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2005

PARLIAMENT OF TASMANIA

REPORT OF THE AUDITOR-GENERAL

GOVERNMENT DEPARTMENTS AND PUBLIC BODIES 2004-2005

PART A
Executive Summary

November 2005

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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22 November 2005

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 Financial 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 year ended 30 June 2005.

Yours sincerely

H M Blake
AUDITOR-GENERAL

GUIDE TO USING THIS REPORT

This Report is prepared under Section 57 (1) of the *Financial Management and Audit Act 1990*, which requires the Auditor-General, on or before 31 December in each year to report to Parliament in writing on the audit of Government departments and public bodies in respect of the preceding financial year. The issue of more than one report now satisfies this requirement each year.

During the 2005 calendar year two reports were tabled:

- Report No. 1 of 2005 tabled on 14 June 2005 – this report dealt with June 2004 financial statement audits incomplete at the time of tabling the November 2004 report, financial statement audits with 31 December 2004 balance dates and the Forestry Tasmania Land Swap; and
- Report No. 2 of 2005 tabled on 22 November 2005 – which is this Report. It deals with those audits of financial statements of entities with a 30 June 2005 financial year-end completed on 31 October 2005. The outcomes from audits completed after this date will be reported in the first half of 2006.

Consistent with past practice, this Report comprises four volumes:

- Part A – Executive Summary which includes an analysis of the Budget Outcomes Statements;
- Part B Volume 1 – Executive and Legislature, Ministerial Departments, Statutory Authorities and Miscellaneous Public Bodies;
- Part B Volume 2 – Government Businesses; and
- Part B Volume 3 – Local Government Authorities.

Where relevant, Agencies and Entities are provided with the opportunity to comment on any of the matters reported. Where they choose to do so, **Agency Responses** are detailed within that particular section.

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1 INTRODUCTION

This Report deals with the outcomes from financial statement audits of 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 2005.

The Report is based on the administrative arrangements set out under the provisions of the *Administrative Arrangements Act 1990* as at 30 June 2005 and has been prepared in accordance with the following classifications:

Part A	Executive Summary Introduction; Treasurer's Annual Financial Report; Accounting for Infrastructure and Other Long Lived Assets; IFRS Readiness and Impact; Timeliness and Quality of Financial Statements; and Matters of Significance and Follow-Up of Matters Previously Reported.
Part B – Volume 1	Executive and Legislature; Ministerial 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 including Local Government Water 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 4 of this Report. The layout of some of the primary statements has been amended to, where appropriate:

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

Some minor changes, relating to the three energy businesses, to the ratios applied in the financial analysis have been introduced. These are explained on page 7. In addition, a comparative analysis of the three energy businesses has also been included for the first time.

STATUS OF AUDITS

The majority of audits for the year ended 30 June 2005 have been completed with some exceptions as detailed in the preamble under each Part of the Report. Outcomes from incomplete audits will be reported to Parliament in the first half of 2006.

AUDITS CONDUCTED FOR THE FIRST TIME

New audit completed this year were:

- Jim Bacon Foundation; and
- Sullivan's Cove Waterfront Authority.

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.

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
EBITDA ($’000s)		Result from Ordinary Activities before Tax, before Gross Interest Expense, Depreciation and Amortization
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 – EBIT	>3	EBIT divided by Gross Interest Expense

Financial Performance Indicator	Benchmark*	Method of Calculation
Interest cover – Funds from Operations	>3	Cash from Operations plus Gross Interest Expense 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 (relevant to the MAIB)		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 (including capitalised employee costs) 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;
- Earnings before income tax, depreciation and amortisation (EBITDA) – measures how well an entity can generate funds

without the effects of financing (debt or equity), depreciation and amortisation and before it has to meet external obligations such as income tax. This measure is of particular relevance in cases of entities with large amounts of non-current assets as the distortionary accounting and financing effects on the entity's earnings are removed, enabling comparisons to be made across different entities and sectors;

- 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 – EBIT – an indicator of the ability to meet periodic interest payments from current profit (before interest expense). The level of interest cover gives a guide of how much room there is for interest payments to be maintained in the face of interest rate increases or reduced profitability.;
- Interest cover – Funds from operations – examines the exposure or risk in relation to debt – an indicator of the ability to meet periodic interest payments from funds from operations (before interest expense). The level of interest cover gives a guide of how much room there is for interest payments to be maintained in the face of interest rate increases or reduced funds from operations;
- 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;
- Dividend to equity – the relative size an entity's dividend payments to shareholders' equity. A low dividend to equity ratio may indicate that profits are being retained by the entity to fund capital expenditure;
- 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. Care should be taken in interpreting these measures, as by definition they are only indicators, and they should not be read in isolation.

Following a review of the indicators relating to the three energy businesses, those relating to EBITDA, Interest Cover – Funds from Operations, and Capital Expenditure/Depreciation have been included for the first time.

2 TREASURER'S ANNUAL FINANCIAL REPORT – BUDGET OUTCOMES STATEMENTS AND PUBLIC ACCOUNT STATEMENTS

INTRODUCTION

The Budget Outcomes Statements are a special purpose financial report prepared on an accrual Uniform Presentation Basis (UPF). These Statements comprise an Operating Statement, Balance Sheet, Cash Flow Statement and notes thereto for the General Government Sector (GGS). The Statements are a special purpose report because they have not been prepared in accordance with existing Australian Accounting Standards.

Explanations of the UPF basis for preparing the statements are provided in note 1 to these Statements and are not repeated here.

The Public Account Statements are a special purpose financial report prepared on a cash accounting basis. Explanations of this basis for preparing the Public Account Statements are provided in note 1 to these statements and are not repeated here.

LEGISLATIVE REQUIREMENTS

The Treasurer and the Secretary of the Department of Treasury and Finance sign both of these Statements, which are chapters within the Treasurer's Annual Financial Report (the TAFR).

The requirement for the TAFR to be prepared is spelt out in Section 26A of the *Financial Administration and Audit Act 1990*, which requires that:

1. As soon as practicable after the end of each financial year, the Treasurer is to prepare an annual report for that financial year.
2. The annual report is to contain for the financial year to which the report relates:
   a. The original estimates disclosed in the budget papers in respect of the major Government Finance Statistics statements; and
   b. The results in respect of the major Government Finance Statistics statements; and
   c. Statements reporting on the transactions within the Public Account during that financial year and the balances in the Public Account at the end of that financial year; and
   d. An explanation of any significant variations between the results for the financial year and the financial estimates and projections described in the budget papers; and

e. The Auditor-General's report on the results and statements referred to in section 26B.

3. The Treasurer may include in the annual report, in such form or manner as the Treasurer may determine, any other financial or statistical report.

The Budget Outcomes Statements satisfy the requirements specified in section 26A (2) (a) and (b) above and the Public Account Statements satisfy the requirements specified in section 26A (2) (c) above.

AUDIT OF THE 2004-05 BUDGET OUTCOME STATEMENTS AND OF THE PUBLIC ACCOUNT STATEMENTS

Section 26B, referred to in Section 26A(2)(e) above, requires that the statements referred to in Sections 26A(2)(b) and (c) must be submitted to the Auditor-General for audit before 30 September in each year. Signed Budget Outcomes Statements and signed Public Account Statements were submitted to me on 28 September 2005.

To enable the Treasurer to table audited Budget Outcomes Statements and audited Public Account Statements by no later than 31 October 2005, I must complete my audits of these statements prior to 31 October 2005. Separate unqualified audit opinions were issued on 21 October 2005.

THIS ANALYSIS

This analysis focuses on the Budget Outcomes Statements (referred to from now onwards as ‘the Statements’). The format of the analysis is consistent with that applied to individual entities reported elsewhere in this Report. The analysis is limited to the last two financial years because preparation of the Statements in their current form commenced in the 2003-04 financial year.

The TAFR includes commentary explaining the 2004-05 financial results against prior years and budget. This analysis does not comment on performance against budget.

In preparing this analysis some material does not appear in the Budget Outcomes Statements and has been extracted from other chapters in this Report. Examples include full time equivalent staffing numbers at 30 June 2005 and at 30 June 2004 and details of grants paid.

