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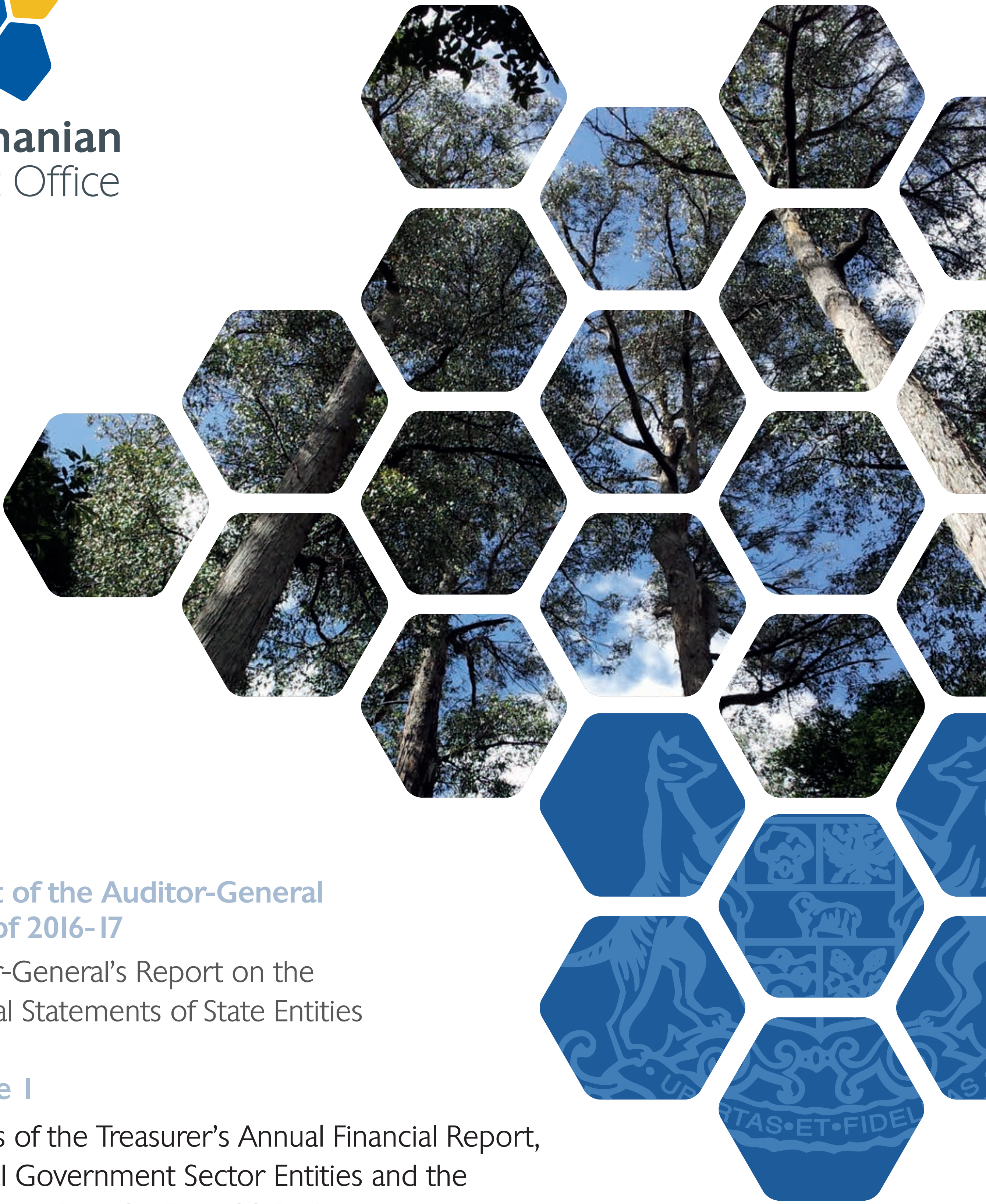

