ACT Audit Office

AUDITOR-GENERAL AN OFFICER OF THE ACT LEGISLATIVE ASSEMBLY

MEDIA RELEASE **21 December 2016**

Financial challenges ahead for the Territory

ACT Auditor-General, Dr Maxine Cooper, today observed that there are financial challenges ahead for the Territory, as outlined in the report titled **2015-16 Financial Audits – Financial Results and Audit Findings.**

Dr Cooper presented the report to the Speaker for tabling in the ACT Legislative Assembly and said it presents information on:

- the financial sustainability of the ACT Government's strategies and policies, particularly when assessed over time – as reflected in the Territory's financial operating results; and
- the capacity of the ACT Government to meet its financial obligations.

Dr Cooper said, "The financial statements of the ACT Government are important as they provide essential information to the community about the Territory's financial performance and the state of its finances."

"The ACT Government achieved its budgeted operating results for 2015-16 as the deficit in the net operating balance ($373 million) and operating deficit ($371 million) were less than their budgeted deficits ($649 million and $391 million respectively)."

"With respect to financial sustainability, deficits are budgeted for the next two years until 2018-19 and 2019-20, where a small surplus is forecast. However, as expenses are estimated to exceed revenue in 2018-19 and 2019-20, the projected surplus includes forecast gains from investments which depend on conditions in investment markets which are volatile."

"Past deficits and estimated future deficits mean that the costs of providing public services exceed revenue. These deficits will eventually have to be paid for in the future by higher revenue and/or reductions in costs."

This report, among other things, highlights the financial challenges for the Territory, in particular, meeting the unfunded superannuation liability ($7 330 million at 30 June 2016).

"The capacity of the ACT Government to meet its financial obligations will require, as always, attention to managing risks," said Dr Cooper. "If unexpected adverse events occur, or forecast deficits significantly increase, then the challenge of meeting financial obligations increases."

As the Territory's financial statements and agencies included in these financial statements received unqualified (positive) audit reports, readers can rely on them as presenting a true and fair view of their financial performance.

"Audit findings have decreased over the past four years which indicates that there has been a steady improvement in internal controls, governance arrangements and reporting practices," said Dr Cooper. "Most reporting agencies have implemented effective arrangements for addressing audit findings."

This is the second of three audit reports on the 2015-16 financial audits. The first audit report '2015-16 Financial Audits – Audit Reports' (Report No. 10/2016) was tabled on 7 December 2016. The third report will be on 'Computer Information Systems'.

A summary chapter of this report is attached to this media release.

Copies of **2015-16 Financial Audits – Financial Results and Audit Findings: Report No. 11/2016** are available from the ACT Audit Office's website: www.audit.act.gov.au. If you need assistance accessing the report, then please phone 6207 0833 or visit 11 Moore Street, Canberra City.

SUMMARY

Understanding the financial statements of the Australian Capital Territory Government (the Territory) is important as these provide essential information to the ACT Legislative Assembly and community about the Territory's financial performance and the state of its finances.

The Territory's financial statements can be used to provide an indication of the financial sustainability of the ACT Government's strategies and policies, particularly when assessed over time as well as providing information about the Territory's capacity to meet its financial obligations.

The inclusion of current year, budget and prior year information in the Territory's financial statements shows whether budgeted estimates were achieved and whether the Territory's finances are improving or declining.

The ACT Government's Budget Papers include the budget estimates for the period from 2016-17 to 2019-20 (the forward years). These provide an indication of the Territory's estimated future financial performance and the state of its finances.

This report contains a discussion of the Territory's financial results for the year ended 30 June 2016. It also includes details on the progress made by reporting agencies in resolving audit findings and an overview of the financial results and audit findings for selected reporting agencies.

This is the second of three audit reports on the 2015-16 financial audits. The first audit report '2015-16 Financial Audits – Audit Reports' (Report No. 10/2016) was tabled on 7 December 2016. The third report will be on 'Computer Information Systems'.

Appendix A contains explanations of key terms used in this report.

Conclusions

THE TERRITORY'S FINANCIAL STATEMENTS

An unqualified audit report was issued on the Territory's 2015-16 Consolidated Annual Financial Statements, indicating that the financial statements present a true and fair view of the Territory's financial position and results of operations.

The ACT Government achieved its budgeted operating results for 2015-16 with the deficit in the net operating balance and operating deficit being less than budgeted. However, as expenses exceeded revenue, the Territory incurred an operating deficit as it has done in each of the previous four years.

Deficits are budgeted for the next two years until 2018-19 and 2019-20, where a small surplus is forecast. However, as expenses are estimated to exceed revenue in 2018-19 and 2019-20, the projected surplus includes forecast gains from investments which depend on conditions in investment markets.

Past deficits and estimated future deficits mean that the costs of providing public services exceed revenue. These deficits will eventually have to be paid for in the future by higher revenue (for example, by increases in Commonwealth Government grants, land sales and taxes) and/or reductions in costs (for example, through efficiencies or reducing public services).