FINANCIAL RESULTS

FINANCIAL PERFORMANCE/OPERATING STATEMENT

	Percentage change	2004-05 $M	2003-04 $M
Revenue			
Grants and subsidies	5.91	2 115	1 997
Taxation revenue	8.72	686	631
Sales of goods and services	4.64	248	237
Interest income	30.30	43	33
Dividends and income taxes	4.97	190	181
Other revenue	(28.36)	96	134
Total Revenue	**5.14**	**3 378**	**3 213**
Expenditure			
Employee expenses	(9.61)	1 448	1 321
Other operating expenses	6.59	765	819
Grants and transfers	(33.49)	578	433
Depreciation	(10.91)	183	165
Nominal superannuation expense	(2.68)	115	112
Other interest payable	26.87	49	67
Total Expenditure	**(7.61)**	**3 138**	**2 916**
Net Operating Result	**(18.92)**	**240**	**296**
Less Net acquisition of non-financial assets:			
Purchase of non financial assets	(57.76)	(254)	(161)
Less Sale of non financial assets	(39.13)	42	69
Less Depreciation	10.91	183	165
Net acquisition of non financial assets	**(139.73)**	**(29)**	**73**
Fiscal Surplus (also referred to as Fiscal Balance)	**(42.82)**	**211**	**369**

Comment

Grants and subsidies primarily comprise revenues from the Commonwealth in the form of GST, specific purpose grants and capital grants. In percentage terms the GST represents 42% of the State's revenues as illustrated on the next page:

	Revenues expressed as a percentage	
	2004-05	**2003-04**
GST (Commonwealth)	42	43
Specific purpose grants (Commonwealth)	13	12
Capital grants (Commonwealth)	1	1
Total revenue from the Commonwealth	**56**	**56**
Other grants and subsidies	6	6
Payroll tax	6	5
State taxes on property	8	8
Other State taxes	7	7
Sales of goods and services	7	7
Dividends and income taxes	6	6
Interest income	1	1
Other revenues	3	4
Total	**100**	**100**

In total State revenues increased by 5.14% or $165.000m with State taxes increasing by 8.72% ($55.000m) and Commonwealth grants by 5.91% ($118.000m). However, as can be seen from this summary by percentages, the sources of revenue have remained unchanged.

Employee expenses represents 46.14% (2003-04 – 45.30%) of total expenditure and this cost increased by 9.61% or $127.000m in 2004-05. The increase from 45.30% to 46.14% equates to approximately $26.000m in additional costs as a percentage of total State recurrent expenditure.

The GGS is primarily comprised of Government Departments and their full time equivalent staffing levels at 30 June 2005 were 3.86% greater than the position at 30 June 2004 as is evident from the table below. (Note that these are not the average staffing levels and impacts on costs should be considered with caution.)

Government Departments	FTE at 30 June 2005	FTE at 30 June 2004	% Increase (decrease)
Economic Development	211	200	5.50
Education	8 013	7 799	2.74
Health and Human Services	7 677	7 251	5.88
Infrastructure, Energy and Resources	658	674	(2.37)
Justice	740	710	4.17
Police and Public Safety	1 589	1 535	3.52
Premier and Cabinet	407	406	0.25
Primary Industries, Water & Environment	1 085	1 040	4.33
Tourism, Parks, Heritage and the Arts	629	607	3.62
Treasury and Finance (excluding GPOC)	302	297	1.68
Total	**21 311**	**20 519**	**(3.86)**

In some cases, reasons for increases in staff numbers include transfer of staff from outside the Departmental sector – for example at Education where staff was transferred in from TAFE. Where material, reasons for other movements in staff numbers are explained within individual chapters for each agency within this Report.

While the overall increase in employee costs of $127.000m is manageable in an environment of strong revenue growth and positive net operating results, as occurred in 2004-05, this is a cost that requires careful management particularly as it is increasing at a rate in excess of the rate of growth in revenues. The need to manage employee related expenditures was also made in my analysis of the Whole of Government financial report for the year ended 30 June 2004.

Expenditure on grants and transfers increased by $145.000m or 33%. This primarily represents increases in:

- Current grant expenses by $98.000m to $446.000m;
- Expenditure on capital grants of $30.000m (nil in 2003-04). This included $14.5.00m incurred in relation to the Tasmanian Community Forest Agreement; and
- Grants to Local Government Councils of $11.000m to $75.000m.

Increases in Grant and transfer expenditures were mainly incurred by the Departments of:

	$m
Economic Development	5.7
Education	20.1
Infrastructure and Energy	4.5
Tourism, Parks, Heritage and the Arts	18.3
Treasury and Finance	80.0

Grants made by the Department of Primary Industries, Water and Environment dropped by $11.400m compared to 2003-04.

The Depreciation expense increased by 10.91%, primarily due to investment in property, plant and equipment and as a result of infrastructure and building upward revaluations.

In total the GGS expenditure increased by 7.61% and because revenue growth was lower at 5.14%, the net operating result, whilst healthy, declined by $56.000m.

The investment in non-financial assets was $93.000m higher than in 2003-04, which is the main reason why the Fiscal Surplus decreased by $158.000m. Expenditure on non-financial assets is commented upon in the Balance Sheet section of this Report.

In its Preliminary Outcomes Report 2004-05 issued in August 2005 the Department of Treasury and Finance noted that, at that time, the Fiscal Surplus was $233.000m (the final outcome was $211.000m) and that this

surplus did not reflect $210.600m of commitments and equity contributions to government business which comprised:

- Equity Contributions to Government Business, which were made prior to 30 June 2005 but were not a charge against the Operating Statement:

TT-Line	75.200m
TOTE Tasmania	22.600m
Forestry Tasmania	1.000m

- Special capital investment funds appropriated to Departments but not spent at 30 June 2005. Because commencement of the capital projects had not started at 30 June, these appropriations were not charged to "Purchase of non-financial assets" in the Operating Statement. Details are:

Royal Hobart Hospital Redevelopment Fund	35.000m
Better Roads Fund	25.000m
Community Health and Well being Fund	14.100m
Structural Performance and Initiatives Program	8.000m
Economic and Social Infrastructure Fund	12.000m

In addition, Capital Investment Program projects with commitments totalling $17.700m were carried forward into 2005-06.

I support Treasury's view that these are commitments that would, if incurred earlier, have reduced the reported surplus.

FINANCIAL POSITION/BALANCE SHEET

		Change $M	2005 $M	2004 $M
Assets				
Financial assets				
Cash and deposits	A	(62)	623	685
Advances paid	A	(24)	42	66
Investments. Loans and placements	A	(2)	10	12
Other non-equity assets	B	20	334	314
Equity in GBEs and SOCs	B	(424)	3 782	4 206
Total financial assets	***C***	***(492)***	***4 791***	***5 283***
Non-financial assets				
Land and other fixed assets		1 310	7 633	6 323
Other non-financial assets		39	61	22
Total non-financial assets		***1 349***	***7 694***	***6 345***
Total assets	***D***	***857***	***12 485***	***11 628***
Liabilities				
Advances received	E	**12**	261	273
Borrowings	E	**216**	387	603
Superannuation	F	(50)	2 292	2 242
Other employee provisions		(18)	329	311
Other non-equity liabilities		8	210	218
Total liabilities	***G***	***168***	***3 479***	***3 647***
Net Worth	**D-G**	**1 025**	**9 006**	**7 981**
Net Financial Worth	**C-G**	**(324)**	**1 312**	**1 636**
Net Financial Liabilities	**H+F**	**90**	**(2 265)**	**(2 355)**
Net Debt	**H=A-E**	**140**	**28**	**(113)**

Comment

The State’s investments in its GBEs and SOCs represent 100% of the audited net assets of these entities, which at 30 June 2005 were:

GBE/SOC	Movement $m	2005 $m	2004 $m
Forestry Tasmania	(30)	697	727
Hydro Tasmania	(518)	1 538	2 056
Motor Accidents Insurance Board	51	173	122
Port Arthur	2	12	10
Printing Authority	0	3	3
The Public Trustee	1	4	3
Rivers and Waters Supply Commission	7	43	36
Southern Regional Cemetery Trust	0	6	6
Tascorp	10	20	10
Aurora Energy	28	404	376
Burnie Port Corporation	2	21	19
Hobart Ports Corporation	5	64	59
Metro Tasmania	0	21	21
Port of Devonport Corporation	1	38	37
Port of Launceston	0	27	27
TOTE Tasmania	24	40	16
Transend Networks	20	572	552
TT-Line Company	(4)	110	114
Total net assets	**402**	**3 793**	**4 195**
Amount recorded as Equity	**424**	**3 782**	**4 206**
Variance accepted as not material*	**22**	**(11)**	**11**

* Variance arises because the Budget Outcomes Statements are completed prior to finalisation of audits of GBEs and SOCs.

