Parliamentary Committees

Review of the Auditor-General's Report 11 : 2012-13 Results of audit: Education sector entities 2012

Report No. 19
Education and Innovation Committee
August 2013

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Acknowledgements

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Contents

Abbreviations and definitions

Annual financial statements	Annual financial statements refer to the audited financial statements included in the entity's Annual Report.
Asset Stock Management	Asset stock management refers to whether entities are deferring making capital expenditure in the short term, due to their being insufficient funds available for its normal business activities or it is unable or unwilling to increase borrowings to increase or improve its assets.
CQUniversity	Central Queensland University
Emphasis of Matter Paragraph in the audit opinion.	The financial statements are 'true and fair'. The auditor uses the emphasis of matter paragraph to draw the reader's attention to a specific matter that is included by management in the financial statements.
Debt to Equity Ratio	The Debt to Equity ratio measures the ability to repay debts and interest.
Issuing of an audit opinion or an independent audit reports by the Auditor-General	The Auditor-General Act 2009, allows the Auditor-General to delegate this function. While the report makes reference to the Auditor-General issuing audit opinions or an independent audit report, an approved delegate may have carried out the function.
Key Management Personnel	Those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly … Definition used by Queensland Treasury and Trade, based on Australian Accounting Standards.
Liquidity management	Liquidity management' means balancing the cash held each day to the university's daily expenses and cash needs. It includes selecting the most appropriate short term investment strategy, which matures when the cash is needed and achieves the best market return.
Massive Open Online Courses (MOOCs)	MOOCs are courses provided to a large volume of students usually via the internet, for free or at a very low cost to the student.
Special purpose financial statements	Special purpose financial statements are prepared when there are limited number of users of the financial information, all of whom can access additional information from the entity. The Statements comply with only the requirements in the Accounting standards which set when items should be recorded and reported (recognition) and how items are to be valued (measurement). The Emphasis of Matter paragraph included in the Independent Audit Report is a reminder to the reader that the Statements are not fully compliant with the Australian Accounting Standards or other prescribed requirements.

Qualified Audit Opinion	The qualified audit opinion indicates to the reader of the financial statements that they are true and fair, except for account balances and accounting policy notes highlighted in the qualification paragraph of the audit opinion.
TAFE	Technical and Further Education
Universities	In the report, ‘universities’ refers only to Queensland’s public sector universities.
Unmodified or unqualified audit opinion	An unqualified or unmodified audit opinion means that the financial statements are a true and fair representation of the financial transactions, balances and events during the year. All accounting standards and other prescribed requirements have been complied with.
VET	Vocational education training.

Chair’s foreword

One of the committee’s roles is to assess the integrity, economy, efficiency and effectiveness of the financial management of public accounts within our area of responsibility. To this effect, we have reviewed the Auditor-General’s Report 11 : 2012-3 on the results of the education sector entities audits for 2012.

I am pleased to note that overall the governing bodies of the universities, grammar schools and their controlled entities were able to prepare reliable, good quality financial statements within the legislative timeframe.

The Boards of Trustees of the grammar schools were able to resolve the issue that led to the qualification of their 2011 financial statements regarding the interpretation of “key management personnel” used for financial reporting purposes. Consequently, the Auditor-General removed the qualification from the 2012 financial statements.

The majority of entities within the education sector continue to be in a strong financial position; however future risks have been identified which may impact on their future financial sustainability.

The Board of Trustees of the Ipswich Girls’ Grammar School was able to improve its operating result for the 2012 year. While the CQUniversity and the Board of Trustees of the Ipswich Grammar School again produced a negative operating result, both entities have responded to the concerns raised about their current operating position and their correspondence is appended to the Auditor-General’s report.

The committee notes and supports the Auditor-General’s recommendation that the Ipswich Grammar School and the Ipswich Girls’ Grammar School continue to review their expenditure policies to improve future financial performance.

