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PARLIAMENT OF TASMANIA

REPORT OF THE AUDITOR-GENERAL

GOVERNMENT DEPARTMENTS AND PUBLIC BODIES 2003-2004

PART A
Executive Summary

November 2004

Presented to both Houses of Parliament in accordance with the requirements of Section 57 of the Financial Management and Audit Act 1990

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Tasmanian Audit Office
GPO Box 851
Hobart
TASMANIA 7001

Phone: (03) 6233 4030, Fax (03) 6233 2957
Email:- admin@audit.tas.gov.au
Home Page: http://www.audit.tas.gov.au

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16 November 2004

President
Legislative Council
HOBART

Speaker
House of Assembly
HOBART

Dear Sirs

In accordance with the requirements of Section 57 of the *Financial Management and Audit Act 1990*, I have pleasure in presenting my Report on the audit of the Treasurer's Annual Report (my audit report covers the Public Account Statements and the Budget Outcomes Statements only), Government Departments, Government Business Enterprises, State-Owned Corporations, other public bodies and Local Government Authorities for the years ended 31 December 2003 and 30 June 2004.

In prior years this Report was referred to as the Auditor-General's No. 2 Report with the No. 1 Report being the Independent Audit Report on the Public Account. Changes to the *Financial Management and Audit Act 1990* since 2003 now require, in Section 26A, the Treasurer to prepare the Treasurer's Annual Report which must contain the Auditor-General's report on the Public Account Statements and on the Budget Outcomes Statements. As a result, a separate Auditor-General's report is now not required.

Yours sincerely

H M Blake
AUDITOR-GENERAL

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1 INTRODUCTION

This Report deals with the Public Account Statements, the Budget Outcomes Statements, Government Departments, State-Owned Corporations, Statutory Authorities, Government Business Enterprises, Local Government Authorities, Port Corporations, and other public bodies together with special comments on various other issues.

FORMAT OF THE REPORT

Unless specifically indicated, comments in this Report are current as at 31 October 2004.

The Report is based on the administrative arrangements set out under the provisions of the *Administrative Arrangements Act 1990* as at 30 June 2004 and has been prepared in accordance with the following classifications:

Part A	Executive Summary Introduction; Treasurer's Annual Report; Basslink; Sale of Government Businesses; Accounting for Infrastructure and Other Long Lived Assets; IFRS Readiness and Impact; Timeliness and Quality of Financial Statements; and Significant issues arising from audits.
Part B – Volume 1	Executive and Legislature; Government Departments; Superannuation Funds; Other Authorities; and Miscellaneous Public Bodies.
Part B – Volume 2	Government Businesses Government Business Enterprises; and State-Owned Corporations including Port Corporations.
Part B – Volume 3	Local Government Authorities

This classification does not attempt to recognise any lines of responsibility that some Statutory Authorities have through Ministerial Departments to the appropriate Minister, however the Portfolio or Responsible Minister is stated in each case.

FORMAT OF THE FINANCIAL ANALYSIS

Each entity's financial performance is analysed by discussing the primary financial statements being the Statement of Financial Performance, Statement of Financial Position and the Statement of Cash Flows supplemented by financial analysis applying the indicators documented on page 5 of this Report. The layout of some of the primary statement has been amended this year to, where appropriate:

- Make the statements more relevant to the nature of the entity's business. An example is the Motor Accidents Insurance Board; and
- Highlight the entity's net working capital, which is a useful measure of liquidity.

STATUS OF AUDITS

The majority of audits for the year ended 30 June 2004 have been completed with some exceptions as detailed in the preamble under each Part of the Report.

AUDITS DISPENSED WITH

In accordance with Section 41 of the *Financial Management and Audit Act 1990* (FMAA), the following audits have been dispensed with after consideration of alternative accountability arrangements for the public bodies concerned. Two of the aspects considered were the materiality of the financial transactions involved and the most cost-effective means of conducting the audits.

Grants to Public Bodies

An organisation in receipt of a grant from the Consolidated Fund automatically becomes a public body as defined under the FMAA, and is required to meet certain accountability requirements in accordance with the Treasurer's Instructions. A recipient of a grant of $5 000 or more is required to provide the appropriate Head of Agency with:

- A signed copy of the public body's financial statements, showing the receipt and manner of disbursement of each grant, together with an audit report signed by a suitably qualified person; or
- A Statutory Declaration made in accordance with the *Evidence Act 1910*, and signed by two office holders or members considered to be bona fide representatives of the public body, to the effect that

the grant was received and disbursed for the purpose for which it was given; or

- A certificate signed by a suitably qualified person to the effect that the grant was received and disbursed for the purpose for which it was given.

In the course of the various Agency audits, Audit Office staff ensures that Heads of Agencies comply with the requirements of the Treasurer's Instructions.

Registration Boards

The audits of the following Boards have been dispensed with on the basis that a suitably qualified person undertakes an audit:

Board of Architects;
Chiropractors Registration Board;
Dental Board;
Dental Prosthetists Registration Board;
Medical Council of Tasmania;
Nursing Board of Tasmania;
Optometrists Registration Board;
Pharmacy Board of Tasmania;
Physiotherapists Registration Board;
Plumbers and Gasfitters Registration Board;
Podiatrists Registration Board;
Psychologists Registration Board; and
Radiographers Registration Board.

Other Public Bodies

The audits of the financial statements of following public bodies have also been dispensed with on the basis that a suitably qualified person undertakes an audit:

Togari Drainage Trust; and
Mowbray Swamp Drainage Trust.

In the Auditor-General’s No. 2 Report for 2002-03 it was noted that the audit of the financial statements of the National Trust of Australia (Tasmania) (the National Trust) was a dispensed with audit. I am in the process of conducting this audit for the 2003-04 financial year. The outcomes of prior audits are reported in Part B Volume I.

Local Government Committees

Committees appointed under the *Local Government Act 1993* are required to provide copies of their annual financial statements to the respective Council to enable the General Manager, or some other appropriate person, to perform an audit of those financial statements.

Statements of Committees are normally consolidated into the financial statements of the respective Councils.