Reasons for significant movements between years include:

- Downward revaluation in Hydro's generation assets and in Forestry Tasmania's forest assets;
- Profits generated in Transend and Aurora,
- Profits, including unrealised gains in market values of investments, in the MAIB; and
- Asset additions at TOTE.

The change in the net assets at TT-Line was small but was represented by losses of $79.000m offset by equity contributions of $75.000m.

Land and other fixed assets increased by $1.310b ($1.493b before depreciation) primarily due to:

- Asset construction/acquisitions in Education, Health, DIER, Tourism, TAFE, State Fire Commission and Treasury - $224.000m;
- Assets identified for the first time in Tourism - $73m.000; and
- Net revaluation surpluses in Education, Health, DIER, Tourism and TAFE - $1.143b.

Borrowings decreased consistent with Government's policy of reducing net debt. During the year Borrowings in excess of $240.000m were settled. As a result net debt was positive in an amount of $28.000m. However, net financial liabilities remains high at $2.265b almost all of which comprises unfunded superannuation liabilities.

Net worth has grown by $1.025b to $9.006b the increase being due to asset revaluations already referred to and the operating surplus for the year. The Budget Outcomes Statements includes a reconciliation of movements on Net Worth, which is repeated below as follows:

	$m
Opening Net Worth	7 981
Add net operating result	240
Add net revaluations of non-financial assets	1 256
Add assets acquired at below fair value	79
Less equity investment revaluations	(520)
Add revaluation of superannuation liability	20
Less other changes in net assets	(50)
Closing Net Worth	**9 006**

The main components in this reconciliation have been commented upon previously.

CASH POSITION

		Change $m	2004-05 $m	2003-04 $m
Cash receipts from operating activities	A	148	3 417	3 269
Cash payments for operating activities	B	(195)	(2 971)	(2 776)
Net Cash Inflows from operations	C=A-B	**(47)**	**447**	**493**
Net acquisition of non-financial assets				
Sale of non-financial assets		(34)	42	76
Purchase of non-financial assets		(72)	(241)	(169)
Net acquisition of non-financial assets	**D**	**(106)**	**(199)**	**(93)**
Net cash flows from investments in financial assets for policy purposes	E	**(47)**	**22**	**69**
Net cash flows from investments in financial assets for liquidity purposes	F	11	0	(11)
Net cash flows from financing activities				
Advances received		37	(13)	(50)
Net borrowings repaid		(97)	(242)	(145)
Other financing		(86)	(106)	(20)
Net cash flows from (on) financing activities	G	**(146)**	**(360)**	**(215)**
Cash surplus/(deficit)*	H=C-D	**(153)**	**248**	**400**
Net increase/(decrease) in cash held	I=H+G +E+F	**(333)**	**(90)**	**243**
Cash at beginning of year			**685**	**441**
Cash at end of year			**623**	**685**

* Cash surplus/(deficit) is equal to net cash flows from operating activities plus net cash flows from investments in non-financial assets.

Comment

Reasons for movements in the State's cash flows are consistent with the commentary already provided relating to the operating statement and balance sheet. For example, the $47.000m decrease in net cash flows from operating activities confirms that whilst State receipts are growing, operating payments are growing at a faster rate.

OVERALL COMMENT

The State's financial position is sound.

My audit of the 2004-05 Budget Outcomes Statements and of the Public Account Statements was completed with satisfactory results.

3 ACCOUNTING FOR INFRASTRUCTURE AND OTHER LONG LIVED ASSETS

BACKGROUND

INTRODUCTION

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

Significant concerns that arise from asset accounting and 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.

Long-lived infrastructure assets include electricity generation and transmission assets, State roads and bridges, local government roads and bridges, sewerage, drainage and stormwater assets, water storage and reticulation assets, and port facilities.

These assets are collectively recorded at over $10.000b, and most of these asset classes have useful lives of asset components ranging from 40 to 100 years and beyond.

PRESENT ACCOUNTING PRACTICES

For many years, government departments have been required to record all land, buildings, infrastructure, heritage and cultural assets, and long-lived items of property, plant and equipment at fair value.

For many years, Treasurer's Instructions (TIs) issued under the *Government Business Enterprises Act 1995* required government business businesses to adopt deprival values based on written down replacement cost. Following the introduction of Australian Accounting Standards Board standard AASB 1041 "Revaluation of Non-current Assets" from 1 July 2000, TI GBE 13-114-01 "Asset Valuation" was withdrawn in June 2002. Most GBEs continue to report infrastructure assets at fair value subject to any recoverable amount write-downs.

State-owned companies subject to the *Corporations Act 2001* have not had any mandated accounting or asset valuation practices prescribed. Electricity utility companies are carrying their infrastructure assets at fair value, while the four port companies deemed the carrying values of the infrastructure assets to be cost under the transitional provisions of AASB 1041 in 2001.

The introduction of the Australian Equivalents to International Financial Reporting Standards (AIFRS) from 1 July 2005 offers the option for reporting entities to measure an item of property, plant and equipment at the date of transition to AIFRS at its fair value and using that fair value as its deemed cost at that time.

Hydro Tasmania has elected to deem the carrying value of its generation assets at transition date to be cost under the provisions of AASB 1 "First Time Adoption of AIFRS".

A number of local government authorities elected to deem carrying values of infrastructure to be cost at the time that AASB 1041 was implemented on 1 July 2000. Ten of Tasmania's 29 councils are carrying at least one class of infrastructure assets at cost, however a number of those councils are moving back to a fair value measurement basis.

All local government water authorities are carrying infrastructure assets on a fair value measurement basis.

PREVIOUS RECOMMENDATIONS

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."

In my report to Parliament in November 2004, I made the following recommendations:

- Local Government Authorities be required to adopt fair values when accounting for long-lived assets with useful lives of 10 years or more;
- The "fair value" option for valuing long-lived infrastructure assets with useful lives greater than 10 years be mandated by Treasurer's Instruction for Government Business Enterprises and Government Departments; and
- Shareholding Ministers mandate the adoption of fair values by State-Owned Companies when accounting for infrastructure assets with useful lives greater than 10 years.

The Local Government Board has likewise 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.

RESPONSE FROM GOVERNMENT

From 1 July 2005 Treasurer's Instruction 909 continued the requirement for Government departments to record at fair value all land, buildings, infrastructure, heritage and cultural assets and long-lived plant and equipment.

On 26 October 2004 I was advised that the Minister Assisting the Premier on Local Government had decided not to proceed with my proposal that Councils use the fair value option for valuing long-lived infrastructure assets. The decision not to proceed was made on the basis that my proposal was had been made towards the end of a lengthy period of consultation in respect of the *Local Government Amendment Bill 2005,* and the timing constraints imposed by that review did not allow for further consultation.

I understand that Government has made no decisions in relation to my recommendations to mandate fair values for Government Business Enterprises and State–owned Companies.

INFRASTRUCTURE ASSET RENEWAL

AN ILLUSTRATIVE EXAMPLE

The Sydney Harbour Bridge was opened in 1932 at a cost of £4,218m, or $8.436m, and while this amount is a reliable measure of historic cost it has very little relevance in 2005. Likewise any depreciation charge based on that historic cost would also have little relevance today.

Today the bridge carries more than 160 000 vehicles each day, with southbound vehicles paying a toll of $3.00. Annual revenue from bridge tolls would be in excess of $87.600m, and this amount has both reliability and relevance being measured in today's dollars.

The tolls collected each year are now more than 10 times the historic cost of building the bridge in 1932.

SOURCES OF FUNDING FOR ASSET RENEWAL

As with any business there are generally four sources for funding the purchase of new or replacement assets, two internal and two external. These sources are profits or surpluses generated from operating activities; funds generated from depreciation provided there is a balanced bottom line, borrowing from external sources, and grants from Commonwealth and State Governments.

