

# Report on State Finances

OCTOBER 2017



NEW SOUTH WALES AUDITOR-GENERAL'S REPORT

STATE FINANCES

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# Auditor-General's introduction

Pursuant to the *Public Finance and Audit Act 1983*, I present my Report on State Finances 2017.

You will note that the format of this report has changed from previous years.

The intent of this change is to draw attention to the key matters that have been the focus of our audit and highlight significant factors that have contributed to the outcome.

First, it is pleasing to report once again that I issued a clear audit opinion on the State's consolidated financial statements. This outcome demonstrates the Government's continued focus on the quality of financial reporting across the NSW public sector.

High quality financial management and reporting are crucial to properly inform the public and build community confidence in our system of government.

The Treasury's Financial Management Transformation program also aims to improve financial governance, budgeting and reporting arrangements across the sector. My Office is working collaboratively with The Treasury on reforms to reduce the burden of reporting, without weakening established safeguards.

The reforms should include measures to provide independent assurance of the budget process, of outcome reporting by agencies, and the power to "follow the dollar" given the increasing use of non-government organisations to deliver Government programs.

This Report also highlights another year of strong financial performance. The State's budget result was a \$5.7 billion surplus, and investment in new infrastructure has continued, in part funded by the long-term leases of Ausgrid and Endeavour Energy assets.

Finally, could I take this opportunity to thank the staff of The Treasury for the way they approached this audit. Our partnership is critical to ensuring NSW is an exemplar of quality financial management and reporting.



**Margaret Crawford**

Auditor-General  
24 October 2017



# Audit opinion

A clear audit opinion on the State's consolidated financial statements was issued.

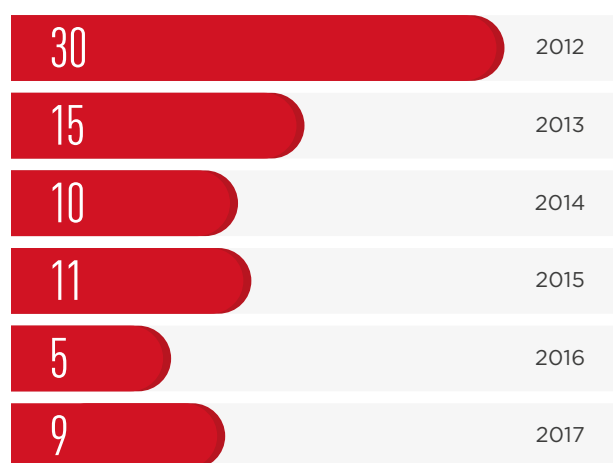
**Timely and accurate financial reporting is essential for informed decision making, effective management of public funds and enhancing public accountability.**

This year's clear audit opinion reflects the Government's continued efforts to improve the quality of financial reporting across the NSW public sector.

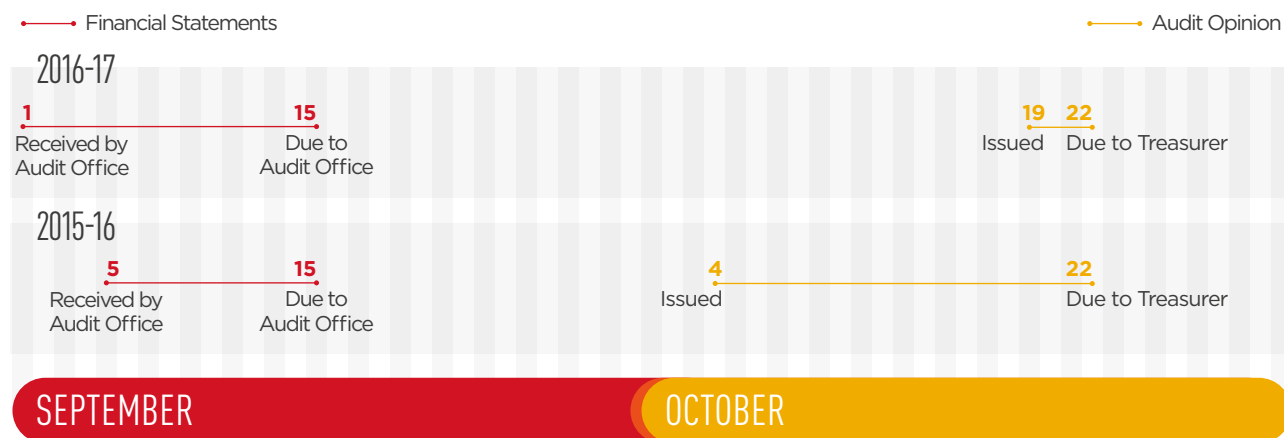
Since the introduction of 'early close procedures' in 2011-12, the number of significant errors in financial statements of agencies has generally fallen largely due to identifying and resolving complex accounting issues early. Agencies' 2016-17 financial statements submitted for audit contained nine errors exceeding \$20 million. All errors were subsequently corrected in the individual agencies financial statements.