I would like to thank all members of the Education and innovation Committee for their continuing hard work and dedication to our portfolio areas.

I commend the report to the House.

Rosemary Menkens MP
Chair

August 2013

Recommendations

1. Introduction

1.1 Role of the committee

The Education and Innovation Committee (the committee) was established by resolution of the Legislative Assembly on 18 May 2012, and consists of government and non-government members.

Amongst its range of functions, the committee is required to consider the integrity, economy, efficiency and effectiveness of the government's financial management by examining government financial documents and considering the annual and other reports of the Auditor-General.[1]

1.2 Review process

The Auditor-General's Report 11 : 2012-13 Results of audits: Education sector entities 2012 ("the report") was tabled in the Legislative Assembly on 30 April 2013 and referred to the committee by the committee of the Legislative Assembly on 1 May 2013. The committee has reviewed the report, including the published responses of Central Queensland University (CQUniversity) and Ipswich Grammar School; and received a verbal briefing from the Auditor-General on the report.

2. Audit overview

The Auditor-General has audited the financial statements of the seven universities, eight grammar schools and the entities that they control, as required by section 40 of the *Auditor-General Act 2009*. A financial audit investigates an entity's financial statements to assess whether they are true and fair, and checks the account-keeping methods to ensure they meet prescribed requirements. Information systems auditing is an integral part of the QAO audit process.[2]

Universities and grammar schools are "statutory bodies" as defined in section 9(1) of the *Financial Accountability Act 2009*.

Each university operates under its own enabling legislation. The enabling legislation also establishes the governing body of the university: the Senate for the University of Queensland and a council for the each of the other six universities. The Senate or Council has a number of functions including the management and control of the university's finances.

The eight grammar schools are established under the *Grammar Schools Act 1975*. A Board of Trustees is established for each grammar school and is responsible for establishing and keeping the financial accounts, books and records of the school.

The enabling legislation establishes the financial year as 1 January to 31 December each year.

The majority of the universities' controlled entities are public companies, and so are subject to the requirements of the *Corporations Act 2001*. These companies are set up to undertake research which may lead to the development of a commercial product or service. Each company is governed by a small board of directors. The Auditor-General is appointed under the *Auditor-General Act 2009* as the auditor of every public sector company.

2.1 Audit report

The Auditor-General is required to prepare a report to the Legislative Assembly on each annual audit of a public sector entity, which identifies:

- whether the audit has been finished;

[1] *Parliament of Queensland Act 2011*, section 94(1)(a)
[2] Queensland Audit Office, 'Our Business' site accessed on 17 July 2013 http://www.qao.qld.gov.au/our-business

- whether the annual financial statements of the public sector entity have been audited;
- whether the public sector entity has been granted an exemption and the reasons why;
- any case in which the functions relating to the financial management of the public sector entity were not adequately or properly performed;
- the results of audits conducted and, if the audits were not conducted, reasons why; and
- action taken to remedy significant deficiencies reported in previous reports on audits of the public sector entity.[3]

The report provides the Legislative Assembly with a summary of the results of the 2012 financial audits of universities and grammar schools and the entities that they control. The Report discusses:

- the number and type of audit opinions issued;
- the timeliness and quality of financial reporting by the universities and grammar schools;
- systematic issues with internal controls identified during the financial audit;
- an analysis of financial sustainability indicators; and
- potential future financial risks and challenges for the sector.[4]

3. Examination of the report

In 2012, the Auditor-General issued 46 unqualified audit opinions on the financial statements of all universities, grammar schools and their controlled entities. For 11 entities, an emphasis of matter paragraph was included in the audit opinion to draw the reader's attention to the financial statements being prepared on a special purpose basis, the entity being wound up, or the auditor being uncertain about whether the entity will be able to pay its debts as and when they fall due and become payable within the next 12 months.

Two entities did not meet the legislative timeframe. One of these entities is controlled by one of the eight grammar schools and the other is a small company, the board of which includes members from two Queensland universities.