Obviously, the first two sources of funding are under the control of the reporting entity and would generally be the major source of financing for asset renewal. While borrowing may be an option for very large projects, costs of borrowing are difficult to control, and Government grants are policy decisions of the Governments of the day and may not always be available.

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

Many Councils 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 many Councils may not be maintaining their physical capability.

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

INTER-GENERATIONAL EQUITY

While in the case of the Sydney Harbour Bridge example quoted above the construction of the bridge was financed by past generations, and the replacement of the bridge will be financed by future generations, the consumption of the asset, represented by current cost depreciation, should be born by the present users.

The Victorian Government has required councils to ensure inter-generational equity by requiring that “decisions are made and actions taken having regard to their financial effects on future generations” – Victorian *Local Government Act 1989*.

AUSTRALIAN INTERNATIONAL FINANCIAL REPORTING STANDARDS FINANCIAL REPORTING FRAMEWORK

From 1 January 2005, Australia adopted 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 (AASB), has decided that Australia will have one set of sector neutral accounting standards that will apply to both the for-profit and not-for-profit sectors including the public sector.

In July 2004 the AASB issued its "Framework for the Preparation of Financial Statements" based on the international framework. The framework replaces Statements of Accounting Concepts SAC 3 and SAC 4. The main differences are that the framework contains a different notion of income (which includes gains) and revenue, and a different notion of expenses (which includes losses), from those contained in SAC 4.

The framework discusses a number of accounting conventions including underlying assumptions, qualitative characteristics of financial reports, measurement issues and concepts of capital and capital maintenance.

QUALITATIVE CHARACTERISTICS

There are four principal characteristics that make the information provided in financial reports useful to users:

Understandability

Users are assumed to have a reasonable knowledge of the business and a willingness to study the information. Complex information should not be excluded on the grounds that it is difficult for users to understand.

Relevance

Information has relevance when it influences the economic decisions of users by helping them evaluate past, present or future events. Information about financial position and past performance is frequently used to predict future events.

Reliability

Information is reliable when it is free from material error and bias and can be depended on by users. It is necessary that transactions and other events be presented in accordance with their substance and economic form and not merely their legal form.

Comparability

Users must be able to compare financial reports of an entity through time, and be able to compare different entities to be able to evaluate relative financial performance, financial position and cash flows.

MEASUREMENT BASES

A number of different measurement bases are used to different degrees including the following:

Historic cost

Assets and liabilities are recorded at the amount of cash or cash equivalents paid or receivable in the normal course of business.

Current cost

Assets are carried at the amount that would have to be paid to acquire the same or a similar asset if it were acquired currently. Likewise liabilities are carried at the undiscounted amount of cash required to settle the obligation currently.

Realisable value

Assets are carried at the amount that would be realised in an orderly disposal. Liabilities are carried at settlement values.

Present value

Assets are carried at the present discounted value of future cash flows that the item is expected to generate, and liabilities are carried at the present discounted value of future cash outflows required to settle the obligation.

FAIR VALUE DEFINITION

Fair value is generally defined as the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing paries in an arm's length transaction.

Where market-based evidence is not available a depreciated replacement cost approach is recommended for assets, while liabilities are valued at the present value of future cash outflows required to settle the obligation using an appropriate discount rate.

CONCEPTS OF CAPITAL

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.

ACCOUNTING MODELS

While a number of measurement bases are often employed, 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.

The AASB in framing AIFRS 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 AIFRS.

TRUE AND FAIR VIEW/PRESENTS FAIRLY

Financial reports are frequently described as showing a true and fair view, or presenting fairly financial information that has been prepared under an appropriate accounting model and disclosed in accordance with approved accounting standards.

Corporations Act disclosures

Section 296 of the *Corporations Act 2001* mandated compliance with accounting standards. Section 297 also requires that the financial report must give a true and fair view, and acknowledges that compliance with accounting standards may not necessarily give a true and fair view.

Auditing standards

Auditing Standard AUS 702 deals with the audit report on a general purpose financial report. The standard provides for an unqualified audit opinion to be given where the financial report is presented fairly in accordance with Accounting Standards and any relevant statutory requirements. Where an unqualified opinion cannot be given then a range of qualified opinions is available depending on the circumstances.

In certain limited circumstances it will be appropriate for the auditor to draw attention to or emphasise a matter that is relevant to users of the audit report but is not of such a nature that it affects the audit opinion.

CONCLUSION

It is my considered opinion that the historic cost accounting model is inappropriate when accounting for long-lived infrastructure assets.

In those situations where the historic cost model has been adopted and the difference between historic cost and fair value is considered to be not material I propose to include an emphasis of matter section in my audit report, which would draw attention to the accounting model adopted by the entity. The report would not be qualified.

At some point after the adoption of an historic cost model for infrastructure assets a qualified audit opinion would be issued when

demonstrated material mis-statements in reported balances arise from differences between the historic cost model and a fair value model. Each case would be determined on the circumstances prevailing at the time of issue of the audit report, but would be based the movements in appropriate cost indices available from the Australian Bureau of Statistics and other reputable sources.

RECOMMENDATION

I repeat my recommendation that fair values be mandated for all entities, including Government departments, GBEs, SOCs, local government authorities and other state authorities, when reporting the carrying values of long-lived infrastructure assets with useful lives greater than 10 years.

Department of Treasury and Finance Response

I note your recommendation that fair values should be mandated for all entities, including Government departments, Government Business Enterprises (GBEs) State-owned Companies (SOCs), local government authorities and other state authorities. I also note your comment that the Government has made no decisions in relation to recommendations by the Auditor-General to mandate fair values for GBEs and SOCs.

On 2 February 2001, the former Auditor-General, Dr Arthur McHugh, wrote to the then Treasurer, Dr David Crean MLC, specifically in relation to non-current asset valuation in the State's Ports. This letter recommended that all SOCs should adopt fair value as the basis of measuring the value of their non-current assets, rather than continuing with or reverting to historical cost, as permitted by the then Australian Accounting Standard AASB 1041, Revaluation of Non Current Assets.

The response of 19 April 2001, from the then Treasurer and Deputy Premier, noted that, in general, accounting standards are moving away from historic cost as a basis of measurement and recording, in favour of fair value and that the Auditor-General's recommendation was consistent with this trend.

However, the response noted further that:

> *We were mindful of the need to balance your recommendation for a consistent approach to asset valuation, with Government's objective in establishing SOCs to operate on a fully commercial and competitive basis, being subject only to enabling legislation, Corporations Law and accounting standards.*
>
> *While we would encourage a consistent approach to asset valuations across all SOCs, we consider that, in this instance, the Australian Accounting Standards provide appropriate guidance to commercially independent entities such as State-owned Companies, and their private-sector counterparts…*
>
> *We therefore do not consider it appropriate, in this instance, to override the Government's policy of providing maximum commercial freedom to SOCs by directing all SOCs to adopt a fair value approach to valuation of major asset classes.*

Whilst I agree that valuation of infrastructure assets under a fair value basis provides superior information for asset management purposes and for funding decisions, I consider the principles contained in the April 2001 response from the then Treasurer and Deputy Premier, remain valid.

It is my position that entities that have been established to operate on a commercial basis, and compete with other entities in the private sector, should be encouraged to adopt fair value in determining values for infrastructure assets. However, these entities should remain free to

determine their own accounting policies within the framework, established by the Corporations Law and Australian Accounting Standards, under which other commercial entities operate.

I note your interpretation of sections 296 and 297 of the Corporations Law, that an entity, may report in compliance with Accounting Standards but fail to report a true and fair view in the financial statements and that, accordingly, if material misstatements were to arise between infrastructure valued at historic cost and the value that you determine would be appropriate under a fair value model, that an audit qualification may result. I consider that the Board of a SOC is best placed to determine the most appropriate valuation basis for application within that SOC.

As you are aware, the Australian Accounting Standards Board (AASB) is currently pursuing harmonisation of Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics (GFS). The use of fair values is an important element of GFS and its application is likely to be mandated for the valuation of infrastructure assets during the development of a GAAP-GFS Harmonised standard. While the scope of the harmonisation project is currently restricted to the General Government Sector, the project will, in the medium term, be extended to cover other government entities such as GBEs and SOCs.