Agencies should continue to respond to key accounting issues as soon as they are identified. Where issues are identified, accounting position papers should be prepared for consideration by the Audit Office, their Audit and Risk Committee members, and when relevant, The Treasury.

## SIGNIFICANT ERRORS IN AGENCY FINANCIAL STATEMENTS EXCEEDING \$20M 2012-2017



## KEY DATES



# Accounting matters

The State addressed the following key accounting matters during 2016-17.

## The State recognised rail tunnels and earthworks valued at \$8.5 billion.

Some rail tunnels and earthworks have never been valued by the State. These include the City Circle, the country rail network and other tunnels and earthworks built before the year 2000. Some of these tunnels and earthworks date back to the early 1900s.

For many years, the State did not account for these assets as they believed that their value could not be reliably measured. This year an independent valuer was engaged to perform a comprehensive valuation. The methodology used demonstrated that the assets could have been reflected in the financial statements earlier.

The State recorded an additional \$8.5 billion to correct the value of infrastructure assets at 1 July 2016.



## Cabinet members' compensation and related party transactions were reviewed.

**Due to changes in Accounting Standards, the State had to consider "related party information" in the financial statements. Previously, this only applied to for-profit entities.**

This year, requirements to report related party information extended to members of Cabinet, considered to be "key management personnel" of the State, as defined by Accounting Standards.

The Treasury implemented a process to assess and report Cabinet member's compensation, and transactions between Cabinet members and/or their close family members, and government agencies.

Collectively, Cabinet members' remuneration was \$8.8 million, which was mainly salaries and allowances, and \$3.5 million of non-monetary benefits such as security and drivers. The Treasury determined there were no other specific "related party" transactions or balances that required disclosure in the State's financial statements.

## Accounting matters (Cont.)

### Information system limitations continue at TAFE NSW.

**TAFE NSW has experienced ongoing issues with its student administration system.**

TAFE NSW has again implemented additional processes to verify the accuracy and completeness of revenue from sales of goods and services.

TAFE NSW expects to spend up to \$89 million on a new information system to address these issues. Modules of the new student enrolment system are expected to be in place for the 2018 enrolment period.



### Restatements relating to the General Government Sector's investment in the commercial sector.

**The State corrected two previously reported balances relating to the General Government Sector's investment in the commercial sector.**

Accounting Standards require the General Government Sector to effectively store gains or losses related to its investment in the commercial sector in reserves until the investment is derecognised.

When these investments are disposed of, the cumulative gains and losses must be cleared and recognised in the operating result. However, the Government had previously cleared the cumulative gains and losses directly to Accumulated Funds within equity.

To comply with Accounting Standards, a total of \$6 billion previously reported as a movement in equity at 30 June 2016, has now been corrected to the operating result.

In addition, Accounting Standards only allow gains or losses on its investments to be stored in reserves. In past years, the State recognised all changes in the value of its investment in Available for Sale Reserves, including the capital contributed to establish the State's investment. In 2016-17, a total of \$23.4 billion of contributed capital was corrected to accumulated funds at 1 July 2015.

# The State's results

The State's budget result was a \$5.7 billion surplus, \$2.0 billion higher than the budget estimate.

## The Total State Sector comprises 310 entities controlled by the NSW Government.

Of the total, the General Government Sector comprises 215 entities that provide goods and services not directly paid for by consumers.

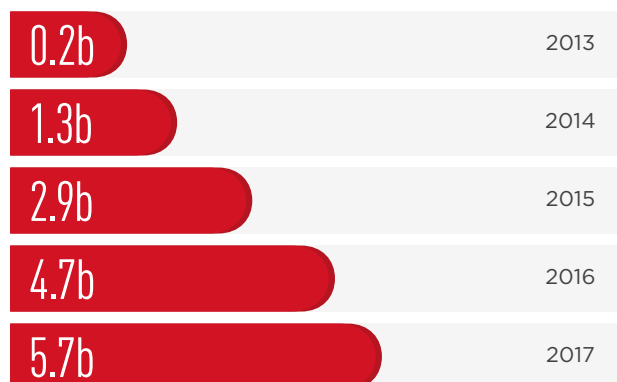
The non-General Government Sector comprises 95 Government businesses that provide goods and services such as water and electricity, or financial services.