Report of the Auditor-General No. 6 of 2016-17

Auditor-General's Report on the Financial Statements of State Entities

Volume 1

Analysis of the Treasurer's Annual Financial Report, General Government Sector Entities and the Retirement Benefits Fund 2015-16

November 2016

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FOREWORD

Each year, the Treasurer prepares the consolidated financial report of the State. The Treasurer's Annual Financial Report (TAFR) discharges Government's accountability for the State's finances to Parliament. I then audit the General Government Sector (GGS), Total State Sector (TSS) financial statements and Public Account (PA) statements which are included in the TAFR.

My audits resulted in unqualified audit opinions being issued in time for the Treasurer to table those statements by 31 October 2016. This gives Parliament and the Community assurance that the financial statements present fairly, in all material respects, the financial performance and position of the GGS, TSS and PA and that they were prepared in accordance with prescribed financial reporting frameworks.

This report includes my Office's assessment of the State's overall financial performance and position, focusing on the GGS which recorded a Net Operating Balance surplus in 2015-16 of $62m. Within the surplus were capital grants for rail and road infrastructure of $81m received from the Australian Government. Once these one-off capital grants were excluded, the GGS incurred an Underlying Net Operating deficit of $19m. This was a significant improvement on previous years.

Other significant observations included:

- the continued high reliance on GST revenues, with the trend expected to continue
- the growing defined benefit superannuation liability and increased defined benefit contribution requirement, however the Government has recognised this problem
- the percentage growth in expenditure, which was higher than growth in State Final Demand
- reduced dividend revenue in 2015-16, largely due to a significant reduction in dividends received from the Hydro-Electric Corporation (Hydro Tasmania) and Motor Accidents Insurance Board (MAIB)
- the decline in the State's Net Worth, which fell from $13.07bn at 30 June 2010 to $7.16bn at 30 June 2016. The $5.95bn decrease was largely explained by the $3.99bn increase in unfunded defined benefit superannuation obligations, primarily caused by lower discount rates and other economic assumptions
- the trend increased capital expenditure, with significant projects being undertaken
- a negative net debt position in all of the past four years, with the level of negative net debt continuing to improve since June 2014.

In addition to our analysis of the TAFR, we also report separately on each Government department, the Tasmanian Health Service (THS) and the Retirement Benefits Fund (RBF). Results and assessments of the financial performance and position of other GGS entities, Executive and Legislature and other State entities, all of which reported at 30 June 2016, have been summarised in a separate Chapter.

State entities included in this Report submitted their financial statements for the year ended 30 June 2016 within the statutory deadline with the exception of one entity. Audits were completed satisfactorily and unqualified audit opinions were issued for all but one entity.

Rod Whitehead
Auditor-General
17 November 2016

GENERAL GOVERNMENT SECTOR ENTITIES

INTRODUCTION

The Tasmanian Public Sector, also referred to as the Total State Sector (TSS), comprises the General Government, the Public Non-Financial Corporations and the Public Financial Corporations sectors, with entities classified according to the nature of activities that they undertake.

The focus of this Report is on the GGS, which consists of ministerial departments and not-for-profit State entities controlled and mainly financed by the Tasmanian Government. The primary function of these entities is to provide public services which are mainly non-market in nature and are for the collective consumption of the community.

Other State entities included in this Report are statutory authorities and other non-profit entities not consolidated into the GGS financial statements, including the RBF.

STATE ENTITIES COVERED IN THIS REPORT

TAFR includes the audited GGS and TSS financial statements and the PA statements. It also includes other information, such as an overview of the Fiscal Strategy and the Loan Council Outcome, which are not audited. This Report provides an analysis of the GGS and TSS financial statements and of the PA statements.

The full Report also contains individual chapters on each of the eight ministerial departments, the THS and RBF.

Results and assessments of the financial performance and position of other GGS entities, Executive and Legislature and other State entities have been summarised in a separate Chapter in the full Report.