FINANCIAL ANALYSIS

The following table illustrates the methods of calculating performance indicators used in the financial analysis sections of this Report, together with a number of benchmarks used to measure financial performance.

Financial Performance Indicator	Benchmark*	Method of Calculation
Financial Performance		
Result from operations ($'000s)		Operating Revenue less Operating Expenses
EBIT ($'000s)		Result from Ordinary Activities before Tax and before Gross Interest Expense
Operating margin	>1.0	Operating Revenue divided by Operating Expenses
Return on assets		EBIT divided by Average Total Assets
Return on equity		Result from Ordinary Activities after Taxation divided by Average Total Equity
Return on Investments	5.5%	Net Investment income divided by Average Investments
Financial Management		
Debt to equity		Debt divided by Total Equity
Debt to total assets		Debt divided by Total Assets
Interest cover	>3	EBIT divided by Gross Interest Expense
Current ratio	>1	Current Assets divided by Current Liabilities
Cost of debt	7.5%	Gross Interest Expense divided by Average Borrowings (include finance leases)
Debt service ratio		Borrowing costs plus Repaid borrowings divided by Operating revenue
Debt collection	30 days	Receivables divided by billable Revenue multiplied by 365
Creditor turnover	30 days	Payables divided by credit purchases multiplied by 365
Capital Exp/Depreciation	100%	Payments for Property, plant and equipment divided by Depreciation expenses
Solvency Ratio		Net Assets less FITB less dividend payable divided by provision for outstanding claims
Returns to Government		
Dividends paid or payable ($'000s)		Dividends paid or payable that relate to the year subject to analysis
Dividend payout ratio	50%	Dividend divided by Result from Ordinary Activities after Tax
Dividend to equity ratio		Dividend paid or payable divided by Average Total Equity
Income tax paid or payable ($'000s)		Income Tax paid or payable that relates to the year subject to analysis
Effective tax rate	30%	Income Tax paid or payable divided by Result form Ordinary Activities before Tax
Total return to the State ($'000s)		Dividends plus Income Tax and Loan Guarantee fees
Total return to equity ratio		Total Return divided by Average Equity
Other information		
Staff numbers FTEs		Effective full time equivalents
Average staff costs ($'000s)		Total employee expenses divided by Staff Numbers

* Benchmarks vary depending on the nature of the business being analysed. For the purposes of this Report, a single generic benchmark has been applied.

An explanation of the performance indicators is provided below:

- Result from operations – summarises revenue transactions and expense transactions incurred in the same period of time and calculates the difference;
- Earnings before income tax (EBIT) – measures how well an entity can earn a profit, regardless of how it is financed (debt or equity) and before it has to meet external obligations such as income tax. This is a measure of how well it goes about its core business;
- Operating margin – this ratio serves as an overall measure of operating effectiveness;
- Return on assets – measures how efficiently management used assets to earn profit. If assets are used efficiently, they earn profit for the entity. The harder the assets work at generating revenues, and thus profit, the better the potential return for the owners;
- Return on equity – measures the return the entity has made for the shareholders on their investment;
- Return on investments – in the case of superannuation funds the measure indicates the return on funds invested on behalf of superannuants;
- Debt to equity – an indicator of the risk of the entity's capital structure in terms of the amount sourced from borrowings and the amount from Government;
- Debt to total assets – an indicator of the proportion of assets that are financed through borrowings;
- Interest cover – examines the exposure or risk in relation to debt, it calculates how many times earnings cover the unavoidable interest costs;
- Current ratio – current assets should exceed current liabilities by a 'considerable' margin. It is a measure of liquidity that shows an entity's ability to pay its short term debts;
- Cost of debt – reflects the average interest rate applicable to debt;
- Debt service ratio – indicates the capacity of the entity to service debt by repaying principal as well as interest on borrowings;
- Debt collection – indicates how effectively the entity uses debt collection practices to ensure timely receipt of monies owed by its customers;
- Creditors turnover – indicates how extensively the entity utilises credit extended by suppliers;
- Capital Exp/Depreciation – indicates whether the entity is maintaining its physical capital by reinvesting in or renewing non-current assets;
- Solvency Ratio – solvency is the ability of an insurance company to pay future claims. In order to remain solvent, insurance companies must always keep an adequate surplus of funds in case an unforseen increase in claims occurs;
- Dividends paid or payable – payment by the entity to its shareholders (whether paid or declared as a payable);

- Dividend payout ratio – the amount of dividends relative to the entity’s net income;
- Income tax paid or payable – tax payments (paid or payable) by the entity to the State;
- Effective tax rate – is the actual rate of tax paid on profits;
- Total return to the State – is the funds paid to the Government consisting of income tax, dividends and guarantee fees;
- Total return to equity ratio – measures the Government’s return on its investment in the entity;
- Staff numbers FTEs – As at the end of the reporting period the number of staff employed expressed as full-time equivalents (FTEs); and
- Average staff costs – measures the average cost of employing staff in the entity for the year.

The above indicators are used because they are commonly applied to the evaluation of financial performance. Some indicators have less relevance to departmental agencies and I will be reviewing these measures in 2004-05.

2 TREASURER'S ANNUAL REPORT

The 2003-04 Treasurer's Annual Report (TAR) was prepared in accordance with section 26 of the *Financial Management and Audit Act 1990*, which requires the tabling of the TAR by 31 October in each year.