Department of Premier and Cabinet Response

The response referred to was made in the context of the Local Government Act Review process and was largely guided by the timing constraints imposed by that review.

Your proposal, received on 27 May 2004, came at the end of a lengthy consultation process that had commenced in March 2003. That process had included release of an Issues Paper, consideration of submissions by a Working Group, and release by the Steering Committee of a Report on the Working Group's Findings and Recommendations.

The Minister's decision not to proceed with your proposal was made entirely within the context of that review process and the fact that your proposal was unfortunately received too late for sufficient consultation at that time. The Government's Communication and Consultation Agreement with Local Government requires that Local Government be provided with lengthy periods of consultation. A decision was therefore made that it was not possible to undertake the required consultation on your new legislative proposal within the timeframe required for completion of the Local Government Amendment Bill 2005 and subordinate legislation package.

The Minister is not opposed to the adoption of 'fair value' as an accounting standard. It is agreed that the proposal may have merit. However, it is also considered that further detail is needed to present a convincing argument that a significant detriment arises for ratepayers from not adopting this standard.

Local Government makes its own decisions with respect to the adoption of various accounting standards and the Government would be reluctant to intervene in a manner that interfered with this autonomy unless there is a clear argument that the adoption of such a standard is essential.

Therefore, there would need to be further discussion with Local Government and a formal engagement in consultation in accordance with the Communication and Consultation Agreement. While it is not possible for that consultation to occur before the delivery of your report, it would be useful to discuss how we might progress this matter during 2006.

4 IFRS READINESS AND IMPACT

Australia adopted 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.

Despite a number of cautions noted below and on the following pages, there was generally a high level of readiness by Tasmanian public sector entities for IFRS and this part of my report has been included to provide an indication of some of the significant changes that will arise due to the introduction of these new accounting standards in Australia.

IFRS IMPACT FOR 2004-05

For entities with a 30 June 2005 balance date, existing Australian Accounting Standards applied. However, AASB 1047 "Disclosing the Impacts of Adopting Australian Equivalents to International Financial Reporting Standards" required entities to disclose as a note to their 2004-05 financial statements quantification of the financial effects of the adoption of IFRS. Accurate quantification is 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 applied. Entities should, therefore, have been in a position to prepare their June 2005 financial statements on the basis of IFRS. Where quantification of the impact of IFRS was not possible at 30 June 2005 this fact had to be stated.

Entities with a 31 December balance date prepared their 2004 financial statements in accordance with existing Australian Accounting Standards and they quantified the effects of adopting IFRS at that 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.

While the adjustments disclosed in the notes to the financial statements of entities are based on their management's best knowledge of expected standards and interpretations, and on current facts and circumstances, these may change. For example, amended or additional standards or interpretations may be issued by the Australian Accounting Standards Board and by the International Accounting Standards Board. In some instances, where entities have yet to finalise their business impact analysis, the final impacts of the adoption of IFRS on the financial statements was not known as at 30 June 2005. Therefore, until entities prepare their first full IFRS financial statements, the possibility cannot be

excluded that the disclosures made as at 30 June 2005 may have to be adjusted.

OPTIONS AVAILABLE IN IFRS

The new standards allow optional accounting treatments in certain circumstances. For agencies, Treasurer's Instruction No 710, issued on 15 April 2005, mandates the selection by Departments of the available options. This will facilitate comparable accounting by this group of entities.

All other entities are free to select which of the options to take up with disclosure of choices made appearing in their financial statements.

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 whose 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. As an Agency's principal objective is not the generation of profit, Treasurer's Instruction TI 710 states that all agencies are not-for-profit.

For Government Business Enterprises, the Department of Treasury and Finance holds the view that their establishment under the GBE legislation makes all of them for profit entities. However, there are a limited number of cases where this classification remains outstanding. In such cases the entities have not been able to quantify the effects of transitioning to IFRS until this issue has been resolved.

All other entities were required to individually make such determination. Councils have all determined that they are not-for-profit while all state owned companies are for-profit. Statutory Authorities are not for profit.

STATUS OF IFRS CONVERSION PROJECTS

A small number of public sector entities have yet to complete their IFRS projects. In some cases this is due to unresolved issues while in others as a result of an inability to reliably quantify the impacts. All such matters must be resolved in order for such entities to produce their first fully compliant set of IFRS financial statements as at next balance date.

While I accept that in some instances the failure to complete IFRS projects was unavoidable, I am disappointed that projects were not completed, particularly given that these requirements have been known for a considerable time.

QUANTIFICATION OF IMPACTS

Examination of the 30 June 2005 financial statements of public sector entities and the disclosures required under accounting standards in relation to the impact of transitioning to IFRS reveals that, in total, write downs to equity as at 1 July 2004 in excess of $1.000bn will be required.

The most significant impacts arise from recognition of superannuation liabilities for defined benefit schemes which are in deficit, and from restatement of tax balances. These changes occur mainly in relation to State Owned Companies and GBE's with some of the larger changes shown below:

IFRS Reduction in (increases to) Equity 1 July 2004 ($m)				
Entity	*Tax*	*Superannuation*	*Other*	*Reduction in Equity*
Hydro Tasmania	588.8	72.6	-	661.4
Forestry Tasmania	133.6	15.9	(11.4)	138.1
Aurora Energy	66.8	8.5	2.4	77.7
Motor Accidents Insurance Board	(37.9)	0.4	125.7	88.2
Transend Networks	75.2	3.0	0.3	78.5

AUDIT OF OPENING BALANCE PREPARED UNDER IFRS

Public sector entities whose financial statements at 30 June 2005 will change as a result of IFRS will have to prepare amended opening balances at 1 July 2005. It is necessary that my Office audit these opening positions as they will represent the restated comparatives for financial statements to be prepared under IFRS at 30 June 3006.

Discussions with entities' management about the timing of these audits are under way.

5 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 by when financial statements are to be transmitted to my Office.

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. In some instances entities have signed their financial statements by the 15 August, but did not provide them to my Office until a few days later.

These dates have been set to allow sufficient time for the audit to be completed and for the reporting entities to prepare their Annual Reports 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 2004-05 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 an effective internal quality assurance process as an integral role in compiling work papers to support financial statements remained.

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:

- Based on completion of 2003-04 financial audits, presented 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 early 2005 in Hobart and Launceston and provided guidance on steps to take to facilitate earlier financial reporting.

In the 2002-03 Auditor-General's No. 2 Report it was 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 remains unchanged.

SIGNED STATEMENTS NOT RECEIVED ON OR BEFORE 15 AUGUST 2004

INTRODUCTION

Listed below are entities whose signed financial statements were not received prior to the statutory deadline. Dates shown in brackets represent the date signed financial statements were received, unless otherwise stated.

Ministerial Departments

- Department of Police and Public Safety (18 August 2005); and
- Office of the Governor (20 August 2005)

Government Business Enterprises

- Forestry Tasmania (incomplete signed 31 August 2005; amended 29 September 2005); and
- Port Arthur Historic Site Management Authority (signed 19 September 2005; amended 4 October 2005)

Other Statutory and Public Bodies

Under FMAA the entities listed below are required to submit completed financial statements within 45 days of financial year-end:

- Aboriginal Land Council (outstanding);
- Inland Fisheries Service (24 August 2005);
- Legal Aid Commission (outstanding);
- Maritime and Safety Authority (27 September 2005);
- Nominal Insurer (11 October 2005);
- Royal Tasmanian Botanical Gardens (21 October 2005);
- Tasmanian Beef Industry (Research & Development) Trust (outstanding); and
- Tasmanian Heritage Council (3 October 2005).

National Trust of Australia (Tasmania)

Under section 17 of the *National Trust of Australia (Tasmania) Act 1975*, a copy of the Trust's annual financial statements is required to be submitted to the Minister by 30 September of each year. As of the time of printing this Report, these statements were still outstanding

Local Government

Refer to Part B, Volume 3 for comments.

6 MATTERS OF SIGNIFICANCE AND FOLLOW-UP OF MATTERS PREVIOUSLY REPORTED

This Report contains analysis of financial information of Ministerial departments, government businesses (including state-owned companies), local government authorities, statutory authorities and other public bodies. Comparative information is also provided for groups of similar entities such as port corporations, councils and, for the first time, energy entities.