The result for 2012 is an improvement over the 2011 year, when all eight grammar schools received a qualified audit opinion due to their incomplete disclosure of key management personnel information in their annual financial statements.

The number of entities that prepare financial statements within the education sector has been reduced from 75 in 2011 to 48 in 2012. The reduction stems from 21 small propriety companies controlled by the universities accepting the exemption available in the *Corporations Act 2001*[5] to not prepare financial statements. A further eight are no longer trading.

3.1 Resolution of previous issues that resulted in the qualification of the grammar schools annual financial statements in 2011

A requirement from 2011 is that government agencies provide details of key management personnel and their remuneration in their annual financial statements. However in 2011 the grammar schools interpreted that the role of principal or headmaster did not meet the definition which was set by Queensland Treasury and Trade. The Auditor-General took a different view of the definition and as a result, concluded that the remuneration of all key management personnel had not been disclosed,

[3] *Auditor-General Act 2009*, s60
[4] Auditor-General of Queensland, Report 11 : 2012-13, Results of Audits: Education sector entities 2012, p1
[5] *Corporations Act 2001*, s292(2)

and therefore the Queensland Treasury and Trade requirements were not complied with. This resulted in the 2011 financial statements of all eight grammar schools receiving qualified audit opinions in that year's independent audit report.

In 2012, the grammar schools reviewed and negotiated the reporting requirements for key management personnel. The 2012 financial statements provided the required level of information on key management personnel for both the 2011[6] and 2012 financial years. The inclusion of the required information enabled the Auditor-General to remove the qualification from the 2012 annual financial statements. Unqualified audit opinions were issued for all grammar schools this year.

3.2 Going concern – grammar schools

Going concern is an assumption made by an entity that in the next 12 months it will be able to operate its business and pay its debts as and when they fall due and become payable. The Auditor-General assessed the validity of this assumption for all education sector entities.

Based on the financial results of the 2012 audit, the Auditor-General[7] concluded that there is material uncertainty regarding Ipswich Grammar School's ability to continue as a going concern and included an emphasis of matter paragraph to this effect in the independent audit report. The 2012 Ipswich Grammar School annual financial statements reported an operating loss of $2.396 million for the year ended 31 December 2012 and as at that date its current liabilities exceeded its current assets by $3.697 million.

The Chairman of the Board of Trustees and the Headmaster/CEO provided a formal response to the Auditor-General's draft report. The Board advised that it is committed to addressing the concerns about financial performance; however it believes the school is in a strong financial position due to its asset base and favourable debt to revenue ratio.[8]

In 2011, similar concerns were raised about the financial situation at Ipswich Girls' Grammar School. The Board of Trustees of Ipswich Girls' Grammar School reviewed its revenue and expenditure policies during 2012 and this resulted in a small operating surplus and improved financial position. This turnaround meant the Auditor-General did not need to draw attention to the matter in the School's 2012 annual financial statements.

Committee comment

In the government response to the committee's report no. 5 2012, which related to the Auditor-General's report on the 2011 education sector financial statements, the Minister indicated that in respect of Ipswich Girls' Grammar School issues he "will continue to monitor compliance with the Auditor-General's requirements, or if matters are otherwise resolved, and will inform the Parliament of this progress when tabling the 2012 annual reports in the Legislative Assembly next year."

The committee notes the improved financial position of Ipswich Girls' Grammar School and supports the Auditor-General's recommendation that the Ipswich Grammar School and the Ipswich Girls' Grammar School continue to review their expenditure policies to improve future financial performance.

The committee would still welcome the Minister's confirmation that the matters raised by the Auditor-General in the 2011 education sector report are now resolved.