This TAR is the first such report prepared under the State's new external reporting framework. The reporting framework was given legislative effect in the *Financial Management and Audit Amendment Act 2003* which received Royal Assent on 4 July 2003. The new reporting framework was introduced to align with the annual accrual Budget. The TAR contains the following information:

- An Executive Summary highlighting progress against the Key Fiscal Strategy Measures contained within the 2003-04 Budget Papers and commentary on significant variations to the Budget outcomes. The Executive Summary is not required to be audited;
- The Budget Outcomes Statements for 2003-04. The Section includes the Operating Statement, Balance Sheet and Cash Flow Statement for the General Government Sector showing the original Budget estimates and the actual outcomes presented on a Government Finance Statistics (GFS) basis. Additional financial information is also included providing details on all material revenue, expenditure, asset and liability items. This information is based on the format of Notes to the Accounts presented in general purpose financial statements, and has been customised to the Uniform Presentation Framework (UPF) format. This Section has been audited as a special purpose financial report and my opinion is included in this Section;
- The uniform government reporting requirements for the Loan Council Outcomes Report, in accordance with the UPF, agreed by the Australian Loan Council in March 1997. This Section presents the outcomes for the Total State Sector and its component sectors, being the General Government, Public Non-Financial Corporations and Public Financial Corporations Sectors. Previously, Treasury released this information as a separate publication in October each year. In order to harmonise the release of public sector financial information, this information has been incorporated into the TAR. The Loan Council Outcomes Report is not required to be audited;
- A summary of details for the transactions and balances within the Public Account – referred to as the Public Account Statements. This information is consistent with that previously provided, has been audited as a special purpose financial report and my opinion is included in this Section; and
- An overview of the key concepts and definitions used within the TAR.

Unqualified audit opinions were issued on 20 October 2004 for the Budget Outcomes Statements and the Public Account Statements. Extracts from these opinions are reproduced below.

Audit Opinion – Budget Outcomes Statements

In my opinion the Budget Outcomes Statements:

a) Present fairly the financial position of the General Government Sector as at 30 June 2004, and the results of its operations and its cash flows for the year then ended; and
b) Is in accordance with the *Financial Management and Audit Act 1990* and with the Uniform Presentation Framework.

Audit Opinion – Public Account Statements

In my opinion the Public Account Statements present fairly, in accordance with the *Financial Management and Audit Act 1990* and the cash basis of accounting referred to in the notes to the report, the financial transactions of the Public Account for the year ended 30 June 2004 and such components of the financial position of the General Government Sector at that date as are required to be disclosed.

3 BASSLINK

Basslink will be a high voltage direct current (HVDC) inter-connector which will transport electricity between Tasmanian and Victorian regions of the National Electricity Market (NEM).

Background

The NEM commenced in December 1998. It operates in Queensland, New South Wales, the Australian Capital Territory, Victoria and South Australia. Its existence provided an opportunity for Hydro Tasmania (HEC) to consider a proposal for it to sell power into the grid via a cable across the Bass Strait at prices considered attractive. When the concept was originally considered in 1998, benefits included the ability to sell Tasmania's excess power into the Victoria market at peak periods and drought proofing for Tasmania by being able to access mainland energy. Additional benefits identified by the HEC since then include solutions for Tasmania's growing energy demands and the catalyst for large-scale wind developments.

The Tasmanian Government established the Basslink Development Board (BDB) in February 1998 with the objective of overseeing a tender process for the construction of Basslink. The successful tenderer would own and bear the capital costs of building the link as well as maintenance costs thereafter. In exchange for paying an annual facility fee the HEC would receive the inter-regional revenues from the cable. This link would be used to either import power into Tasmania or export power into Victoria, depending on market prices.

The tender was won by Basslink Pty Ltd (BPL) and formal contractual arrangements were finalised in 2002.

Disclosure in Audited Financial Statements

While the cable is under construction, in order to hedge its obligations and ensure it maintains its rights, the HEC has entered into a number of financial instruments, disclosed in note 23 to the financial statements. These are described below.

In order to manage the financial market risks that will arise from the fluctuating nature of the Basslink facility fee payments, the HEC executed a financial instrument relating to the Basslink project. The facility fee obligations to the Basslink project include an interest rate exposure similar to that of a floating interest rate exposure on amortising debt. The financial instrument involves the HEC paying a fixed amount and receiving a variable amount thus removing any exposure to interest rate fluctuations during the term of the contract.

This financial instrument has been transacted with a single counterparty. As at 30 June 2004 the notional principal amount for this instrument was $599.810m. The instrument will be amortised over the period of the 25-year Basslink contract and is currently disclosed in the notes to the financial statements. During 2001-02 and 2002-03 supplementary interest rate swaps were entered into with other counterparties to mitigate the potential credit risk associated with a single counterparty.

A key contractual agreement is the Basslink services agreement (BSA), which establishes the rights and obligations between BPL, the builders and owners of Basslink, and the HEC. The net fair value of the BSA is disclosed as an unfavourable obligation of $429.400m in note 23 to the financial statements. The amount represents the net present value of future facility fee payments due to, and inter-regional revenues receivable from, BPL over the 25-year agreement. This obligation will be offset by pool and other revenues once Basslink becomes operational.

The fair value of the Basslink facility fee instrument is disclosed as an unfavourable amount of $245.500m in note 23 to the financial statements. The unfavourable nature of the instruments represents the net 'out of the money' position created by hedging, or locking in, firm interest and currency exchange rates over the 25 year contract term discounted back to a present value.

Environmental and Other Approvals

Environmental approval for the Basslink interconnector project was achieved in mid-July 2002. The Basslink Joint Advisory Panel, established to conduct this assessment, recommended the project should proceed as it has substantial benefits for Tasmania, Victoria and Australia. The Panel was satisfied that environmental impacts of Basslink were minimal.

Tasmanian Government Jurisdictional Approval was gained in early August 2002 and both Victorian and Federal Jurisdictional Approvals occurred in mid-September 2002. The formal Notice to Proceed was signed in November 2002.

Construction of the Basslink cable is currently underway with the expectation that the HEC will have physical access to the non Tasmanian regions of the NEM in November 2005. Tasmania is due to enter the NEM as a stand alone region in May 2005. The HEC will neither own nor control the cable upon completion of construction. However, the facility fee will not be payable to BPL in the event that there is a failure by BPL to operate or maintain Basslink within defined parameters. In that situation, the State will be able to exercise its right to step in or appoint an administrator to operate Basslink and would also be able to commence a transfer of the Basslink assets to another party.

4 SALE OF GOVERNMENT BUSINESSES

During 2002-03 the Government assessed its ongoing ownership of each business in its portfolio against a public interest test to determine whether the equity invested in the business was the best strategic use for the community, taking into account financial, industry and community issues. The key rationale for divestment was to enable the Government to release equity in non-core investments and reapply those funds for the benefit of the Tasmanian community. In this context, the funds raised from the implementation of the divestment strategy have been channelled into the Economic and Social Infrastructure Fund.