A principal measure of a Government's overall performance is its Net Operating Balance, or Budget Result. The Net Operating Balance reports the difference between the cost of General Government service delivery and the revenue earned to fund these sectors.

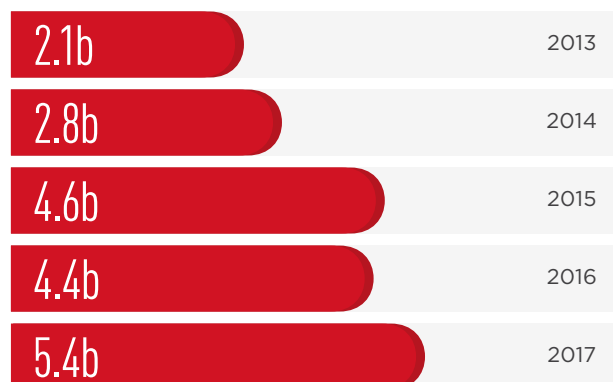
The State has recorded budget surpluses and exceeded the original budget result in nine of the last ten years.

## NET OPERATING BALANCE 2013-2017

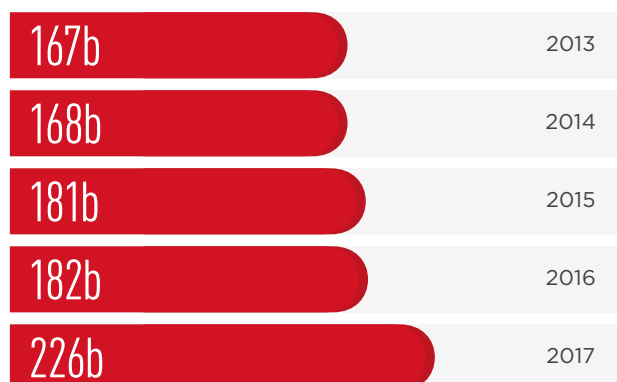
### General Government Sector



### Total State Sector



## NET WORTH 2013-2017



## The State's net worth increased by \$44.7 billion in 2016-17.

This included:

- a decrease in superannuation liabilities of \$12.6 billion primarily due to an increase in the discount rate to 2.62 per cent
- a decrease in borrowings of \$9.5 billion primarily from the leases of Ausgrid and Endeavour Energy assets
- an additional \$8.5 billion in assets to correct the value of rail tunnel and earthwork infrastructure at 1 July 2016.

A strong balance sheet with robust financial oversight should help the State:

- maintain its AAA credit rating
- support a low cost of borrowing
- attract a wide range of potential investors to the State's debt issuance and private financing for capital projects
- respond to emerging fiscal and economic pressures
- provide capacity to absorb adverse fiscal shocks
- raise debt in a fiscally responsible manner.



# Fiscal responsibility targets

The State maintained its AAA credit rating.

## The object of the Act is to maintain the AAA credit rating.

NSW's finances are managed in alignment with the *Fiscal Responsibility Act 2012* (the Act).

The Act established the framework for fiscal responsibility and strategy needed to protect the State's AAA credit rating and service delivery to the people of NSW.

**The purpose of maintaining the AAA credit rating is to reduce the cost of, and ensure the broadest access to, borrowings.**

A triple-A credit rating also helps maintain business and consumer confidence so economic activity and employment are sustained. The legislation sets out targets and principles for financial management to achieve this.

New South Wales has credit ratings of AAA/Negative from Standard & Poor's and Aaa/Stable from Moody's Investors Service.

## THE FISCAL TARGETS FOR ACHIEVING THIS OBJECTIVE ARE:

**General Government expenditure growth is lower than long term revenue growth.**

General Government expenditure growth was 4.2 per cent in 2016-17, below the long-term revenue growth of 5.6 per cent.

**Eliminating unfunded superannuation liabilities by 2030.**

The Act sets a target of eliminating unfunded defined benefit superannuation liabilities by 2030. The State's net superannuation liability was \$58.6 billion at 30 June 2017 (\$71.2 billion at 30 June 2016).