In addition, the fullReport contains our conclusion on compliance with the *Firearms Act 1996* in relation to the disposal of firearms and ammunition.

CONCLUSION

The GGS and TSS financial statements and PA statements were submitted in time for the Treasurer to table TAFR by the statutory deadline. Separate unqualified audit opinions were issued on the GGS and TSS financial statements and PA statements.

Government departments, THS and RBF submitted financial statements within the statutory deadline. Their audits were completed satisfactorily and unqualified audit opinions were issued in all cases.

Other GGS and State entities submitted financial statements for the year ended 30 June 2016 within the statutory deadline apart from two entities. Unqualified audit reports were issued in all cases except for the National Trust of Australia (Tasmania).

KEY MATTERS CONSIDERED DURING THE AUDITS

Key audit matters were those matters that, in our professional judgement, were of most significance to the audit, and were addressed in the context of the audit of the financial statements as a whole. The most prevalent key matters considered during the audits of entities included in the full Report were:

- valuation of non-current physical assets
- information systems
- revenue recognition.

The main reason these key matters required particular audit attention was the high level of judgement and accounting estimation used to determine the financial statement balance. Key matters specific to each audit are discussed within individual Chapters in the full Report.

FINDINGS FROM FINANCIAL AUDITS

Audits were completed satisfactorily. However a number of matters were raised during the course of the audits. Depending on the significance of the matters, they were either discussed and cleared with management (generally low risk issues) or formally communicated to those charged with governance. Where required, responses to these matters were sought from management and these will be followed up during the course of the next audit.

As a result of the audits, we raised 20 audit matters, 16 of which were rated as moderate risk. A number of entities had issues relating to the valuation of non-current physical assets, covering issues such as recognition and valuation, reconciliation with sub-ledgers and timing of valuations to ensure fair values were current. A small number of departments had issues raised relating to deficiencies in the design and implementation of controls over computer information systems used for the processing, storage and communication of financial information.

Matters specific to each audit are discussed within individual Chapters in the full Report.

SUBMISSION OF FINANCIAL STATEMENTS AND TIMELINESS OF AUDIT OPINIONS

Apart from the requirement for all State entities to submit their financial statements within 45 days after the end of each financial year, section 19 of the *Audit Act 2008* (the Audit Act) required the Auditor-General to finalise audits within 45 days from the day the financial reports were received. Table 1 details when financial statements were received and audit opinions were issued. The audit of the Department of Health and Human Services (DHHS) was completed on 27 September 2016, which was one day after the statutory deadline.

The Treasurer is required to prepare TAFR by no later than 31 October immediately following the financial year to which the report relates. The Treasurer submitted the GGS financial statements and PA statements for audit on 29 September 2016. Final GGS and TSS financial statements were signed on 24 October 2016. Separate unqualified audit opinions were issued on the GGS and TSS financial statements and PA statements on 26 October 2016.

TREASURER’S ANNUAL FINANCIAL REPORT

KEY RESULTS AND DEVELOPMENTS

General Government Sector

The GGS incurred net Underlying Operating Deficits in each of the past four years, although the trend showed improvement.
The GGS recorded a Net Operating Balance surplus in 2015-16 of $62m, the first time since 2009-10. This improved result, along with contained expenditure growth, suggested the current and previous Governments had been addressing the gap between revenues and expenditures.
Australian Government funding reached 64.1% of operating revenue in 2015-16, higher than the four-year average of 61.4%, demonstrated significant and on-going reliance by Tasmania on this funding.
Dividends and income tax equivalent revenue from Government businesses decreased by 41.9% to $222m in 2015-16 (a 17.5% increase to $382m in 2014-15). This meant that this source of revenue represented 4.1% of Total revenue in 2015-16 (7.5% in 2014-15), which was the lowest return in the past four years.
In the current year, four Government businesses provided 97.8% of the total dividend, guarantee fees and income tax revenue. In contrast, seven Government businesses provided no returns during the four-year period under review.
Expenditure related to employees totalled $2.83bn, or 52.6% of total expenses in 2015-16. This year’s increase in employee related costs was limited to $37m, or 1.7%.