On 4 July 2003 the *Government Business Enterprises (Sale) Act 2003* (the Sale Act) received Royal Assent. As provided by section 7(1) of that Act, the Government sold the following Government Business Enterprises (GBEs) during 2003-04:

- Civil Construction Services Corporation (CCSC)
- Stanley Cool Stores Board (SCSB); and
- Tasmanian Grain Elevators Board (TGEB).

Details of each GBE's operations for the 2003-04 year are set out in their respective chapters in Volume 2 of this Report. The following is a summary of the outcomes of the sales.

Civil Construction Services Corporation

On 22 October 2003, CCSC was sold, as a going concern, to Works Infrastructure Pty Ltd (Works Infrastructure), a wholly owned subsidiary of Downer EDI Ltd (Downer EDI). The Sale Agreement between the Crown, Works Infrastructure and Downer EDI (the Sale Agreement) stipulated the effective date of the sale as 1 July 2003.

135 employees were offered employment with Works Infrastructure. Works Infrastructure did not make offers of employment to six employees and all six employees were paid their accrued entitlements and redundancy entitlements on the terms consistent with their contractual or award conditions.

The CCSC Board conducted business from 1 July 2003 to the date of the sale completion, 22 October 2003 (the completion period). However, by virtue of the effective date in the Sale Agreement, the CCSC Board conducted business for and on behalf of Works Infrastructure (excluding those assets and liabilities not purchased) during the completion period.

In 2002-03, the Board had determined that CCSC's interest in the iNFRAMAX division would be divested due to under-performance of the division.

All CCSC's assets and liabilities, except excluded assets and liabilities, transferred to Works Infrastructure under the Sale Agreement. On 22 October 2003, in accordance with sub-section 35(1)(a) of the Sale Act, those assets and liabilities excluded from the sale have transferred to the Crown.

The net assets transferred to the Crown are set out below:

	$'000s
Cash Assets	7 446
Receivables	164
Other Current Assets	222
Property Plant and Equipment	13
Accounts Payable	(46)
Interest-Bearing Liabilities	(2 250)
Net Assets	**5 549**

Cash includes the profit on the sale of the business, which was $0.165m. The above liabilities do not include those pertaining to six employees who are employed under the *State Service Act 2000*.

Stanley Cool Stores Board

The Government announced the sale of the SCSB on 21 March 2003. The sale process was administered by the Department of Treasury and Finance.

The sale was conducted via an open tender process with representatives from the Department of Treasury and Finance, and the Department of Primary Industries, Water and Environment evaluating tenders and putting final recommendations to the Portfolio and Stakeholder Ministers. The sale of the business was completed on 10 December 2003.

The net assets transferred to the Crown are set out below:

	$'000s
Cash	1 467
Investments	593
Receivables	49
Other Assets	8
Accounts Payable	(79)
Current Tax Liability	(70)
Net Assets	**1 968**

Cash assets include proceeds from the sale of $1.325m.

There was a profit on the sale of $0.256m.

Tasmanian Grain Elevators Board

The Government announced the sale of the TGEB on 21 March 2003. The sale process was administered by the Department of Treasury and Finance.

The sale was conducted via an open tender process with representatives from the Department of Treasury and Finance and the Department of Primary Industries, Water and Environment evaluating tenders and putting final recommendations to the Portfolio and Stakeholder Ministers. The sale of the business was completed on 12 December 2003.

The net assets transferred to the Crown are set out below:

	$'000s
Cash Assets (including Investments)	3 561
Receivables	1 608
Property Plant and Equipment	130
Accounts Payable	(804)
Current Tax Liability	(24)
Employee Provisions	(1 746)
Net Assets	**2 725**

Cash includes the profit on the sale of the business, which was $1.991m. The above liabilities do not include those pertaining to five employees who are employed under the *State Service Act 2000*.

The business was sold at a loss of $0.702m, albeit as a going concern.

5 ACCOUNTING FOR INFRASTRUCTURE AND OTHER LONG LIVED ASSETS

For a number of years this Office has been concerned about accounting and asset management issues associated with long-lived infrastructure assets such as roads, water, sewage and drainage assets.

In November 2001 the then Auditor-General reported to Parliament:

> "In my view, long-term asset management decisions and funding arrangements for long-lived infrastructure such as road networks would be enhanced by the adoption of fair values in determining asset values and depreciation charges."

Likewise, the Local Government Board has raised concerns about financial management and asset management practices adopted by Tasmanian Local Government Authorities. Particular concerns have included the practice by a number of Authorities of running significant annual deficits, and the failure to fund a significant proportion of depreciation expense.

Significant accounting issues that impact on asset management practices include carrying long lived assets at cost, thereby understating their values and as a consequence understating depreciation charges in current cost terms, recording annual deficits as a result of not budgeting to recover depreciation charges in full, and potentially failing to reinvest in or continually renew the infrastructure asset base.

The Scale of Infrastructure Assets Holdings

The following non-current assets are a selection of the infrastructure assets recorded in the Financial statements of selected Government Business Enterprises, State Owned Companies, Government Departments and Local Government Authorities at 30 June 2004. Major asset classifications are as follows:

Hydro Generation assets	$3.158 bn
Electricity transmission assets	$0.590 bn
State Roads and Bridges	$3.276 bn
Local government Roads and Bridges	$1.625 bn
Sewerage, Drainage and Stormwater	$1.099 bn
Water Storage and Reticulation	$0.847 bn

Most of these asset classes have useful lives of asset components ranging from 40 to 100 years and beyond.

Financial Reporting Framework

Australian Accounting Standard AAS 27 "Financial Reporting by Local Governments" introduced the preparation of financial statements on an accrual basis by Local Government Authorities with initial application from 1 July 1993. Transitional provisions allowed for the progressive recognition of non-current assets during the period up to 30 June 1997.

Due to a lack of historic cost records, most Authorities recognised long-lived infrastructure assets at written down current replacement cost. During the transition period Authorities used a combination of external consultants and/or in-house engineering staff to estimate current replacement costs, which were then written down to account for the assets' remaining useful lives.

