses, and the operating result for the Superannuation Provision Account (SPA).

The investment assets of the SPA are subject to global financial market forces. It is therefore important to note that these financial assets are invested with a long-term time horizon. Over the short-term, asset valuations (and thus investment earnings) will be volatile, but over the long term estimated investment asset valuations and revenues will prove more predictable.

Table 1 – SPA Investment Earnings

	2000-01 $'m	2001-02 $'m	2002-03 $'m	2003-04 $'m	2004-05 $'m	Total $'m
Budget	10.1	61.8	77.6	59.1	83.5	**292.0**
Actual	38.0	(43.1)	3.6	128.9	161.9	**289.3**
Variance	**27.9**	**(104.9)**	**(74.0)**	**69.8**	**78.4**	**2.7**

Table 1 outlines actual SPA 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 2000 until 30 June 2005 actual investment earnings have totalled $289.3m as compared to the budget estimate of $292m – a deficit of only $2.7m.

The superannuation liabilities of the SPA are actuarially determined using certain underlying financial and demographic assumptions, such as staffing levels, level of employee contributions, salary increases, inflation, percentage of final benefits taken as pension, death, mortality and disability, etc.

Development in accounting standards, as well as Government employment policy, can cause significant variation to liability valuations.

As the Superannuation Unit conducts annual actuarial reviews, any differences with actual experience versus the actuarial assumptions, as well as changes due to accounting standards or employment policy, will cause variations to the estimated liabilities.

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 can cause significant variations to original Budget estimates for the SPA.

Audit Qualification at paragraph 4.106

There are insufficient investments set aside to meet superannuation liabilities.

Government Response

The ACT has made significant progress in the funding of defined benefit superannuation liabilities. As at 30 June 1999, the value of investments per one dollar of liabilities was \$0.29. Even with significant increases in the estimated superannuation liabilities, from approximately \$1.2 billion in 1999 to \$2.5 billion in 2005, and with two years of poor market returns, the Territory has doubled its liability coverage to \$0.59 as at 30 June 2005.

The Auditor-General's report acknowledges that the full extent of unfunded superannuation liabilities does not have to be met for some years and that there is no current threat to the Territory's finances (paragraph 1.18, p4).

Over 60% of the Territory's liabilities are superannuation liabilities that will be extinguished over the next 80 to 100 years. The Government remains committed to its strategic objectives, including a commitment to a 90% coverage of accrued superannuation liabilities by 2039-40.

It is also notable that the introduction of the Public Sector Superannuation Accumulation Plan, which is a fully funded scheme, will significantly assist in managing the future growth in superannuation liabilities.

Audit Qualification at paragraph 4.107

The recent significant upward trend in unfunded superannuation liabilities raises a question on whether the Government's current strategies to manage the growing shortfall will be sufficient to prevent significant long-term financial difficulties for the Territory.

Government Response

The PSS defined benefit scheme closed to new full time ACT employees on 1 July 2005. From that date new permanent ACT employees access the PSS Accumulation Scheme, which is a fully funded scheme.

As noted above, the Auditor-General's report acknowledges that the full extent of unfunded superannuation liabilities does not have to be met for some years and that there is no current threat to the Territory's finances (paragraph 1.18, p4).

TOTALCARE

An unqualified audit opinion was issued

Significant Finding at paragraphs 4.116

Totalcare continues to recognise a liability of $17.3m for the estimated amount of superannuation contributions owing in respect of approximately 1,200 former employees who were incorrectly exited from the Commonwealth Superannuation Scheme (CSS) or the Public Sector Superannuation Scheme (PSS). Work continues in order to determine the exact amount of this liability.

Government Response

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. Treasury is currently reviewing each eligible employee's file to collect the data required and then calculate the amount of contribution owing.

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 time, 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.