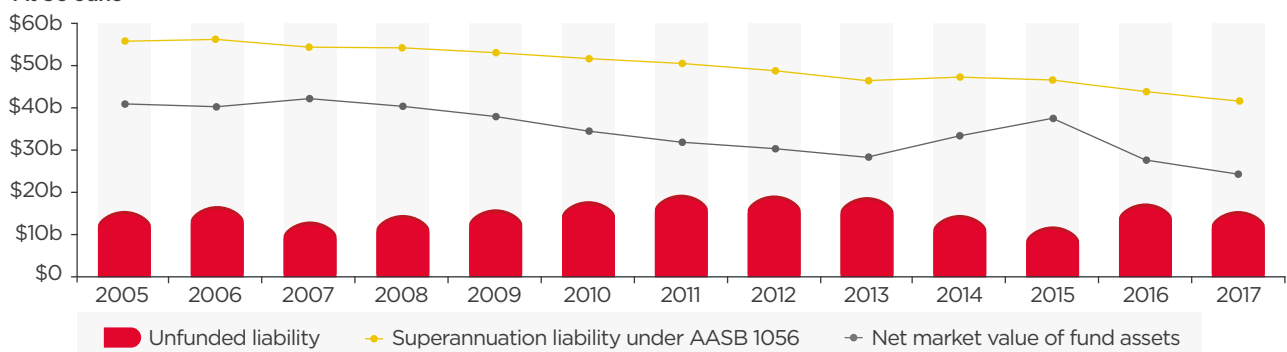
The Government predicts the 2030 target will be achieved. The State's funding plan is to contribute amounts escalated by five per cent each year so the schemes will be fully funded by 2030. In 2016-17, the State made employer contributions of \$1.5 billion, which is largely consistent with contributions over the past five years.

The liability values in the graph below do not reflect the values recorded in the Total State Sector Accounts. For financial reporting purposes, Accounting Standards (AASB 119 Employee Benefits) require the State to discount its superannuation liability using the government bond rate (refer to page 10 of this report). The relevant government bond rate in the current economic climate is 2.62 per cent.

The State's target for the unfunded superannuation liability is measured using AASB 1056 Superannuation Entities. This is because it adopts a measurement basis that reflects expected earnings on fund assets, which are currently between 5.9 and 7.4 per cent. Using these rates, the liability is \$15.0 billion at 30 June 2017 (\$16.1 billion at 30 June 2016). The unfunded liability is \$2.4 billion less than when the Act was introduced.

## SUPERANNUATION FUNDING POSITION SINCE INCEPTION OF THE ACT

At 30 June





# The State's assets

The State's assets grew by \$31.6 billion during 2016-17 to \$409 billion.

## Valuing the State's physical assets.

When we audit the financial statements, we focus on areas we consider as higher risk. These areas are often complex, and require the use of estimates and judgements.

The State has \$307.2 billion of physical assets measured at fair value in accordance with Australian Accounting Standards. Fair value calculations are inherently complex and sensitive to assumptions and estimates, increasing the risk these assets are incorrectly valued.

In our audits, we assess the reasonableness and appropriateness of assumptions used in valuing physical assets. This includes obtaining an understanding of the valuation methodologies applied and judgements made. We also review the completeness of asset registers, and the mathematical accuracy of valuation models.

Net movements between years includes additions, disposals, depreciation and valuations. This year, valuations of physical assets added \$16.2 billion to the State's assets, comprising:

- Transport for NSW and Railcorp \$8.5 billion
- New South Wales Land and Housing Corporation \$4.8 billion
- Roads and Maritime Services \$930 million
- Crown Entity \$400 million.

## The State's financial assets increased \$27.5 billion in 2016-17.

The State's financial assets have increased by 88 per cent over the past four years. In 2016-17, financial assets increased primarily due to proceeds from the sale of government assets and businesses.











The Government implemented reforms to better use the State's financial assets. A key element was the creation of an Asset and Liability Committee (ALCO) to provide advice on ways to improve balance sheet management.