In the case of Government Business Enterprises and Government Departments, Treasurer's Instructions were issued mandating the use of deprival values, which had the effect of entities using either market value, written down replacement cost, or recoverable amount. These carrying amounts were derived by a valuation process, and in accordance with AAS 10, "Revaluation of Non-Current Assets" there was a requirement that carrying amounts be revalued at regular intervals, which required a revaluation to be carried out every three or four years.

In 1999 the Urgent Issues Group issued UIG 30 "Depreciation of Long-Lived Physical Assets, Including Infrastructure Assets: Condition-Based Depreciation and Other Related Methods" dealing with depreciation of long-lived physical assets including infrastructure assets, and outlined a number of practices that did not comply with AASB 1021 and AAS 4 "Depreciation". UIG 30 also required major components of complex assets to be separately identified and accounted for to reliably determine depreciation expense.

From 1 July 2000 revisions to the revaluation standard saw the issue of AAS 38 and AASB 1041 "Revaluation of Non-Current Assets" that placed conditions on the adoption of cost or fair-value options, and allowed a transitional arrangement where entities could revert to historic cost, or deem the carrying values at that time to be cost.

Adoption of this option allowed a number of Local Government Authorities and other entities to get off the revaluation "tread-mill" for infrastructure assets at a point where they would have been required to revalue to maintain up-to-date carrying amounts.

From 1 January 2005, Australia will adopt International Financial Reporting Standards, and while international standards are primarily developed for the "For Profit Sector", the Financial Reporting Council, which oversights the Australian accounting Standards Board, has decided that Australia will have one set of sector neutral accounting standards.

These standards will include an option in AASB 1 "First-time Adoption of Australian International Financial Reporting Pronouncements" (AIFRP) for entities to measure an item of property, plant and equipment at the date of transition to AIFRPs at its fair value and use that fair value as its deemed cost at that date.

Accounting Concerns

Local Government

A number of Local Government Authorities took the option in 2000 to deem their carrying values to be cost. Many of those authorities had not revalued those assets following initial recognition during the 1993 to 1997 transition phase.

In respect of the largest asset class, Roads and Bridges, 8 Authorities deemed their carrying values to be cost, while for other infrastructure asset classes, 13 Authorities have deemed cost.

In the period from June 1994 to June 2004, the CPI index has moved from 111.2 to 144.8, representing an increase of 30.2% over the 10-year period. Carrying values of infrastructure assets based on values adopted during the initial recognition period are no longer representative of fair value, and this means that depreciation expense calculated on those values is likewise not representative of fair values and will not provide sufficient funds for asset replacement and renewal programs in future years.

It is anticipated that a number of Authorities presently using fair values may also elect to deem carrying values to be cost in 2005 when the Australian equivalents of International Financial Reporting Standards (IFRS) are adopted.

Government Business Enterprise, Government Departments and State-Owned Companies

At the present time Government Business Enterprises and Government Departments are still carrying their infrastructure assets at fair values. Since the application of AASB 1041 the GBE Treasurer's Instruction mandating the use of deprival value methodologies has been withdrawn. This would allow GBEs to adopt the cost basis of accounting with the introduction of IFRS Accounting Standards.

State-Owned Companies are not presently subject to direction in relation to asset accounting practices and a number have already adopted historic cost as the basis for valuing assets.

Depreciation and Asset Renewal

Since the adoption of accrual accounting many Authorities have been slow to deliver a balanced bottom line and are progressively increasing rates to cover all expenses including depreciation.

Many Authorities that are "funding" depreciation are not however reinvesting those funds in capital assets. Comparison of depreciation expense over the last five years with funds re-invested in capital assets over the same period indicates that a significant number of Authorities may not be maintaining their physical capability.

This failure is compounded with the fact that many Authorities have "deemed cost" for financial reporting purposes resulting in asset values and depreciation expense being considerably understated, a situation that will get worse over time.

Accounting Conventions

Financial statements are prepared under a number of accounting conventions that have been adopted by the International Accounting Standards Board (IASB) in the "Framework for the Preparation of Financial Statements" adopted in April 2001. These conventions include an accrual basis, a going concern basis, understandability, relevance, reliability, comparability, timeliness, and true and fair presentation.

While a number of measurement bases are employed such as historical cost, current cost, realisable value and present value, the basis most commonly adopted by entities in preparing their financial statements is historical cost. However, the historical cost accounting model is unable to deal with the effects of changing prices of non-monetary assets.

Concepts of Capital and Capital Maintenance

Most enterprises adopt a financial concept of capital in the preparation of their financial statements. Under a financial concept of capital, such as invested money or invested purchasing power, capital is synonymous with net assets or equity. Under a physical concept of capital, such as operating capability, capital is regarded as the productive capacity of the entity to deliver a service continuously over time.

The physical capital maintenance concept requires the adoption of the current cost basis of measurement.

The IASB in framing International Financial Reporting Standards has not chosen to prescribe a particular measurement basis or concept of capital. The framework is applicable to a range of accounting models and provides guidance on preparing and presenting the financial statements constructed under the chosen model.

Different accounting models exhibit differing degrees of relevance and reliability and it is for regulators and/or preparers to choose the most relevant and reliable model for their circumstances. It is the view of this Office that selection of a physical concept of capital and a current cost basis of measurement will provide a basis for improved asset management by entities with significant holdings of long-lived infrastructure assets. This basis will also assist users of annual financial statements to better assess performance both over time and in comparison to other entities.

It should be noted, however, that regardless of the measurement basis and concept of capital chosen by reporting entities, both historic cost and fair value are allowed by accounting standards, and adoption of either measurement basis would result in an unqualified audit opinion on a general-purpose financial report.

Recommendations

On 27 May 2004, in response to a review of the *Local Government Act 1993*, I made the following recommendation to the Local Government Division of the Department of Premier and Cabinet:

- All Local Government Authorities be required to adopt fair values when accounting for long-lived assets with useful lives of 10 years or more;
- A date of effect of 1 July 2005 was recommended for adoption of this measure, in conjunction with the adoption of International Financial Reporting Standards issued by the Australian Accounting Standards Board; and
- This requirement was recommended for implementation by Regulations issued under the *Local Government Act 1993*.