At 30 June 2016, the Territory had the capacity to meet its liabilities. However, net assets were much lower than anticipated in the budget due to large increases in the unfunded superannuation liability, which accounts for over half of the Territory's total liabilities. While the ACT Government predicts that its ability to cover its liabilities will increase from 2016-17 to 2019-20, this depends on a large decrease in the unfunded superannuation liability. The ACT Government has advised that 'for the expected reduction in the unfunded superannuation liability to occur, interest rates would need to return to around their long-term level with a resultant decrease in the superannuation liability'.

At 30 June 2016, the Territory had a strong capacity to pay its liabilities that were due within 12 months. The Territory is expected to retain a strong capacity to pay its liabilities due within 12 months, although net short-term assets of $1 147 million at 30 June 2016 are estimated to reduce to $760 million by 30 June 2020.

AUDIT FINDINGS

As audit findings have decreased in the last four years, this indicates that governance arrangements, internal controls and reporting practices of reporting agencies have steadily improved with reporting agencies implementing effective arrangements for addressing audit findings.

Key findings

THE TERRITORY'S FINANCIAL STATEMENTS

Paragraph

In 2015-16, the Territory incurred a deficit in its net operating balance of $373 million and an operating deficit of $371 million as the cost of services provided by the ACT Government ($5 486 million) exceeded revenue ($5 113 million) by $373 million (7.3 percent). 1.7

The deficit in the net operating balance ($373 million) in 2015-16 was lower than the budgeted deficit ($649 million) by $276 million (42.5 percent) due largely to higher than anticipated revenue ($242 million or 5.0 percent) as land revenue exceeded the budget estimate by $93 million (30.0 percent), taxation revenue by $82 million (5.6 percent), revenue from joint ventures by $40 million (59.7 percent) and sales of goods and services by $28 million (3.4 percent). 1.8

The operating deficit ($371 million) was less than budgeted ($391 million) by $20 million (5.1 percent) as the lower than expected deficit in the net operating balance was largely countered by lower than estimated gains from investments (recorded in other economic flows) as conditions in investment markets resulted in a lower return than estimated in the budget. 1.9

The deficit in the net operating balance in 2015-16 ($373 million) decreased from the deficit incurred in 2014-15 ($646 million) by $273 million (42.3 percent) due to an increase in revenue of $270 million (5.6 percent). 1.10

The increase in revenue of $270 million (5.6 percent) resulted from higher: 1.11

- taxation revenue of $197 million (14.7 percent) with significant increases in payroll tax ($65 million or 18.8 percent), duties mainly from residential and property sales ($57 million or 21.1 percent) and general rates ($45 million or 12.4 percent); and
- land sales (value-added component) of $157 million (64.9 percent) due to an increase in land settlements.

These were partially offset by a decrease in Commonwealth grants of $107 million (5.4 percent) as the Territory received:

- a smaller share of the National GST revenue pool from the

Commonwealth Government; and

- funding from the Commonwealth Government early (in 2014-15) for road infrastructure maintenance costs.

The operating deficit incurred in 2015-16 ($371 million) decreased by $44 million (10.6 percent) from the deficit incurred in 2014-15 ($415 million) due to increased revenue ($270 million or 5.6 percent). This was partially offset by a large reduction in other economic inflows ($229 million or 99.1 percent) as conditions in investment markets resulted in a lower return than estimated in the budget. 1.12

The deficit in the operating balance ($373 million) and operating deficit ($371 million) incurred in 2015-16 represents a continuation of: 1.13

- deficits in the operating balance which have ranged from $97 million to $646 million from 2011-12 to 2014-15; and
- operating deficits ranging from $26 million to $415 million from 2011-12 to 2014-15;

as the Territory's costs have not been managed to within revenue streams.

The ACT Government estimates that deficits in the net operating balance will decrease over the forward years from the deficit of $373 million incurred in 2015-16 to a deficit of $205 million in 2019-20. Achievement of these lower deficits is dependent on higher revenue, in particular, increases in taxation (general rates and payroll tax) and the ACT's share of the National GST revenue pool from the Commonwealth Government. 1.14

Deficits in the net operating balance have been incurred since 2011-12. The ACT Government estimates that deficits will continue over the forward years from 2016-17 to 2019-20 as the costs of providing public services exceed revenue. These past deficits and estimated future deficits cover a nine-year period. 1.15

The ACT Government estimates that operating deficits will decline from the deficit of $371 million incurred in 2015-16 to a deficit of $33 million in 2017-18 before achieving small surpluses of $25 million in 2018-19 and $35 million in 2019-20. 1.16

Achievement of these projected (estimated) lower deficits and small surpluses depends on continued growth in revenue, constraining expenses to forecasted amounts and the generation of sufficient gains from investments to offset the continued estimated deficits in the net operating balance. As investment markets are volatile, the Territory's exposure to more deficits remains high. 1.17

The Territory’s net assets at 30 June 2016 were less than budgeted. Net assets ($12 882 million) at 30 June 2016 were less than budgeted ($16 489 million) by $3 607 million (21.9 percent) due mainly to higher than estimated unfunded superannuation liability. 1.21