Since the creation of the ALCO, reforms include:

- Establishment of the New South Wales Infrastructure Future Fund (NIFF). The net proceeds from the State's asset recycling program are invested into the NIFF, which is managed by TCorp, with a balance of \$14.6 billion by 30 June 2017. Funds raised are invested through the NIFF until the Government requires them for critical infrastructure projects that are part of the Restart NSW and Rebuilding NSW program of works. ALCO and TCorp provide advice on the NIFF's performance and management.
- Establishment of the Social and Affordable Housing Fund (\$1.1 billion at 30 June 2017). ALCO oversees the Fund to ensure an appropriate investment approach that will maintain funding certainty for new social and affordable housing stock.
- Cash and liquidity management reforms to centralise cash previously held by agencies in the Treasury Banking System. This reform is designed to ensure agencies have adequate levels of liquidity but with surplus funds invested centrally for better returns.

\$ 377b  8.4 409b Total Assets

Key assets include:

	2015-2016	Change %	2016-2017	
	151.5b	 3.0	147.0b	Infrastructure
	135.5b	 5.8	143.4b	Land and Buildings
	12.5b	 121.9	27.7b	Equity Investments
	17.0b	 21.1	20.6b	Cash and Receivables
	31.8b	 27.4	40.5b	Investments and Placements

# The State's liabilities

The State's liabilities decreased by \$13.1 billion during 2016-17 to \$182 billion.

## Valuing the State's liabilities relies on an actuarial assessment.

Nearly half of the State's liabilities relate to its employees. This includes unfunded superannuation, and employee benefits, such as long service and recreation leave.

Valuation of these obligations is subject to complex estimation techniques and significant judgements. Small changes in assumptions can materially impact the financial statements.

We address the risk associated with auditing these balances:

- using actuarial specialists
- testing controls around underlying employee data used in data models, and testing the accuracy of the calculations
- evaluating assumptions applied in calculating employee entitlements such as the discount rate and the probability of long service leave vesting conditions being met.

## The State's superannuation obligations reduced by \$12.6 billion in 2016-17.

The State's \$58.6 billion superannuation liability represents obligations for past and present employees, less the value of assets set aside to meet those obligations. The superannuation liability decreased from \$71.2 billion to \$58.6 billion, largely due to an increase in the discount rate from 1.99 per cent to 2.62 per cent. This alone reduced the liability by \$9.2 billion.

## The State's borrowings totalled \$70.6 billion at 30 June 2017.

The State's borrowings totalled \$70.6 billion at 30 June 2017, \$9.5 billion less than the previous year. This was largely due to the repayment of borrowings when the assets of Ausgrid and Endeavour Energy were leased to the private sector.




TCorp issues bonds to raise funds for NSW Government agencies. The bonds are actively traded in financial markets providing price transparency and liquidity to public sector borrowers and institutional investors. All TCorp bonds are guaranteed by the NSW Government.

The Government manages its debt liabilities through its balance sheet management strategy. The strategy extends to TCorp, which applies an active risk management strategy to the Government's debt portfolio.

General Government Sector debt is being restructured by replacing shorter-term debt with longer-term debt. This lengthens the portfolio to better match liabilities with the funding requirements of infrastructure assets and reduces refinancing risks. It also allows the Government to take advantage of the low interest rate environment.

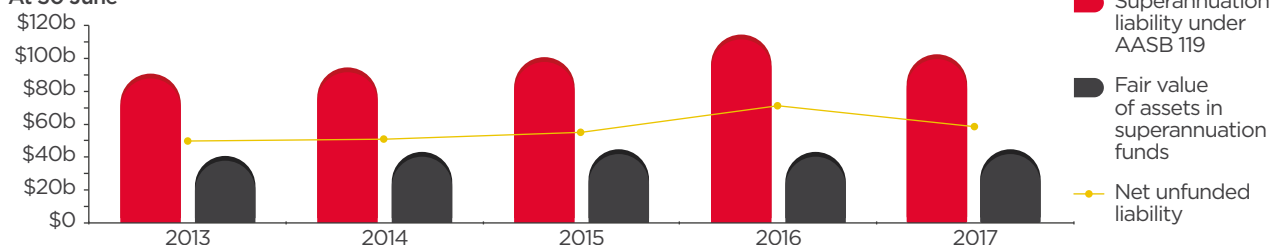
**\$ 195b** **6.7** **182b** **Total Liabilities**

Key liabilities include:

	2015-2016	Change %	2016-2017	
	71.2b	17.6	58.6b	Superannuation
	18.5b	3.2	18.0b	Other Employee Benefits
	80.1b	11.9	70.6b	Borrowings

## TREND IN UNFUNDED SUPERANNUATION LIABILITY

At 30 June



# The State's revenue

The State recorded revenue of \$83.5 billion in 2016-17, an increase of \$5.3 billion from 2015-16.