Supplies, consumables and other expenses increased by $156m, or 15.6%. This was principally due to significant increases noted within State Fire Commission (State Fire) of $56m, THS, $45m, and State Growth of $32m. The increase within State Fire included significant expenditure for bushfire fighting activities, while for THS, the reclassification of cross border expenses from grants expenditure of $33m. The increase for State Growth was primarily due to the reclassification of road expenditure from capital to maintenance.
Other economic flows included a significant revaluation increase in the present value of the superannuation liability of $1.51bn, primarily due to a lower discount rate used in the actuarial calculation, from 3.7% to 2.7%. Due to the inverse relationship between the discount rate and the present value, the liability increased when the discount rate fell.
Superannuation defined contribution and defined benefit payments this year totalled $396m (2014-15, $419m). Payments related to the defined benefits schemes are expected to continue to increase until 2036.
Other economic flows included a gain of $31m compared to a loss of $189m in the previous year. The loss in the previous year included the final portion of the Housing Tasmania assets transferred to Non-Government Organisations (NGOs) under the Better Housing Futures (BHF) program, which amounted to $133m.
Our analysis showed that operating revenue grew at a faster rate than operating expenses. It also showed that expenditure growth exceeded the percentage change in the State Final Demand.
The increased superannuation liability was the main reason for the decrease in Equity, of $1.46bn to $7.16bn at 30 June 2016.
Total assets of the GGS decreased by $1.27bn since 2010 due to the reclassification of TasWater as a Local Government sector entity of $1.80bn, effective at 1 July 2013. Equity in GBEs and SOCs decreased by $1.56bn. These decreases were offset by increases in the value of land, buildings and infrastructure assets.
During this period, GGS liabilities increased by $4.64bn, primarily due to the increased net unfunded defined benefit superannuation liability, from $4.86bn to $8.84bn. The capacity of the State to meet its future superannuation obligations will require close monitoring.
Purchases of non-financial assets increased by $75m to $352m, which included higher capital works at DHHS principally for the Royal Hobart Hospital Redevelopment.

Total State Sector

The TSS achieved a net Underlying Operating Surplus of $26m in 2015-16, after deficits in each of the past three years. This was despite a significant loss incurred by the Hydro Tasmania of $292m, which was principally caused by net fair value losses of $286m incurred on Basslink financial assets and liabilities and energy price and treasury derivatives.
Other economic flows included a significant increase in the present value of the superannuation liability of $1.65bn, primarily due to a lower discount rate used in the actuarial calculation, from 3.7% to 2.7%. Due to the inverse relationship between the discount rate and the present value, the liability increased when the discount rate fell.
The increase in the superannuation liability led to an operating deficit of $1.86bn, the highest deficit recorded within the past four years.
Total assets of the TSS increased by $2.01bn from the prior year, with increased investments of $1.40bn and infrastructure assets of $0.30bn.
During this period, TSS liabilities increased by $3.52bn, primarily because: • the net unfunded defined benefit liability increased from $7.93bn to $9.75bn • gross borrowings increased from $5.53bn to $6.58bn at 30 June 2016.

CONCLUSION

The Treasurer submitted the TAFR financial statements and PA statements for audit on 29 September 2016 meeting the statutory deadline. Final TAFR financial statements were signed by the Treasurer and Acting Secretary, Treasury on 24 October 2016.

Separate unqualified audit opinions were issued on the GGS and TSS financial statements and PA statements on 26 October 2016.

The audits were completed with satisfactory results and no outstanding matters. The statements presented fairly, in all material respects, the financial performance and position of the GGS, TSS and PA and were prepared in accordance with the prescribed financial reporting frameworks.

