Parliamentary Committees

Review of Auditor-General's Report 16 : 2013-14 Results of audit: Education sector entities 2013

Report No. 37
Education and Innovation Committee
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Abbreviations and definitions

CQU	Central Queensland University
The committee	The Education and Innovation Committee
The department	Department of Education, Training and Employment
DETE	Department of Education, Training and Employment
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.
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.
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.

Chair's foreword

On behalf of the committee, I am pleased to report on the committee's consideration of the Auditor-General's report *Results of audit: Education sector entities 2013* (Report 16: 2013-14).

The Auditor-General's report found the sector continues to produce reliable and timely financial statements, and universities and most grammar schools remain in a sound financial position. All entities' financial statements received unmodified audit opinions for 2013.

I am pleased to note that the long standing issue of disclosure of remuneration for key management personnel at grammar schools was resolved, which saw grammar schools make full disclosures of remuneration for key management personnel in 2013.

It was also pleasing to see that Central Queensland University recorded an operating surplus for the first time in four years ($23 million) and Ipswich Grammar School recorded a reduced loss.

As a result of the focus on internal controls, particularly procurement and delegations, some weaknesses were identified for both universities and grammar schools. The Auditor-General's report includes Better Practice Guidelines in respect of delegations, supplier engagement and preparation of financial statements to help these entities address the identified weaknesses.

On behalf of the committee I would like to thank the Queensland Audit Office staff who briefed us, and our secretariat staff for their assistance.

I commend the report to the House.

Rosemary Menkens MP
Chair

August 2014

Recommendations

1. Introduction

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.

Portfolio committees support the Parliament to fulfil its functions, one of which is to hold the government to account. This includes assessing the integrity, economy, efficiency and effectiveness of the management of public accounts within its area of responsibility.[1] The committee then reports back to the Parliament on its considerations. This report represents the committee's assessment of the Auditor-General's Report No. 16 for 2013-14: Results of audit: Education sector entities 2013.

1.1 Committee review process

The Auditor-General's Report No. 16 for 2013-14: *Results of audit: Education sector entities 2013* (the Auditor-General's report) was tabled in the Legislative Assembly on 6 May 2014 and referred by the Committee of the Legislative Assembly to the Education and Innovation Committee for consideration on 7 May 2014.

The committee reviewed the report on behalf of the Parliament, receiving a briefing by staff from the Queensland Audit Office on 21 May 2014. It then deliberated and finalised its report.

1.2 Audit overview

Universities and grammar schools in Queensland are statutory bodies that are subject to the *Financial Accountability Act 2009* and the *Statutory Bodies Financial Arrangements Act 1982*. The enabling legislation for both universities and grammar schools establishes the financial year as 1 January to 31 December. Each university and grammar school is required to produce an annual report to cover this period, setting out its operational and financial performance and position, and must include audited financial statements. These financial statements must have regard for the minimum reporting requirements contained in the financial reporting requirements for Queensland Government agencies issued by Queensland Treasury and Trade.[2]

Each year the Auditor-General undertakes an audit that looks at the timeliness of financial statements, the quality of the draft financial statements, internal controls and financial stability. Often, the audits will have a special area of focus. The Auditor-General focussed particularly on delegations and procurement by universities during the 2013 audit.

1.3 Audit report

The Auditor-General is required to prepare a report for the Legislative Assembly on annual audits of public sector entities. The Auditor-General's report summarises the results of the financial audits with the aim of providing assurance about the reliability of the financial report, including compliance with legislative requirements.[3]

1 *Parliament of Queensland Act 2001* s94(1)(a)
2 Auditor-General Report *Results of audit: Education sector entities* 2013, p7
3 Ibid, p1

Recommendation 1

The committee recommends that the House notes the content of this report.

2. Examination of the report

For 2013, all of the opinions issued by the Auditor-General were unmodified. The Auditor-General issued 44 unmodified opinions, which is a decrease in the number of opinions from previous years due to some small proprietary companies owned and controlled by universities electing not to prepare financial statements, which is permitted under the *Corporations Act 2001* (Cth).[4]

Emphases of matter were included with 12 audit opinions. There were 11 emphases of matter in 2012. Emphases of matter are not a modification, but instead draw attention to the fact that the financial statements were special purpose financial statements, rather than general purpose financial statements; that the entity was being wound up; or that there were 'going concern' issues identified.[5]

2.1 Timeliness of financial statements

Timely preparation of financial statements ensures the reports are useful for informing stakeholders about entity performance and decision-making, and for enhancing accountability. The legislative requirement is for education sector entities to have the statements audited within two months of the financial year end, that is, by 28 February.[6]

2.1.1 Universities

All universities produced timely financial statements in 2013, and met the agreed timetable for providing the initial draft version of their financial statements.