## The State's results are underpinned by revenue growth in taxation, fees and fines.

Taxation, fees, fines and other revenue comprises \$30.5 billion of taxation (\$28.7 billion in 2015-16) and \$5.3 billion of fees, fines and other revenue (\$4.6 billion).

Tax revenue for the Total State Sector increased by \$1.8 billion, or 6.4 per cent compared to 2015-16, primarily due to:

- one-off business asset sales and lease transactions, including \$718 million in transfer duty from the Ausgrid and Endeavour Energy lease transactions
- \$385 million increase in payroll tax from growth in NSW employment and average employee compensation
- a \$426 million increase in land taxes.

## Growth in stamp duty is expected to slow over the next 4 years.




General Government Sector stamp duties have increased from \$6.2 billion in 2012-13 to \$11.5 billion in 2016-17, an annual average growth rate of 16.5 per cent. The Government's budget forecasts the growth in stamp duties to decline, to an average annual growth rate of 2.6 per cent between 2016-17 and 2020-21.

## The State received Commonwealth grants and subsidies of \$30.8 billion in 2016-17.

The State received \$30.8 billion from the Commonwealth Government in 2016-17, \$1.6 billion more than in 2015-16. This was primarily due to transaction based asset recycling grants of \$1.0 billion and a \$720 million increase in national land transport grants. This increase was offset by a \$435 million decrease in General Purpose Grants, which mainly comprises New South Wales' share of the Goods and Services Tax (GST).

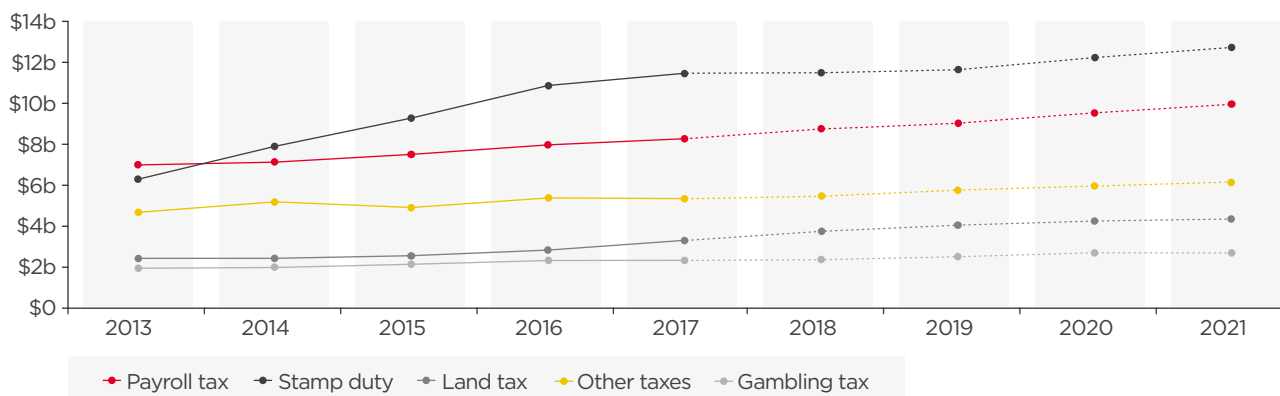
**\$ 78.2b** **6.7** **83.5b** Total Revenue

Key revenues include:

	2015-2016	Change %	2016-2017	
	33.3b	7.5	35.8b	Taxation, Fees, Fines, and Other
	29.2b	5.4	30.8b	Commonwealth Grants & Subsidies
	13.2b	3.3	13.6b	Sales of Goods and Services

## TRENDS IN TAX COLLECTION (General Government Sector)

Year ended 30 June



# The State's expenses

The State spent \$79.4 billion in 2016-17 to deliver services to the community, an increase of \$3.9 billion from 2015-16.

Overall expenses increased 5.2 per cent from last year. Most of the increase was due to higher employee costs and operating costs.

## Total salaries and wages increased by 4.2 per cent from 2015-16.

Total salaries and wages increased to \$30 billion from \$28.8 billion in 2015-16. The Government wages policy aims to limit the growth in remuneration and other employee costs to no more than 2.5 per cent per annum.