The accompanying text summarises significant matters identified from our analysis of the financial statements. A cross reference to the relevant detailed report is provided. Not included are financial and reporting matters that are common across public sector entities, such as timeliness of reporting, because these are dealt with separately in this volume. In addition, not included are matters dealt with in the analysis of the Treasurer's Annual Financial Report.

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. Also included below are summaries of the more significant accounting changes made by some entities.

A section is again included here following up matters reported in previous Reports to Parliament.

PRELIMINARY COMMENT

Administered versus Controlled transactions

Australian Accounting Standard AAS 29 'Financial Reporting by Government Departments' requires that departments report separately on transactions and balances that they control and those that they administer on behalf of government.

Departments in Tasmania comply with this requirement. There is recognition, however, that the classification of transactions and balances between those controlled or administered is not straightforward. I reported last year that this classification was the subject of extensive discussion resulting in a number of changes in 2003-04 financial reports and in the preparation of the 2004-05 budgets.

Further changes were made in 2004-05 financial reports with the primary objective being to facilitate easier understanding and interpretation of the reported financial results. This included changes in classifications and disclosures in Finance-General details of which are included in the Chapter dealing with the Department of Treasury and Finance.

A small number of additional items were identified for reclassification in the 2004-05 financial year in other departments.

MATTERS IDENTIFIED IN THE AUDITOR-GENERAL'S NOVEMBER 2004 REPORT AND IN THE JUNE 2005 REPORT NO. 1

Department of Justice – Prepayment of $10.061m

- November 2004 Report 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*.

This was a one-off transaction and, as noted in my November 2004 Report, following completion of the 2003-04 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.

Southern Regional Cemetery Trust – Emphasis of Matter

- November 2004 Report Part B, Volume 2 and

- November 2005 Report Part B, Volume 2

In my November 2004 General Report I noted that the Trust last valued non-current assets in 1998 on a fair value basis and that, as these assets had 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 was urged to obtain an updated revaluation during the 2004-05 year.

During 2004-05, based on independent advice received, which was not from a property valuer, the Trust decided that, in view of the unique nature of its operations and assets, revaluations of its property assets are inappropriate and, as a result, it ceased applying a revaluation policy in accounting for these assets. In addition, it introduced a policy of valuing new cemetery assets acquired for no consideration at cost being nil. I am sympathetic with this course of action particularly as it relates to the Trust's land assets. However, consideration should be given by the Trust to revaluing its buildings and other infrastructure at depreciated replacement cost. I have recommended to the Trust that it obtains an independent valuation from a property valuer.

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

- November 2004 Report Part B, Volume 1 and

- June 2005 Report No. 1 Chapter 4

The above two reports contained outcomes of audits of the National Trust of Australia (Tasmania) (the Trust), which included details of an audit qualification relating to its depreciation policy and reference to an inherent uncertainty as to whether the Trust was able to continue as a going concern.

Neither of these two matters have been followed up in 2004-05 because the financial statements of the Trust for this financial year have not been received.

Sale of former Department of Transport site

- November 2004 Report Part A, Executive Summary

This matter is being followed up the outcomes from which will be reported in my next report.

Forestry Tasmania - Land Swap Report

- June 2005 Report No. 1 Chapter 8

It is not my intention to follow up this matter at this time.

MATTERS IDENTIFIED DURING 2004-05 AUDITS

This section summarises significant matters highlighted for information as well as matters that I consider may require management attention. Matters dealt with are entity specific. Further details are provided in specific chapters for each entity.

Situations where Audit Opinions were qualified

- November 2005 Report Part B, Volume 3

Central Highlands Council

My audit opinion on the annual financial statements of Council was qualified. In October 2004, Council entered into a contract for the provision of road construction services, totalling $3 211 615. Contrary to the requirements of Section 346 of the *Local Government Act,* Council did not seek tenders when approving this contract. This Section requires a council to invite tenders for any contract valued at or above $50 000.

Council's financial statements appropriately record transactions to date relating to this contract. Expenditure to 30 June 2005 totalled $1 197 833. However, I was not in a position to quantify the effects, if any, on the contract sum had Council invited tenders and I qualified my audit opinion on Council's financial statements accordingly.

Use of "emphasis of matter" paragraphs in audit opinions – revaluations of non-current assets

Auditors use "emphasis of matters" paragraphs within audit opinions to draw the attention of users to particular information in or about the financial statements relevant to their reading and interpretation thereof. An unqualified audit opinion is still issued. "Emphasis of matters" paragraphs are infrequent and were used in five audit opinions at 30 June 2005 all in relation to the same matter, that is, revaluations of land, buildings and infrastructure assets.

Existing Australian Accounting Standards (AAS) allow reporting entities to account for non-current assets on the cost or fair value basis. This matter

relates to those public sector entities that have adopted the fair value basis under which:

> "revaluations must be made with sufficient regularity to ensure that the carrying amount of each asset in the class does not differ materially from its fair value at the reporting date…" and
>
> "Where a class of non-current assets is measured on the fair value basis, the frequency of revaluations depends on the frequency and materiality of changes in the fair values of the assets within that class of non-current assets. Where the fair value of an asset in the class of non-current assets being revalued differs materially from its carrying amount, a revaluation is necessary… The requirement … may be met by indexing the carrying amounts of non-current assets in reporting periods between more comprehensive valuations.
>
> Assets within a class of non-current assets are revalued as at substantially the same date in order to measure those assets at amounts that can meaningfully be aggregated. However, a class of non-current assets may be revalued on a progressive basis within a reporting period provided the carrying amount of each asset within the class does not differ materially from its fair value at the reporting date."

With effect from 1 July 2005 revised accounting standards apply under which reporting entities adopting the revaluation, or fair value, model must apply the following:

> "After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, … Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the reporting date.
>
> The frequency of revaluations depends upon the changes in fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is required."

Audits identified some agencies adopting the fair value basis of accounting in relation to land, buildings and infrastructure assets whose valuations were regarded by me as being out of date. Increases in property valuations, building costs and costs to construct infrastructure such as roads and other local facilities in recent years have meant that valuations carried out as recently as two years ago may be out of date.

Attention to this fact was documented in audit reports at the following entities:

- The Office of the Governor;
- Department of Health and Human Services;
- Housing Tasmania;
- Inland Fisheries Service; and
- Southern Regional Cemetery Trust.

In each case I recommended that revaluations be brought up to date prior to 30 June 2006. In a number of other cases, particularly within local government, late adjustments to the carrying values of infrastructure assets were initiated by my Office based on relevant indices. Whilst these were acceptable short-term solutions, the entities concerned have also been advised to update valuations of the assets concerned.

Department of Infrastructure, Energy and Resources and Abt Railway Ministerial Corporation

- November 2005 Report Part B, Volume 1

DIER's 2004-05 financial statements included the financial results of Apt Railway as a "controlled" entity for the first time. This had the effect of bringing to account assets at a value of $34.212m on DIER's Statement of Financial Position, and an equivalent amount of revenue in its Statement of Financial Performance.

Department of Infrastructure, Energy and Resources – adequateness of investments in infrastructure

- November 2005 Report Part B, Volume 1

DIER's performance in maintaining its asset base was examined by application of the ratio of capital expenditure to depreciation. This ratio is commonly used in Local Government. Effective performance is regarded as being 100% assuming that expenditure being incurred on assets is appropriate. This ratio is normally calculated annually and suggests that entities managing infrastructure type assets should be re-investing funds in infrastructure at rates at least equal to the annual depreciation charge.

Over the past five years DIER's depreciation charges have totalled $377.524m while amounts invested in road infrastructure during this period amounted to $263.105m. This represents a ratio of 70% and, assuming the ratio has validity, represents a shortfall of 30% over this period.

However, is it fair to suggest that DIER has "under invested" in road infrastructure, as measured by this ratio, over the past five years? Various factors need to be examined in considering this further including:

- The annual depreciation charge may be too high (due to inappropriate lives being attributed to infrastructure assets);
- Insufficient investment is being made in the road network;
- The impact on the depreciation charge of regular revaluations of the infrastructure assets;
- The levels of maintenance expenditures; and/or
- The impact of the current high levels of inflation in the building sector.