The unfunded superannuation liability ($7 330 million) exceeded the budget estimate ($2 518 million) by $4 812 million (191.1 percent) due mainly to the use of a lower rate to estimate the present value of the superannuation liability at 30 June 2016 compared to the long-term rate used to prepare the budget estimate. A lower discount rate increases the estimated present value of the superannuation liability and the related expense. The long-term rate is used in budget estimates to reduce short-term volatility in liabilities. 1.22

The Territory’s net assets at 30 June 2016 were less than that at 30 June 2015 and at 30 June 2012. 1.24

Net assets ($12 882 million) at 30 June 2016 decreased by $1 792 million (12.2 percent) from that at 30 June 2015 ($14 674 million) due mainly to an increase in the unfunded superannuation liability of $2 117 million (14.4 percent). 1.25

The Territory’s net assets have decreased since 30 June 2012. Net assets have decreased by $1 210 million (8.6 percent or an average decrease of 2.1 percent) since 30 June 2012. 1.26

The decrease in net assets is due to a significant increase in: 1.27

- the unfunded superannuation liability of $2 088 million (39.8 percent or an average annual increase 10.0 percent); and
- borrowings of $1 550 million (79.0 percent or an average annual increase of 19.8 percent) to fund property, plant and equipment purchases (including land, buildings and infrastructure assets) as well as properties acquired under the Loose-Fill Asbestos Insulation Eradication Scheme.

These were partially offset by an increase in assets of $3 944 million (17.5 percent or an average annual increase of 4.4 percent) from $22 582 million at 30 June 2012 to $26 526 million at 30 June 2016 from upward revaluations of property, plant and equipment and capital expenditure on property, plant and equipment (in particular, land, buildings and infrastructure assets) as well as the acquisition of properties in 2015-16 as part of the Loose-Fill Asbestos Insulation Eradication Scheme.

The Territory's unfunded liabilities at 30 June 2016 ($11 214 million) exceeded the budgeted unfunded liabilities ($7 472 million) by $3 742 million (50.1 percent) due mainly to higher than estimated unfunded superannuation liability. 1.31

The Territory's unfunded liabilities at 30 June 2016 exceeded that at 30 June 2015 and that at 30 June 2012. 1.32

Unfunded liabilities at 30 June 2016 ($11 214 million) increased by $2 584 million (29.9 percent) from that at 30 June 2015 ($8 630 million) due mainly to a large increase in the unfunded superannuation liability. 1.33

Unfunded liabilities at 30 June 2016 ($11 214 million) have grown by $4 462 million (66.1 percent or an average annual increase of 16.6 percent) since 30 June 2012 ($6 752 million) due mainly to an increase in: 1.34

- the unfunded superannuation liability of $2 088 million (39.8 percent or an average annual increase 10.0 percent); and
- borrowings of $1 550 million (79.0 percent or an average annual increase of 19.8 percent).

The increase in the unfunded superannuation liability is mainly due to the use of a lower discount rate to estimate the present value of the superannuation liability at 30 June 2016 compared to the rate which was used to estimate the liability at 30 June 2015. 1.35

The estimated reduction in the unfunded superannuation liability of $4 627 million (an average annual decrease of $1 157 million or 15.9 percent) from $7 330 million at 30 June 2016 to $2 703 million at 30 June 2020 is due to the use of a higher discount rate in estimating this liability in the forward estimates compared to the rate used to estimate the liability at 30 June 2016. 1.38

For the expected reduction in unfunded liabilities to occur, there would need to be a substantial decrease in the superannuation liability. This projected decrease will not occur while the interest rate used to estimate the present value of the superannuation liability remains lower than the rate used to prepare the budget estimate. The ACT Government has advised that: 1.40

> For the expected reduction in the unfunded superannuation liability to occur, interest rates would need to return to around their long-term level with a resultant decrease in the superannuation liability.

The net short-term assets of the Territory at 30 June 2016 exceeded that anticipated in the budget. The Territory's net short-term assets at 30 June 2016 ($1 147 million) exceeded the budget estimate ($238 million) by $909 million (381.9 percent). 1.42

The short-term assets of the Territory at 30 June 2016 exceeded that at 30 June 2015 and have increased since 30 June 2012. 1.43

The Territory's net short-term assets at 30 June 2016 ($1 147 million) exceeded that at 30 June 2015 ($850 million) by $297 million (34.9 percent) and have increased since 30 June 2012 ($845 million) by $302 million (35.7 percent or an average annual increase of 8.9 percent). 1.44

The ACT Government estimates that net short-term assets of $1 147 million at 30 June 2016 will reduce to $760 million by 30 June 2020. 1.45

AUDIT FINDINGS

Paragraph

Audit findings have decreased from 292 at 30 June 2012 to 100 at 30 June 2016 as the number of audit findings resolved by reporting agencies have exceeded new audit findings. This indicates that: 2.4

- there has been a steady improvement in internal controls, governance arrangements and reporting practices; and
- most reporting agencies have implemented effective arrangements for addressing audit findings.

In 2015-16, the number of audit findings resolved (57) exceeded the number of new audit findings (47). 2.5