[6] The 2011 information is included in the 2012 annual financial statements, so that readers can compare both years

[7] The financial statements of the Board of Trustees of the Ipswich Grammar School were certified by a delegate of the Auditor-General

[8] The debt to equity ratio measures the capacity of the school to repay debts and interest. A low ratio, as achieved by Ipswich Grammar School, is considered to be an indicator of solvency and financial stability

3.3 Financial sustainability

To be financially sustainable in the short term, entities must have the capacity to meet current and future obligations as they fall due. In the longer term, they should be able to absorb foreseeable financial risks without adjusting their current revenue and expenditure policies.[9]

Financial sustainability of universities

The Auditor-General found that the overall financial sustainability of the university sector remains sound with regard to operating margins, the level of debt assumed and asset stock management.[10] A number of benchmarks, including those used by the Federal Department of Industry, Innovation, Climate Change, Science, Research and Tertiary Education, were analysed using information in the universities' annual financial statements. The analysis showed that all universities:

- had adequate liquidity to meet their short-term liabilities as they fall due;
- were not overly reliant on debt to finance their capital structure;
- were able to meet employee expenses; and
- generate sufficient revenue to repay borrowing and loans.[11]

While CQUniversity's ratios are generally positive, the impact of declining international student numbers, redundancy payments and higher pay rates have resulted in operating losses over the last three financial years. An ongoing decline could lead to a weaker overall financial position, as CQUniversity may need to fund normal business operations through the use cash reserves, proceeds from the sale of assets or by borrowing additional funds.

In response to the Auditor-General's analysis, on 16 April 2013, the Vice-Chancellor and President explained the international student business had been a major contributor to the loss and provided an outlined of the university's response to the situation. The operating losses are seen by the university as a necessity to enable it to move forward into a stronger financial position, as it reorganises its business operations and repositions itself in the international student market. A further contributor to the loss was the delay in receiving funding due as part of the merger with Central Queensland TAFE. Funding due in 2012 was not paid during that year.

Emerging potential financial sustainability risks – universities

Massive open online courses

Financial sustainability is about how entities are able to absorb foreseeable financial risks. The report discusses the development of massive open online courses (MOOCs) as a potential financial risk to the sector.

The ease of access to the MOOCs via the internet, and the very low cost to the student, has significant impacts for the revenue earned from students attending campuses, as well as the changing nature of the assets used to deliver educational services.

The university sector is aware of the potential challenges that MOOCs pose to their current business, and the individual universities have been developing and implementing strategies to mitigate the potential future financial risks. Details of the strategies being adopted are included in the Auditor-General's report.

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[9] Auditor-General of Queensland, Report 11 : 2012-13 Results of Audit: Education sector entities, p27

[10] Asset stock management refers to whether entities are deferring making capital expenditure in the short term, due to their being insufficient funds available for its normal business activities or it is unable or unwilling to increase borrowings to increase or improve its assets

[11] Ibid p28

Undergraduate enrolments based on student demand

The Federal Government passed new legislation[12] in September 2011, which created demand driven funding for undergraduate places from 1 January 2012. The legislation allows universities to determine the number of students they want to enrol in undergraduate courses. The Commonwealth will fund every domestic student enrolled in an undergraduate course. Only funding for undergraduate places in the study of medicine will be capped.[13]

The new legislation is a significant change from the previous funding model, under which the number of commonwealth funded places was specifically allocated to each university and the funding from Commonwealth Grants Scheme (CGS) to cover those places was limited to that allocation.

The financial sustainability issue identified in the Victorian TAFE sector has the potential to occur in the higher education (university) sector across Australia. The competition amongst the universities and with private providers will cover both Commonwealth funded students and fee paying overseas students. Revenue from these students represents 42% of total revenue earned by the universities.

In the first year, the seven universities increased their total revenue from the CGS for their commonwealth funded places, but for four universities there was a decline in revenue from full fee-payment overseas students.

As competition increases amongst the universities and with private providers of tertiary education and MOOCs becoming ‘mainstream’, the Queensland universities may find their indicators of financial sustainability waning if they are unable to take an aggressive position to secure funding and undergraduate enrolments. They may be left with the cost of maintaining underutilised assets and being unable to fund their operations for these two major sources of income.