There are no doubt many other factors to be considered and we recommended that DIER review its current levels of investment in light of the above and other factors.

DIER's management has responded to these observations in the DIER chapter of this Report.

Financial impact of the Regional Forestry Agreement (RFA) and of the Tasmanian Community Forest Agreement (TCFA) at 30 June 2005

- November 2005 Report Part B, Volumes 1 and 2

Reporting details of these agreements affected four agencies during the year ended 30 June 2005 as follows:

- Department of Premier and Cabinet - In 2004-05 RFA funding was transferred from DPAC to the Department of Primary Industries, Water and Environment. DPAC had managed these funds as "administered transactions". This resulted in the transfer of cash in hand totalling $26.278m to DPIWE;
- DPIWE – It received this $26.278m as controlled funds causing higher than normal revenue in 2004-05. DPIWE's controlled expenses included an amount of $11.060m relating to agreements and costs associated with the RFA. These funds were paid to many individual private land owners to 'lock up' land with existing trees. The balance of the RFA funds is held by DPIWE for expenditure in future years. At 30 June 2005 DPIWE's cash holdings totalled $83.691m, which included RFA funds of $16.721m; and
- Finance-General Division of the Department of Treasury and Finance – during 2004-05 Finance-General received and expended the following amounts relating to the TCFA:

Receipts and payments	$000's
Receipts	
Supplementary Appropriation Funding 2004-05 – recurrent funding	8 000
Supplementary Appropriation Funding 2004-05 – works and services funding	7 000
Specific Purpose receipt from the Commonwealth	24 000
Sub-total	**39 000**
Payments	
To Forestry Tasmania	12 500
To Newood Holdings Pty Ltd - Forestry Tasmania joint venture partner	2 000
Sub-total	**14 500**
Balance on hand held by Finance-General	**24 500**

Department of Tourism, Parks, Heritage and the Arts

- November 2005 Report Part B, Volume 1

When reviewing the chapter dealing with this Department it is important for readers to note the inclusion of a significant non-operating revenue amount of $75.798m representing the value of land identified as controlled by it not previously brought to account. Of this amount, $73.062m was land the Department controls under the *Nature Conservation Act 2002* which had not been previously reported, and the reminder related to other parcels which had not been included in prior years.

Forestry Tasmania

- November 2005 Report Part B, Volume 2

Valuation of native and other forests - In the 2004-05 financial year, Forestry Tasmania changed its accounting policy with respect to the application of Australian Accounting Standards Board standard AASB 1037 "Self Generating and Regenerating Assets". Forestry Tasmania determined that the native forest asset was more in the nature of Property, Plant and Equipment. This was determined due to:

- The biological growth of native forests occurs up to and sometimes greater than an 80 year rotation and therefore the biological growth measurement as required by AASB 1037 is difficult to measure; and
- The main drivers of the change in value are related to changes in the discount rate, changes in stumpage prices and costs associated with forest management, not from biological growth.

Application by Forestry Tasmania of its valuation methodology resulted in a decrease in the value of the native forest by $74.527m at 30 June 2005.

The major influence on this decrease was a change in the discount rate used, moving from 6.64% to 8.94%. This was altered due to an increase in the weighted average cost of capital due to greater risk associated with native forest and old growth forest movements. It is estimated that the financial impact of the movement in the discount rate alone is approximately $52.700m. Other influences on the decrement include the impact of increased costs due to the payment of local government rates on State forest land and a reduction in woodflows due to additional forest being taken to conservation reserves.

As a result of the change in accounting policy referred to, this decrement was recorded against the Forest Estate Valuation Reserve and not as a charge against current year profits.

This change in accounting policy does not apply to hardwood and softwood standing timber in respect of which a downward Forest Net Market Value adjustment of $12.645m was made in 2004-05. This decrease in the net market value was principally due to increased costs such as the increase in council rates, and increased land rental charges.

Tasmanian Community Forest Agreement – This agreement was signed prior to 30 June 2005 by which date Forestry Tasmania had received $12.500m in compensatory funding. This amount was recognised in the financial statements as an advance receipt and no adjustments were made to the carrying amount of native forests in the statement of financial position in recognition of this agreement. However, Note 11 to the Financial Statements recorded that Forestry Tasmania's native forest asset was reduced by 49 hectares at 30 June 2005, due principally to the transfer of forest into conservation reserves.

It is anticipated that the impact of the agreement will be brought to account by 30 June 2006.

Potential impact of reduction of pulpwood contracts - There has been much media discussion about revenue decreases and job losses in the forestry sector due to the possible loss of major pulpwood contracts. This was acknowledged in Forestry's annual financial statements, but it was not possible to quantify any effect at the time of finalising the audit.

Aurora Energy Pty Ltd

- November 2005 Report Part B, Volume 2

Entry into the National Energy Market - In late May 2005 Aurora joined the National Electricity Market (NEM) and it now purchases wholesale electricity from the National Electricity Market Management Company Limited (NEMMCO). Aurora pays NEMMCO for energy at the market spot price, but is reimbursed any difference between that price and the contracted price with Hydro Tasmania.

Energy contracted amounts totalling $43.994m were accrued at 30 June 2005. This amount represents the difference between the spot price paid to NEMMCO for power and the contracted purchase price from Hydro. Hydro refunds these differences to Aurora.

Hydro-Electric Corporation (Hydro Tasmania)

- November 2005 Report Part B, Volume 2

Bell Bay Power Pty Ltd – It is anticipated that this subsidiary will be separated from Hydro probably in 2006. However, for purposes of preparing Hydro's financial statements at 30 June 2005, Hydro continues to account for Bell Bay Power as integral to its energy generation capability.

Roaring 40s Renewable Energy Pty Ltd – Established in 2004 for the purpose of investing in, developing and operating wind farms or wind farm projects. Hydro's improved liquidity position was assisted by the repayment during 2004-05 of an inter-company loan of $80m owing by this subsidiary.

Since the signing of the audit report on 30 August 2005, Hydro has identified a joint venture partner for Roaring 40's Renewable Energy Pty Ltd. China Light and Power Asia Limited will become a 50% joint venture partner in wind farm development carried out by the Hydro subsidiary. Its capital injection is intended to allow the expansion of wind farm development in Australia and overseas.

Entry into the National Energy Market - A significant change in Hydro's activities in 2004-05 resulted from joining the National Electricity Market (NEM) in late May 2005. Although Hydro is not yet connected to the national electricity grid through Basslink, all generation is sold on the NEM and settled with the National Electricity Market Management Company (NEMMCO).

The large increase in both receivables and payables at 30 June 2005 reflects the new arrangements for transacting with NEMMCO on the sale of electricity to the pool and the settlement of electricity price hedges with Aurora Energy Pty Ltd. Since there is no right of offset the receivables and payables are shown gross with the receivable being $68.200m and the payable being $43.800m at 30 June 2005.

Carrying amount of Hydro's generation assets – There was a material decrement of $523.033m in the net fair value of Hydro's generating assets during 2004-05. This adjustment took effect in 2004-05 resulting in a reduced annual depreciation charge and reduced asset revaluation reserve.

The decrease in asset values arose due to a number of factors including:

- Reduced revenue forecasts as a result of lower price volatility in the market;
- Lower renewable energy certificate prices; and
- Lower actual and forecast electricity prices.

Hydro's Basslink Project

Background – Part B Volume 2 of my November 2004 Report included a section outlining details of the Basslink project. Comments below update that information.

The Basslink inter-connector is a 290 kilometre under-sea cable that runs from Loy Yang in Victoria, across Bass Strait to Bell Bay in Northern Tasmania. The Vic-Tas Consortium comprising Pirelli Cables, who manufactured the 600 MW HVDC cable in Italy, and Siemens Limited, who supplied eight transformers for the AC/DC converter stations, is constructing Basslink. Due to a setback resulting from damage to six of the converter transformers on the delivery voyage, completion of the project is not expected until April 2006.

Financial arrangements - National Grid Australia Pty Ltd (formerly Basslink Pty Ltd) owns the project and bears the capital costs of building the link. When operations commence, Hydro will pay a facility fee that allows it to access the Victorian market and receive the Inter-Regional Settlement Residues (IRRs), regardless of the direction in which the power is flowing. IRRs essentially represent the difference between the Victorian and Tasmanian pool prices. To facilitate competition in the Tasmanian wholesale electricity market, Hydro is required to auction off southbound IRRs.