The GGS Net Operating Balance was a surplus of $62m in 2015-16, an improvement of $119m from the previous year and an improvement of $121m from the 2015-16 Original Budget estimate. The 2015-16 Net Operating Balance surplus was the first surplus since 2009-10. The improved result was primarily attributed to a $377m increase in grant revenue and containment of expenditure growth.

However, the continued high reliance on revenues from the Australian Government remained a risk for Tasmania, especially in light of reduced revenues from Government businesses in the form of income taxation equivalents and dividends.

The $1.46bn reduction in Net equity was mainly attributed to the revaluation of the superannuation liability, which totalled $1.51bn. Although movements in the superannuation liability were highly sensitive to movements in underlying assumptions, including the discount rate, the liability also presented a significant financial risk to the State.

RETIREMENTS BENEFITS FUND (RBF)

KEY RESULTS AND DEVELOPMENTS

Investment revenue for 2015-16 was $235.26m, a decrease of $223.01m from the previous year. The decrease reflected a reduction in the net market value of investments during the year, which was reflected in the return on investments decreasing from 8.4% in 2014-15 to 4.1% for 2015-16.
Net assets reached $5.48bn at 30 June 2016. This was $0.18bn higher than at the same time last year.
The Tasmanian Accumulation Scheme liability of $3.60bn was fully funded by investments held by RBF, and represented 65.7% of the net liability for accrued benefits.
The accrued benefits of three of RBF's five defined benefit schemes were considered to be fully funded at 30 June 2016. The Contributory Scheme and the Parliamentary Superannuation Scheme were not fully funded and represent the unfunded liability of $4.61bn.
In July 2015, the Treasurer announced the Tasmanian Government's support for the creation of a single Tasmanian superannuation fund responsible for the combined accounts of Tasplan, Quadrant and RBF's Tasmanian Accumulation Scheme. On 1 July 2016, RBF and Tasplan entered into a Deed to Successor Fund Transfer (SFT) RBF's accumulation scheme to Tasplan. The SFT date has been set as 31 March 2017. Tasplan will replace RBF as the default fund for Tasmanian public sector employees from that date.
AASB 1056 *Superannuation Entities* became effective on 1 July 2016. The standard replaced AAS 25 *Financial Reporting by Superannuation Plans*. The Standard is to be applied retrospectively for the 30 June 2016 financial year with comparatives needing to be restated.

CONCLUSION

Signed financial statements were received on 11 August 2016 and an unqualified audit opinion was issued on the same day.

In performing our audit we have not identified any significant deficiencies in internal control or any other matters. There were no outstanding findings from the previous year's audit to resolve.

DISPOSAL OF FIREARMS AND AMMUNITION

INTRODUCTION

DPFEM was charged with the responsibility for firearms and ammunition disposed of under the *Firearms Act 1996* (Firearms Act).

Under section 149 of the Firearms Act, the Auditor-General was to arrange for an independent audit of all firearms or ammunition disposed of under the Firearms Act to be carried out once every year and to report on the audit to Parliament annually. This commentary discharges that responsibility for 2015-16.

Firearms destruction encompasses not only firearms and ammunition, but also knives and other weapons. There are several ways by which weapons are surrendered or seized, with approximately 50.0% of weapons being surrendered by their owners. Section 109 of the Firearms Act refers to the surrender of firearms by unauthorised persons and Section 129 provides for a permanent amnesty when firearms are voluntarily surrendered.

Conclusion as to compliance with the Firearms Act

Based on the audit procedures performed, we concluded DPFEM complied with the requirements of the Firearms Act in relation to the disposal of firearms. In relation to ammunition, guidelines have been developed to ensure disposal is in compliance with the Firearms Act. However, at the time of the audit we were unable to conclude on DPFEM's statutory compliance for the disposal of ammunition, or on the implementation of the new guidelines, as no disposals had occurred.

For the full report go to: http://www.audit.tas.gov.au/publications

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