Committee comment

The committee notes the impact of the ‘student demand driven model’ in the Victorian vocational education training (VET) sector, which includes public Technical and Further Education (TAFE) institutes; and hopes the university sector is well positioned to avoid a similar situation in respect of universities. In Victoria the demand driven model led to a massive growth in the number of private providers, enrolments and expenditure on training subsidies between 2008 and 2011.[14] Eighteen public TAFE institutes are in competition for funding and enrolments with over 700 private providers.

Financial sustainability of grammar schools

The Auditor-General analysed a number of benchmarks, including those of the state Department of Education, Training and Employment, using information found in the grammar schools’ annual financial statements. The analysis showed that of the eight grammar schools:

- six had adequate liquidity to meet their short term liabilities as they fall due;
- seven were not overly reliant on debt to finance their capital structure; and
- five had adequate revenue to meet expenditure.[15]

Concern was expressed about the grammar schools’ ability to maintain or replace assets in the future. The level of spending on capital works when compared to the depreciation expense[16] has been declining over the past five years.

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[12] Commonwealth *Higher Education Support Amendment (Demand Driven funding system and Other Measures) Act 2011*

[13] The Commonwealth will limit the number of commonwealth supported places in postgraduate courses and in undergraduate courses in the study of medicine

[14] Victorian State Budget 2012-12, Treasurer’s speech, p8

[15] Auditor-General Report No 11 : 2012-13, Results of audit: Education sector entities 2012, p41

[16] Depreciation represents the expense associated with the usage of the asset. As the asset nears the end of its useful life, funds should be available from the entities reserves to pay for a replacement asset

Emerging potential financial sustainability risks – grammar schools

The current *Grammar Schools Act* was enacted in 1975, for the purpose of maintaining public confidence in grammar schools, which the Act achieves by regulating the establishment and governance of the grammar schools.[17] That act is currently being reviewed by the Government.

Grammar schools presently have access to low cost loans from the Queensland Treasury Corporation. On 31 December 2012, the grammar schools owed the Queensland Treasury Corporation approximately $88.6 million with interest rates ranging between 3% and 9%.[18]

Committee comment

The committee is aware of the Department of Education, Training and Employment is reviewing the *Grammar School Act 1975* to examine the potential for streamlining and reducing duplication, costs and administrative burden for the grammar schools and for Government. The committee expects the impact of any change in the status of grammar schools as statutory authorities, and associated financial implications, will be a key consideration in the review.

3.4 Internal controls

Internal controls are established by a governing body[19] and are designed to prevent or detect fraud and/or error, safeguard assets and produce accurate financial and other underlying records. Effective internal controls also enable the production of annual financial statements that are reliable and prepared within the legislative timeframes.

The Auditor-General has focused on the significant internal controls issues which need to be addressed as a matter of priority. At universities, the Senate or Councils' approach to monitoring controls was also assessed.

Internal controls – universities

Internal audit and audit committees

A governing body uses internal audits to obtain assurance that appropriate internal controls exist, are operating effectively and that risks are being properly managed.

The Auditor-General found universities' internal audits are operating effectively. The report also highlights that almost half of the recommendations made by internal audit across the sector are yet to be implemented by management. The universities' progress towards the full implementation of internal audit recommendations is monitored by their audit committee.

The audit committees established by the universities operated effectively during the 2012 year. They monitor the internal audits' work plans, progress towards the implementation of the internal audit recommendations, and the integrity of financial statements.