In relation to Government Business Enterprises and Government Departments I recommend that:

- The "fair value" option for valuing non-current assets be mandated by Treasurer's Instruction for long-lived infrastructure assets with useful lives greater than 10 years, before the implementation of International Financial Reporting Standards takes effect on 1 July 2005.

Similarly, in relation to State-Owned Companies I recommend that the shareholding Ministers mandate the adoption of fair values by State-Owned Companies when accounting for infrastructure assets with useful lives greater than 10 years.

6 IFRS READINESS AND IMPACT

Australia will be adopting Australian equivalents to International Financial Reporting Standards (IFRS) for reporting periods commencing on or after 1 January 2005. All Government entities will adopt these standards for the first time in their financial statements for the year ending 30 June 2006, or 31 December 2005 for those entities with calendar financial years.

IFRS Impact for 2003-04

Existing Australian Accounting Standards continued to apply to financial reports prepared for the financial year ended 30 June 2004. A new standard, AASB 1047 'Disclosing the Impact of Adopting Australian Equivalents to International Financial Reporting Standards', required a note disclosure in this year's financial statements explaining how entities are managing the transition to IFRS and a narrative detailing the expected key differences in accounting policies as a result of the adoption of IFRS. During the course of the 2003-04 audit cycle Audit ensured that all entities' financial reports disclosed this information.

IFRS Impact for 2004-05

For entities with a 30 June 2005 balance date, existing Australian Accounting Standards will apply. AASB 1047 will require entities to disclose as a note to their 2004-05 financial statements quantification of the financial effects of the adoption of IFRS. Accurate quantification will be essential because in preparing 2005-06 financial statements entities' comparative amounts will have to be prepared in accordance with IFRS as if IFRS had always been employed. Entities must, therefore, be in a position to prepare their June 2005 financial statements on the basis of IFRS.

Entities with a 31 December balance date will prepare their 2004 financial statements in accordance with existing Australian Accounting Standards and they will have to be able to quantify the effects of adopting IFRS at this date. This is so that they can comply with IFRS in preparing their December 2005 financial statements, which must include comparative amounts prepared in accordance with IFRS.

Options available in IFRS

The new standards allow optional accounting treatments in certain circumstances. All available options have been identified for discussion with the Department of Treasury and Finance an objective of which is to ensure consistent option choice to facilitate comparable accounting.

Profit versus not for profit entities

IFRS allows for differential reporting in very limited circumstances for entities referred to as “not for profits” with such entities defined as those principal objective is not the generation of profit. This will require that all Tasmanian Government Businesses be properly classified to ensure appropriate application of IFRS. This matter is also under discussion with the Department of Treasury and Finance.

Audit of opening balance prepared under IFRS

The above matters have been brought to the attention of the relevant public sector entities, as has the need to audit opening balances effective 1 July 2005 (for entities with June balance dates) and effective 1 January 2005 (for entities with December balance dates). Discussions with entities’ management about the timing of these audits are under way.

7 TIMELINESS AND QUALITY OF FINANCIAL STATEMENTS

Statutory financial reporting requirements

Under Section 28 of the *Financial Management and Audit Act 1990* (FMAA) and Section 52 of the *Government Business Enterprises Act 1995* (GBE) specific dates are set by when relevant entities are to provide financial statements to Audit to formally allow the audit process to commence. The dates specified are as follows:

- FMAA: Within 45 days after the end of the financial year; and
- GBE: Within 45 days after the end of the financial year.

Whilst no specific deadline is set for completion of financial statements of Statutory Authorities, I have taken the view that similar deadlines apply.

In most cases entities have a 30 June financial year making 15 August the statutory date. This year 15 August fell on a Sunday and I therefore accepted receipt of financial statements on Monday 16 August as meeting the statutory deadline.

What is not absolutely clear is just what is meant by "… provide financial statements to Audit….". I have interpreted this as requiring that the financial statements submitted to my Office for audit are complete in all respects including that they are certified by the responsible authority – in the case of Departments this is the Secretary and in the case of GBEs and Statutory Authorities this is the Board of Directors.

These dates have been set to allow sufficient time for the audit to be completed and an Annual Report produced for tabling in Parliament by 31 October each year. To facilitate this I set an internal deadline requiring my staff and my contractors to complete audits by no later than 15 October.

The situation for Local Government is set out in Part B, Volume 3 of this Report. State-Owned Companies must comply with the reporting requirements detailed in the *Corporations Law.*

There are no exemptions from meeting the statutory date under either the FMAA or the GBE Act, nor are there penalties for not meeting this date.

Financial reporting outcomes for the 2003-04 financial year

Practically all government entities responded strongly to this initiative. However, as set out in the summary below, some entities did not meet the target statutory dates detailed above.

Poor Quality Financial Statement Working Papers

While most entities met the lodgement deadline, the issue of a lack of a quality assurance process as an integral role in compiling work papers to support financial statements remained, and in some cases worsened.

Accurate work papers supporting all elements of the financial statements are an essential tool for management, particularly as part of the quality assurance process. It is essential that such work papers contain sufficient detail to enable verification by both management and my staff when conducting audits. With the tighter reporting timeframe now in place for FMAA entities and GBEs, this in turn affects my ability to provide audit clients with their audit opinions in time to enable them to table their annual reports in a timely manner.

Steps taken by Audit to facilitate earlier financial reporting

My Office took the following two steps as its contribution towards helping entities to meet the earlier financial reporting requirements:

- Re-introduced, based on completion of 2002-03 financial audits, awards for best working papers supporting financial statements. Separate awards were made for the different types of public sector entities. The purposes of effective financial statement working papers include:

    - A framework for the compilation of financial statements by current and future preparers;
    - A central reference to the evidence required to support transactions, balances and estimates disclosed in the financial statements;
    - A trail between the entity's financial records for the year and the financial statements for the year, which can be followed by persons having a quality assurance function; and
    - A record of the quality control processes employed in the preparation of the financial statements.