2.1.2 Grammar schools

Most grammar schools, with the exception of Ipswich Grammar School, also produced timely financial statements. This was an improvement on 2012 when two grammar schools did not produce timely financial statements. Ipswich Grammar School did not meet the legislated two-month timeframe in 2013 because the Auditor-General identified significant issues late in the process, and these issues took time to resolve.

Committee comment

This is a positive result for the sector and reflects the efforts made by all entities to meet the reporting requirements.

2.2 Quality of draft financial statements

The quality of draft financial statements is reflected by the number and size of changes made to the statements as a result of the audit. Changes can increase the cost and time of the audit.[7]

4 *Corporations Act 2001*, s292(2)
5 Auditor-General Report *Results of audit: Education sector entities 2013*, p2
6 Ibid, p13
7 Ibid, p2

2.2.1 Universities

In 2013, the Auditor-General noted an improvement in the quality of all universities' financial statements with fewer and smaller changes being required during the audit.

2.2.2 Grammar schools

The Auditor-General also noted an improvement in the quality of grammar schools' financial statements from 2012, however this 'represented only half of all grammar schools producing financial statements of a satisfactory quality'.[8] Four grammar schools were noted as needing to improve the quality of their financial statements.

The eight grammar schools also made full disclosure of remuneration for key management personnel. This resolved a longstanding issue regarding the interpretation of whether senior staff should be defined as key management personnel and thus, as required by the Treasurer in section 5 of the *Financial Reporting Requirements for Queensland Government Agencies*, their remuneration was disclosed in the annual report of the entity.

Committee comment

The committee notes the improvement in the quality of draft financial statements. The inclusion of Better Practice Guidelines on the preparation of financial statements in the report should be of particular interest to the grammar schools that were identified as needing to improve the quality of their financial statements.

The committee is pleased to see that with the resolution of the issue regarding reporting remuneration of key personnel, the report this year includes the full disclosure of relevant details.

2.3 Internal controls

When assessing internal controls, the Auditor-General focusses on the effectiveness of internal controls over financial management and reporting to ensure risks are being managed. Poor controls are seen to diminish an entity's ability to comply with relevant legislation and to increase the risk of fraud.[9] The Auditor-General stressed the importance of addressing any weaknesses found to reduce the risk of error or fraud in the future.

2.3.1 Universities

Audits of the universities' financial statements identified 42 internal control weaknesses in 2013, which was an increase of 75 per cent from the 24 weaknesses identified the year before. Eleven of the issues were raised at each of The University of Queensland, University of Southern Queensland and Central Queensland University (CQU). Similar issues were also raised at other universities, but not to the same extent. The issues that were considered high or medium risk related to the universities' non-compliance with their procurement and delegation policies and to information technology security and access to their key financial systems. Weaknesses were found in:

- information system security and user access controls
- breakdowns in controls over corporate card processes

8 Auditor-General Report *Results of audit: Education sector entities* 2013, p2
9 Ibid, p16

- out of date financial policies and procedures that do not reflect current practice
- insufficient supporting documentation to substantiate the authenticity of claims made
- mathematical and other unexplained errors noted in system reports, and
- non-compliance with certain disclosure requirements of the new AASB 12 *Fair Value Measurement* standard.[10]

To assist universities with managing these issues, the Auditor-General included Better Practice Guidelines relating to delegations and supplier engagement as part of the report to assist in improving the control environment.

In particular, the Auditor-General suggested that, in terms of better practice, universities can extract more efficiencies in the cost of processing by procuring low-value, high-volume goods with credit cards rather than going through a traditional procurement process.

Committee comment

The committee notes the sharp increase in the universities' internal control weaknesses as compared to last year, but also recognises the increase was a result of the particular focus by the Auditor-General on delegations and procurement in the 2013 audits. The Auditor-General has included Better Practice Guidelines in respect of delegations and supplier engagement, in addition to the guidelines on the preparation of financial statements referred to earlier, to help these entities address the identified weaknesses.

The committee notes the potential for credit card transactions to lower procurement costs.