While the capital cost of the project and the facility fee were linked, the contract between NGA and Hydro contained a series of clauses whereby, up until financial close, changes in currency rates, interest rates and costs resulting from delays and changes in specifications could be passed on to Hydro, subject to its agreement. Following financial close NGA assumed all construction risks for the project. The arrangements in the Basslink Services Agreement only commence following satisfactory commissioning of the Basslink project.

Financial exposure hedging - Prior to financial close of the project, the facility fee was subject to change based on currency and interest rate movements. Consequently, Hydro took measures to hedge these exposures. Due to a number of delays in the environmental approval process, these hedges were extended through to the eventual financial close date.

At financial close on 22 November 2002 the currency and short term interest rate hedges were closed out and brought onto the Hydro balance sheet. The long-term interest rate exposure was assumed by NGA via a floating facility fee instrument. Hydro transacted a facility fee swap with

Macquarie Bank Limited to fix its interest rate exposure associated with the project. These instruments result in a fixed interest rate exposure at an inherent rate of 7.41% over the life of the project.

Financial statement disclosures - Forecast Basslink Facility Fee payments totalling $2.300b over the 25-year life of the agreement are disclosed as a commitment by way of note to the financial statements. In addition, the net fair value of the Basslink Services Agreement has also been disclosed by note to the financial statements as a financial liability of $436.800m. This represents a net present value calculation of projected facility fee payments and IRR receipts.

The net fair value of the Basslink Floating Facility Fee Instrument and Facility Fee Swap has been disclosed by way of note to the financial statements as a financial liability of $273.100m. The notional principal amount for these instruments at balance date is $599.810m amortising over 25 years to $306.200m.

The liabilities associated with the Basslink Services Agreement, Basslink Floating Facility Fee Instrument and Facility Fee Swap have been disclosed by way of notes to the financial statements as required by current Australian Accounting Standards. Hydro was not required to implement Australian Accounting Standards AASB 132 "Financial Instruments: Disclosure and Presentation" and AASB 139 "Financial Instruments: Recognition and Measurement" until 1 July 2005. Any adjustments arising from the initial recognition of those financial instruments on the transition date of 1 July 2005 has still to be determined and will be against retained earnings.

Motor Accidents Insurance Board

- November 2005 Report Part B, Volume 2

Economic assumptions applied in valuing claims liabilities - Since 2001-02 the Board valued its claims liabilities under a Market Linked Fixed Gap Model, where the discount rate was based on a risk-free rate plus a margin for higher returns expected on investments. At 30 June 2005, the claims liability was calculated using a risk-free discount rate without any margin. This lowered the discount rate applied, which had the effect of increasing the claims liability at 30 June 2005 by $131.400m.

In prior years, superimposed inflation was applied at a flat rate across all expected future claim payments. An actuarial review identified that different benefit types experienced different rates of superimposed inflation and that this should be reflected in the calculation of future claims liabilities. The 30 June 2005 valuation therefore included an allowance for superimposed inflation of 1.5% for scheduled benefits claims and 0.75% for common law claims. Superimposed inflation was removed for future care claim payments as it was observed that this factor was

negligible in relation to these payments. This had the effect of reducing the claims liability by $119.900m.

The net effect of the changes to these two economic assumptions was to increase the claims liability at 30 June 2005 by $11.500m.

Rivers and Water Supply Commission

- November 2005 Report Part B, Volume 2

Administering irrigation schemes - During 2003-04 the Minister appointed the Commission as the responsible water entity for the Clyde Irrigation Scheme. This scheme came into operation in the 2004-05 financial year and the Commission will take over financial responsibility for it from 1 July 2005.

The Commission ceased to administer the Meander Valley Irrigation Scheme during the 2004-05 financial year. At 30 June 2005 the Commission sold related properties to the Department of Primary Industries, Water and the Environment (DPIWE) to facilitate the private consortium development of the proposed Meander Dam.

TT-Line Company Pty Ltd

- November 2005 Report Part B, Volume 2

Operating results and valuation of the ferries - Spirit III was operational for all of the 2004-05 financial year and continued to operate below budgeted expectations. The results for Spirit III reflect lower than expected passenger numbers, vehicle numbers and carriage of freight.

Spirits I and II also incurred losses in 2004-05. While vehicle numbers and carriage of freight were above budget, this was offset by lower than expected passenger numbers.

The below budget operational results are understood to reflect increased competition from budget airlines which increased their operations between Tasmania and mainland Australia during this period.

The loss of $79.279m for 2004-05 includes a valuation decrement of $43.237m, which all related to the carrying value of the company’s three ferries. During this year the Directors changed the company’s basis for valuing the ferries from “at cost” to a fair valuation basis. The decrement arises from independent valuations obtained by the Directors. It is probable that application of the previous “at cost” policy would have resulted in the same decrement because current and projected operating performance would have required a write down in the carrying values of the three ferries in any event.

The decrement of $43.237m comprises write downs for each ferry as follows:

Spirit I	$13.920m
Spirit II	$15.230m
Spirit III	$14.087m

Without this decrement the company traded at an operating loss of $36.042m due primarily to the drop in passenger and vehicle numbers previously referred to. These losses were incurred as follows:

Devonport to Melbourne route	$6.382m
Devonport to Sydney route	$29.533m
Other	$0.127m

The Company's cash position improved in 2004-05, primarily due to a $75.181m contribution from owners during the year. The repayment in 2004-05 of borrowings totalling $57.178m was funded by this contribution.

OTHER MATTERS – TRANSFER OF POLICE BUILDING

(See also chapters on Tascorp - November 2005 Report Part B, Volume 2 – and Police - November 2005 Report Part B, Volume 1)

To lessen the impact to the Tasmanian Public Finance Corporation (Tascorp) of adopting Australian Equivalents to International Financial Reporting Standards (AEIFRS), on 22 December 2004 the Treasurer gave approval for Tascorp to sell the Police Headquarters Building (the Building including the land) at 30-32 Bathurst Street, Hobart to the Crown.

Under AEIFRS standard AASB 140 'Investment Property', Tascorp will be required to undertake mark-to-market reporting of its financial liabilities used to fund the Building from 1 July 2005. The impact of this on Tascorp will be an initial drop in equity and continual fluctuations in the value of these financial liabilities, thus potentially creating volatility in Tascorp's reported profits and returns to the Government. As the consolidated General Government Sector has a greater financial capacity than Tascorp to withstand the financial liability and subsequent volatility under AEIFRS, it was decided to transfer this asset to the Crown prior to 30 June 2005.

Tascorp had recorded the Building at cost, $17.470m, in its 2003-04 financial statements with note disclosure stating that it had been independently valued at $13.750m during 2003. Tascorp had hedged its investment in this Building with a zero coupon bond and an indexed annuity with a combined market value of $26.910m at 20 May 2005, based on a guarantee facility received from Treasury at the time of

purchasing the Building. A 2005 fair value valuation carried out by the Valuer-General of the Building necessitated a write-down to $13.000m.

Consideration for the Building consisted of an indexed annuity arrangement that reflects the rent the Department of Police and Public Services (Police) would have continued to pay Tascorp for the remainder of the lease term as well as a zero coupon loan of $17.470m payable on 2015 to reflect Tascorp's current financing arrangements.

The combination of transfer and valuation decrement resulted in an expense of $13.910m, which was recorded as a valuation expense in Finance-General's statement of financial performance. This expense comprises a combination of a loss of $4.470m when comparing the original cost of the Building to the 2005 valuation and a further $9.440m representing the difference between the rent being paid by Police and an economic rental.

Finance-General, on behalf of the Crown, recorded the sale transaction by recording the Building as an asset and related debt as a liability, and will incur the debt repayments.

Finance-General accounted for the transfer of the Building to Police by removing it from its asset register and recording a corresponding reduction in equity for the same amount. Conversely, Police recorded the asset in its 2004-05 statements as an equity contribution.

It is important to note that, whilst these transactions appear complex, the State as a whole is no better or worse off by transferring this building to Police.

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