  This process assists my staff in the conduct of audits and, more importantly, assists entity accounting staff in the timely completion of accurate and quality assured statements; and

- Held a series of seminars for entity accounting staff dealing with changes to accounting standards and related matters. These sessions were held in May 2004 in Hobart and Launceston and provided guidance on steps to take to facilitate earlier financial reporting.

In the Auditor-General’s No. 2 Report last year he noted that ‘in terms of human resource management, while acknowledging a shortage of skilled and qualified finance personnel in the State Service generally, there were several instances where the preparation of financial statements was being carried out by one person, rather than delegating some of the tasks to others in the section.' This situation has improved slightly.

Signed Statements Not Received On or Before 16 August 2004

Ministerial Departments

Department of Treasury and Finance.

Government Business Enterprises

Forestry Tasmania; and
Rivers and Water Supply Commission.

Other Statutory and Public Bodies

The entities listed below are not required to submit to me completed financial statements within 45 days of financial year end and are listed for information only.

Aboriginal Land Council;
Clyde Water Trust;
Legal Aid Commission of Tasmania;
National Trust of Australia (Tasmania);
Tasmanian Beef Industry (Research & Development) Trust;
Tasmanian Heritage Council; and
Tasmanian Risk Management Fund.

Local Government

Refer to Part B, Volume 3 for comments.

8 SIGNIFICANT ISSUES ARISING FROM AUDITS

This Report contains statements of financial performance, financial position and cash flows, together with analysis of this financial information, of Government departments, government businesses (including state-owned companies), local government authorities and statutory authorities. Comparative information is also provided for groups of similar entities such as port corporations and councils.

The accompanying text sets out significant points, if any, arising from an analysis of the financial statements and in relation to the environment in which each entity operates.

The Report includes details of matters raised with entity management during the course of audits but only where the matter(s) raised was significant. The rationale for inclusion or otherwise rests on my perception of the public interest in each point and the need to confine comments to those matters that have more than a managerial dimension.

PRELIMINARY COMMENT

Timeliness of Annual Reports

In the Auditor-General's November 2003 Report, he commended the Government for amending the *Financial Management and Audit Act 1990* to provide for timelier annual reporting by Departments, Government Business Enterprises and Statutory Authorities. He noted that this would provide an opportunity for Parliamentary scrutiny to occur before the Parliament rises at the end of the year but that this change, whilst not onerous, would require considerable effort by the reporting entities and the Tasmanian Audit Office to achieve the desired outcome.

The new deadlines require entities to provide financial statements for audit within 45 days of the end of each financial year and to submit an Annual Report to Parliament by 31 October.

An overview of timeliness outcomes is reported in section 7 on page 22 of this Report.

Reporting of Non-Financial Performance

In addition to commenting on timeliness of financial reporting in his 2003 Report, the Auditor-General went on to note that:

"…it is actually the information in the whole report that is the issue. The next target for improvement once the reporting time frame has been bedded down must be to examine how to make performance reporting more meaningful. The Tasmania Together process has demonstrated how to report some key aspects of the State's performance in relation to some selected broad-based targets. More reporting entities should adopt targeted outputs and outcomes and report against them with explanatory text."

I support these observations and plan to progress this in the years ahead.

Administered versus Controlled transactions

The introduction of an accrual budgeting framework highlighted inconsistencies in the treatment of administered expenses under AAS 29 'Financial Reporting by Government Departments' between the budgeted and actual financial statements of departments.

Comparability of information in departments' financial statements is essential if increased accountability for the use of Government funds is to be achieved. Accordingly, following an extensive consultation process undertaken by the Department of Treasury and Finance and departments, with Audit providing a monitoring role, 72 of the 112 items classified as 'administered' in the 2003-04 Budget were reclassified as 'controlled', and three were classified as 'true trust' or agency arrangements. The impacts of this reclassification are reflected in the 2003-04 financial statements of departments and receive commentary in this Report. The agreed classifications will also be reflected in the 2004-05 Budget.

Subsequent to the process described above, a small number of additional items were identified for reclassification in the 2004-05 financial year.

SIGNIFICANT ITEMS IDENTIFIED IN 2003-04

Department of Justice – Prepayment of $10.061m

- Part B, Volume 1

Prison Project - Prepayment

On 30 June 2004, the Department made a prepayment for contract works for the new Prison redevelopment of $10.061m, in response to an invoice from John Holland Pty. Ltd. detailed as 'Progress claim for early payment'. Discussion with Department staff established that, although the Department had investigated all possible alternatives, the prepayment was made as there was no legal mechanism to carry the funds forward into the 2004-05 financial year, given the constraints of the *Public Account Act 1986*.

It seems improper to forward such a large sum of money in advance to a contractor, when alternatively the money could be retained within the State Government until the funds were actually required under the normal terms of the contract. It was noted however that bank guarantees were in place to provide security over the prepayment.

Prison Project – Signatories

The invoice for the $10.061m prepayment was approved for payment by the project program manager. The amount of $10.061m is clearly above this position's delegated authority, as even the Secretary can only authorise amounts up to $2.000m. My officers could not find any delegated authority instrument to authorise this payment and as a result, a qualified audit opinion was issued to highlight the breakdown in controls and the non-compliance with Treasurer's Instructions and hence the *Financial Management and Audit Act 1990*.

Following completion of the audit I ascertained that, from management's perspective, the payment was made within the terms of an already approved contract signed and dated prior to making the prepayment referred to above.

Hobart Ports Corporation – Toll Transport - Part B, Volume 2

On 29 June 2004 the Corporation's ownership interest in Hobart International Airports Pty Ltd (HIA) increased from 98% to 100%. The Corporation also acquired the 5 000 B class shares which were held by Toll Transport. In the past, HIA was a joint venture with Toll Transport. The Corporation was only able to exert significant influence over the airport, and hence consolidation of HIA was not appropriate under Australian accounting standards.

The Corporation equity accounted for its interest in HIA until 29 June 2004, and then for one day (30 June 2004) consolidated its interest in HIA in accordance with accounting standards. The consolidation of HIA created a discount on acquisition, which was written off against the capitalised leased assets of HIA in the 30 June 2004 financial report.