2.3.2 Grammar schools

In contrast to the increase in identified internal control weaknesses in the university sector, the Auditor-General identified 12 internal control weaknesses at three of the grammar schools. There had been 17 in 2012 and 45 in 2011, so this represents ongoing improvement in internal controls for grammar schools.[11]

The internal control weaknesses identified arose from deficiencies in their risk management documentation and from weak quality assurance. The issues that were identified as requiring improvement included:

- asset capitalisation thresholds and fixed asset revaluation financial statement disclosures
- compliance of new accounting standards for fair value measurement and reduced disclosure requirements
- controls and monitoring over corporate card payments
- development of a risk management process and a risk register
- excessive annual leave balances and long service leave calculations, and
- financial statement disclosures for leases.[12]

[10] Ibid, p16
[11] Auditor-General Report *Results of audit: Education sector entities 2011*, p34
[12] Ibid, p50

Committee comment

The committee commends the grammar schools collectively for their work on reducing the number of internal control weaknesses.

Recommendation 2

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 delegations, supplier engagement and preparation of financial statements developed by the Queensland Audit Office.

2.4 Financial performance and position

2.4.1 Universities

Universities' risk management systems must mitigate the risk of unacceptable costs or losses from their operations and manage risks that may affect their ability to continue to provide services.[13] In 2013, all universities reported an operating surplus, but the operating surplus of five of the seven universities declined compared to 2012. Queensland University of Technology had the largest reduction, from $100.6 million in 2012 to $56.3 million in 2013.

CQU recorded an operating surplus for the first time in four years ($23 million) as a result of government funding received to fund its merger with the Central Queensland Institute of TAFE and cost containment strategies implemented in past years to manage the impact of declining international student numbers. CQU also increased the number of Higher Education Contribution Scheme and Higher Education Loans Program places which resulted in increased funding. The University of Queensland's operating surplus increased from $58 million in 2012 to $110 million in 2013.

Risks to the financial performance and position of universities were seen to include a tightening in Australian Government research funding for three years from 2013, which will have an impact on universities that perform significant research. It was noted that universities are factoring the likely reduction in government funding into their budgets and are adopting strategies to address the operating and financial risks.

As a result of demand driven funding (an Australian government policy decision which allows universities to decide the number of students to enrol in their undergraduate courses[14]) there was an increase in the number of domestic students at all universities which led to increased competition for domestic student places in Queensland. However, while more domestic students are applying for and being accepted into university, there has been a slight decrease in the percentage of students passing units, which suggests that the quality of academic standards is being maintained despite increasing numbers.

Fees received by universities from international students remained relatively stable indicating that international student numbers did not grow over 2013. This was attributed to risks outside of the

[13] Ibid, p27

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

control of any individual university, such as government reforms, the volatility of the Australian dollar, legislative changes to student visa requirements and competition among Australian and foreign providers of higher education.[15]

2.4.2 Grammar schools

The financial objective for grammar schools is to generate enough money to meet their financial obligations and to fund asset replacement and new asset acquisitions. The ability of grammar schools to achieve this depends on their management of expenditure and revenue, and how they manage their financial risks.[16] The audit found that six of the eight grammar schools are in a sound financial position with acceptable cash balances, minimal debt, adequate expenditure on asset replacement and renewal, and an ability to pay their debts in the short term. Ipswich Grammar School and Ipswich Girls Grammar school were not deemed to be in a sound financial position, and this is further examined in section 3.6.2, financial sustainability.

Committee comment

The committee is pleased to see all universities record an operating surplus, but notes the operating surplus of five universities has declined. Interestingly, the Auditor-General of Victoria in his 2013 audit on Victorian universities also noted a decline in operating surpluses, which has been occurring since 2009.[17]

The committee is particularly pleased to see CQU record an operating surplus for the first time in four years, and hopes the strategies implemented are sufficient to maintain the surplus following the funding for the merger. The committee will watch the future of CQU with interest, as the Victorian Auditor-General's report notes that while the number of students enrolled in higher education in Victorian universities continues to increase, there has been a significant decline in domestic and international vocational education and training and student numbers at dual-sector universities in Victoria during 2013. The Victorian Auditor-General notes that changes to the funding model, where government subsidies vary depending on the course, have seen universities increase the cost to students for some VET courses.[18]

The maintenance of academic standards at universities following the introduction of demand driven funding is also pleasing to see. The committee will watch with interest the impacts of changes to the university sector as announced in the federal government's 2014 budget with regards to the deregulation of the provision of higher education.

The committee notes that, while the report advises that international student numbers did not grow over 2013, a media article released since the audit report was completed indicates there has been a 16.7 per cent growth in the number of new international students beginning university courses in Australia in the first semester of 2014, making 2014 the first year of strong growth since a downturn in 2009.[19] The committee will be interested to see 2014 international student numbers in due course to ascertain whether this growth was sustained throughout the year, particularly in Queensland.