System related internal controls

While the number of significant issues reported by the Auditor-General to the universities' management has fallen from 30 (2011) to 24 (2012), the report has highlighted similar issues to those reported in 2011, which continue to be a risk for the universities. These issues included the need for:

[17] *Grammar Schools Act 1975*, s5

[18] Loan indebtedness and interest rates were extracted from the Grammar Schools' audited financial statements for the year ended 31 December 2012

[19] Governing body for a University is its senate or council. The Board of Trustees is the governing body of the grammar school. The governing bodies are accountable for the management and controls of funds, and for the preparation of annual financial statements

- better password management, to protect information computer systems and data against manipulation, lost or theft;
- properly authorised purchase orders that are raised before the goods or services are procured, to ensure that the goods or services are genuinely needed by the university;
- monitoring of the adherence to the entertainment and hospitality polices and to consider general public sector expectations when incurring this type of expenditure, to limit the university's exposure to wasteful or extravagant expenditure;
- timely preparation and independent review of key account reconciliations to identify irregularities in the accounting processes and records; and
- considered application of Queensland Treasury and Trade's *Non-Current Asset Policies for the Queensland Public Sector*, including the documentation of key assumptions around asset valuations, to support the 'true and fair' presentation of the annual financial statements.

Treasury management

The Auditor-General reported that universities collectively hold more than $1 billion in cash and term deposits. The audit of treasury functions found while that cash flow management processes were satisfactory and funds were earning market returns, the effectiveness of liquidity management[20] varied across the universities.

Improvements identified for four of the universities related to the documenting of investment decisions and monitoring of investment returns against an external benchmark. Other improvement opportunities for all universities related to ensuring liquidity management spreadsheets have controls designed to minimise the risk of arithmetical and computation logic errors occurring, and to improve the treasury reporting to the executive management and governing body.

A better practice guidance on short term cash flow liquidity management is appended to the Auditor-General's report, and is applicable to all statutory bodies.

Recommendation 1

The committee recommends that the Minister for Education, Training and Employment request all statutory bodies within the education sector consider and adopt the Better Practice Guidelines on short term cash flow liquidity management developed by the Queensland Audit Office.

Computer systems 'patch' management

Governing bodies are responsible for ensuring that internal controls are in place and operating to prevent computer systems and data from being manipulated, lost or stolen. Over the life of the computer systems, software coding changes may be required to fix problems, improve the efficiency and/or reliability of the system or add new features.

A key risk is the potential damage to the integrity of computer system and its data, when coding changes are required. The selection, testing and installation of the patches (coding changes) to the 'live' system and data are a key risk to how management limits its exposure to the risk of corrupt or lost data.

The Auditor-General acknowledged that the universities were managing the process well. The positive result was attributed to the good knowledge and skills of the information technology staff, support from the software vendors and the availability of update tools from third parties.

[20] 'Liquidity Management' means ensuring that the entity has sufficient cash available each day to meet the daily cash requirements, and the funds surplus to the cash needs are invested at the best possible rate and the maturity term meets the entity's cash need

The risk exposure from the general lack of patch management policy and risk assessment tools was also reported. The universities are exposed to a significant risk if patch management policies and tools are not up-to-date and readily available, particularly in the case where knowledgeable and skilled staff are not available to undertake ‘patch management’.

Internal controls –grammar schools

The number of significant internal control issues raised across the eight grammar schools decreased from 45 (2011) to 17 (2012). The decrease shows that management is willing to promptly address audit recommendations.

Committee comment

The close monitoring of internal controls should assist the governing bodies to identify and prevent control breakdown to further reduce the number reported by the Auditor-General in the 2013 report on the sector.

3.5 Timeliness and quality of financial statements

Overall the financial statements prepared by universities and grammar schools were prepared within the legislative timeframe and were of good quality. Of the 48 entities in the Education Sector, 46 entities had completed their financial statements within the statutory deadline.

Committee comment

This is a positive result for the sector.

Recommendation 2

The committee recommends that the Minister for Education, Training and Employment advises the Parliament how the issues raised by the Auditor-General in the *Review of the Auditor-General’s Report 11 : 2012-13, Results of audit: Education sector entities 2012* are being addressed.