Southern Regional Cemetery Trust – Emphasis of Matter

- Part B, Volume 2

The Trust last valued non-current assets in 1998 on a fair value basis. As these assets have not been revalued since then, an "emphasis of matter" was included in the audit report for 2003-04 referring to the out-of-date valuation. The Trust has been urged to obtain an updated revaluation during the 2004-05 year.

National Trust of Australia (Tasmania) – Emphasis of Matter (30 June 2003 and 30 June 2004 Financial Statements)

- Part B, Volume 1

Audit Qualification

While incomplete at the time of preparing this Report, consistent with the audit report issued on the 2001-02 financial report, it is likely that the audit reports on the 2002-03 and 2003-04 financial reports will be qualified on the basis that the Trust failed to adopt the requirements of Australian Accounting Standard AAS 4 "Depreciation" by not depreciating or amortising freehold buildings and leasehold improvements respectively. In addition, the Trust possesses certain heritage collections but neither these assets nor any applicable depreciation was reflected in the financial statements.

Emphasis of Matter

For the year ended 30 June 2002, the audit report included an "emphasis of matter" section detailing an inherent uncertainty as to whether the Trust was able to continue as a going concern. While the audits for 2002-03 and 2003-04 were incomplete at the time of writing this Report, the continued operating loss position of the Trust and its considerable debts signify that similar audit reports are likely to be issued for these two years.

Local Government Water Authorities

- Part B, Volume 3

In July 2004, the Government Prices Oversight Commission (GPOC) handed down its final report "Investigation into the Pricing Policies of Hobart Regional Water Authority, Esk Water Authority and Cradle Coast Water. The report provides recommendations for maximum prices and pricing principles for each water authority for the three-year period commencing 1 July 2004.

In the Report, GPOC has recommended maximum revenues and minimum target revenues. For each of the Authorities, projected sales revenue is below the minimum recommended targets in each of the three years. The report noted;

"In summary, none of the authorities receives a commercial rate of return from its projected revenue. To achieve the recommended minimum rate of return (4.5% on pre-1998 assets and 7% on post 1998 assets), the projected revenues need to be raised by around 15 per cent for Hobart Water, 25 per cent for Esk Water and 11 per cent for Cradle Coast…"

As noted by the GPOC review the return on equity for all three Authorities remains low.

SIGNIFICANT ITEMS – FOLLOW UP OF MATTERS RAISED IN 2002-03

Department of Health and Human Services – Valuation of the Housing Portfolio

- Part B, Volume 1

Last year's audit report included an emphasis of matter paragraph on each of the Departmental financial statements and Housing Tasmania's financial statements. This related to an inherent uncertainty regarding the valuation of rental dwellings.

At that date rental dwellings were recognised in the financial statements at a written down value of $703.997m.

Between 2000 and 2003 the Department disposed of a number of surplus rental dwellings, at significant losses compared to the independent valuations provided by the Valuer-General. As part of the disposal process incentives were given in line with the policy of making affordable housing available to eligible applicants. It was recognised that the losses incurred were substantially influenced by incentives offered to purchasers under the "Streets Ahead" sales initiative, and the targeting of sales from the Housing Tasmania portfolio to people on low incomes. During this period proceeds received from houses sold, before these incentives, were below the carrying value of these houses. With continuing losses being made the concern was that the recorded written down value of dwelling stock might be overstated.

During 2003-04 Housing Tasmania disposed of 293 properties with a gain on disposal of $2.453m, a substantial turn-around from the 2002-03 loss of $9.400m. This result persuaded me to remove the "emphasis of matter" caution from my audit report. However the valuation of dwelling stock needs to be closely monitored by management.

Abt Railway Ministerial Corporation

- Part B, Volume 1

The Report No. 2 of 2003 noted that this Corporation had entered into a 20 year operating lease with Federal Holdings Tas Pty Ltd. This lease is ongoing and requires no further comment.

Tasmanian Risk Management Fund – Medical Malpractice Claims

- Part B, Volume 1

The Report No. 2 of 2003 noted that additional funding is to be provided to this Fund over the next five years to fully fund pre July 2001 medical malpractice liabilities. This funding commenced in the 2002-03 financial year.

Forestry Tasmania – Valuation of Forests

- Part B, Volume 2

The Report No. 2 of 2003 noted a revision by Forestry Tasmania of policies and inputs relating to the valuation of the Forest asset, which resulted in a net reduction in the valuation by $17.702m. Similar policies and inputs were applied in determining the 2003-04 valuation, which saw an increase in the valuation by $9.303m.

Port Arthur Historic Management Site – GBE Status

- Part B, Volume 2

The Report No. 2 of 2003 noted that this Authority will require continued Government support to guarantee the long term future of the site. The No. 2 report went on to note that GBE status may not be consistent with the primary objectives of the Authority.

Both these positions remain unchanged.

Rivers and Waters Supply Commission - Revenue

- Part B, Volume 2

The Report No. 2 of 2003 noted that the Commission treats its annual appropriation as a capital contribution to Equity rather than revenue. This situation remains unchanged and the Commission continues to incur operating losses.

Tasmanian International Velodrome - Maintenance

- Part B, Volume 2

The Report No. 2 of 2003 noted that this Authority was concerned with the ongoing maintenance issues at the Silverdome. This position remains unchanged although I note in the Authority's Chapter in Volume 2 that it leases the Silverdome from the Department of Primary Industry, Water and Environment (DPIWE).

Under the terms of the property lease the Authority is responsible for internal maintenance of leasehold improvements, furnishings and fittings and other internal systems such as wiring, water pipes and fire protection systems. DPIWE is responsible for external maintenance including keeping "…the exterior of the Premises including the main drains, the foundations, the main boundary walls and the roof in good and tenantable repair and condition."

I note that while the Authority was conscious that the Government wished to make a decision on the future of the Silverdome before spending significant funds on the facility, the Authority stated that some of the maintenance issues involve occupational health and safety matters and should be considered with some priority.

Community Support Levy

- Part A, Executive Summary

I note that the Public Accounts Committee will be reviewing this matter and I have carried out no further work on this since 2003.

Sale of former Department of Transport site

- Part A, Executive Summary

This matter has still to be followed up.

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