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15 Auditor-General Report *Results of audit: Education sector entities 2013*, p32
16 Ibid, p50
17 Victorian Auditor-General's report: *Universities: Results of the 2013 Audits*, pIX
18 Ibid, p11
19 *Indian influx leads surge in new students*, Australian Financial Review, 5 May 2014

2.5 Financial sustainability

2.5.1 Universities

The Auditor-General advises that universities must have the capacity to meet current and future obligations as they fall due in the short term, and be able to absorb foreseeable financial risks without adjusting their current revenue and expenditure policies in the long term to ensure financial sustainability.[20]

Overall, the university sector is operating sustainably and managing its risks effectively. As mentioned in section 2.4.1, all of the universities reported operating surpluses, along with a manageable level of debt and short-term liquidity ratios that allow for short-term debts and obligations to be paid for over the next 12 months.

An identified emerging risk to university sector financial stability was the proposed efficiency dividends that will be required from the sector, which was seen to have the potential to reduce Australian government funding. At the time of the Auditor-General's report, the proposed efficiency dividends were still being considered by the Australian government, and the report noted that universities were implementing strategies to respond to the potential of reduced funding.

The Auditor-General's report also refers to the growing trend in the delivery of open online courses or massive open online courses (MOOCs) as a possible financial sustainability risk. This risk was first referred to in the Auditor-General's 2012 report on education sector entities.[21] MOOCs currently do not generate revenue, though they can be a 'hook' for attracting fee-paying students. However, the report recognises the risk to student revenue streams and the use and value of infrastructure assets if universities provide academic credit for such courses, and recommends the situation be monitored.

2.5.2 Grammar schools

An analysis of each grammar school's key financial ratios indicated that, according to most ratios, grammar schools in Queensland are in a sound position.

Ipswich Girls Grammar School (IGGS) continued to improve its financial performance in 2013, following the inclusion of an emphasis of matter in 2011 by the Auditor-General due to material uncertainty regarding the school's ability to continue as a going concern.[22] In the 2012 audit, the Auditor-General removed the emphasis of matter following a small operating surplus and an improved financial performance.[23] However, IGGS was identified as being marginally outside the desired position of debt to revenue in the 2013 audit.

It was also noted that there had been an improvement in financial performance by Ipswich Grammar School (IGS) in 2013. In 2012, the Auditor-General concluded there was material uncertainty regarding the ability of IGS to continue as a going concern and included an emphasis of matter paragraph to this effect in the report.[24] IGS implemented various strategies to improve its financial performance, and while IGS recorded its sixth consecutive year of operating losses, the loss for 2013 reduced by $900,000 to $1.495 million. Furthermore, the Board indicated its belief the school can

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20 Auditor-General Report *Results of audit: Education sector entities 2013*, p36
21 Auditor-General Report *Results of audit: Education sector entities 2012,* p32
22 Auditor-General Report *Results of audit: Education sector entities 2011,* p33
23 Auditor-General Report *Results of audit: Education sector entities 2012*, p34
24 Auditor-General Report *Results of audit: Education sector entities 2012*, p35

meet its debt obligations for 2014. The emphasis of matter was removed in 2013 due to the improved financial result.

Despite the improved financial performance of both IGGS and IGS, the Auditor-General considers that both schools are still at risk of not being able to meet short term obligations as they fall due. The Auditor-General suggested that IGGS and IGS need to consider whether their financial policies and practices are sustainable, and need to continue to work on their financial positions, including increasing their revenue base, reducing expenditure or a combination of both to ensure sustainability in the short and long term.

Committee comment

The committee commends Ipswich Girls Grammar School and Ipswich Grammar School for their efforts to improve their financial performance and sustainability, and will be keen to see whether Ipswich Grammar School continues to reduce its loss over the 2014 financial year. The committee would welcome any information from the Minister regarding the support provided to the two Ipswich schools in 2013 to assist them with improving their financial position following on from the engagement of a financial specialist in 2011 and ongoing support provided by the department in 2012.

In its 2012 report, the committee noted its awareness of a review of the *Grammar School Act 1975* being undertaken by the Department of Education, Training and Employment to examine the potential for streamlining and reducing duplication, costs and administrative burden for the grammar schools and for government. The committee will be interested to learn the results of the review, and how any subsequent changes to governance or operations may affect the grammar schools' financial performance and sustainability.