## Operating expenses increased by 12.4 per cent from 2015-16.

Within operating expenses, payments for supplies, services and other expenses increased, in part, due to the State:

- reacquiring mining licenses worth \$482 million and additional land remediation costs of \$101 million
- spending more on health including additional drug supplies relating to Hepatitis C.











## State spend on transport and communications increased by 68.1 per cent since 2012-13.

While spending on health and education remain the largest functional areas provided by Government, expenditure on transport and communication increased, on average, by 13.9 per cent annually between 2012-13 and 2016-17. This increase reflects the Government's investment in transport infrastructure such as the Sydney Metro and Westconnex. Over the same period, spending on health increased by \$3.9 billion.

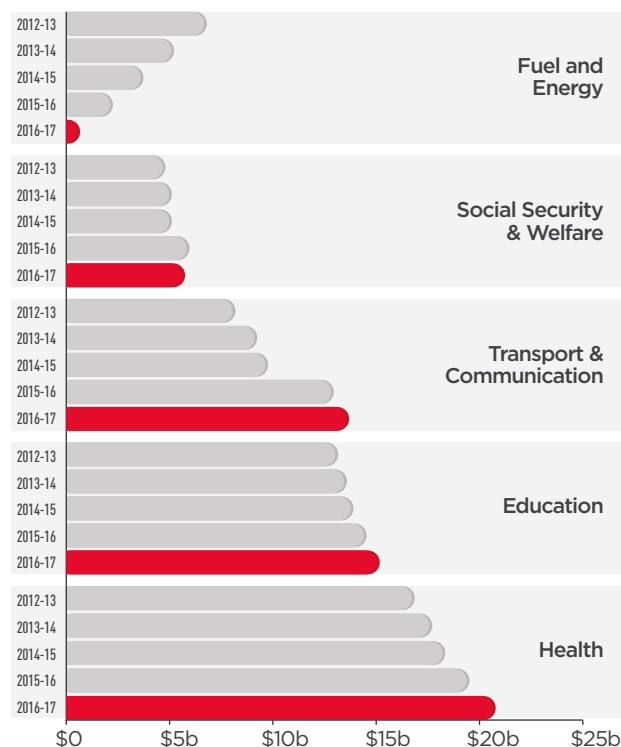
Expenditure on fuel and energy has decreased by an average of 44.7 per cent since 2012-13, reflecting the State's leases of electricity network assets.

\$ 75.5b  5.2 79.4b Total Expenses

Key expenses include:

	2015-2016	Change %	2016-2017	
	31.7b	 3.4	32.8b	Employee Expenses
	19.2b	 12.4	21.6b	Operating Costs
	9.4b	 2.7	9.7b	Grants & Subsidies
	6.8b	 6.0	7.2b	Depreciation
	4.7b	 2.0	4.6b	Superannuation Expense

## EXPENDITURE BY FUNCTION



# In focus:

## Restart NSW and Rebuilding NSW



### In 2011, the Government established Restart NSW to fund high priority infrastructure projects.

Restart NSW projects are primarily funded from the proceeds from the asset recycling program enabling Government to deliver new infrastructure investment.

Restart NSW provides funding for the delivery of Rebuilding NSW, which is the Government's 10-year plan to invest \$20 billion in new infrastructure.

#### The State finalised long-term leases of Ausgrid and Endeavour Energy assets.

In June 2017, the Government finalised its long-term lease of 50.4 per cent of Endeavour Energy. This transaction follows on from the long-term leases of TransGrid in December 2015 and 50.4 per cent of Ausgrid in December 2016. Net proceeds of \$15.0 billion were paid into Restart NSW relating to these transactions.

The Government also finalised an arrangement for the private sector to provide land titling and registry services to the public for 35 years. The State, through Restart NSW, received an upfront payment of \$2.6 billion from the new operator.

#### Restart NSW is funding \$29.8 billion of new infrastructure.

The Government has detailed its plan to invest \$20 billion into the Rebuilding NSW plan from Restart NSW.

At 30 June 2017, around \$2.9 billion has already been spent on Rebuilding NSW projects from Restart NSW, with a further \$9 billion included in the budget aggregates. The Government has also earmarked a further \$8.1 billion in Restart NSW for future projects.

The most significant project is the Sydney Metro. The Government has committed \$7.0 billion from Restart NSW to build a 30-kilometre metro line, linking Sydney Metro Northwest at Chatswood, through new stations in the lower North Shore, the Sydney CBD and southwest to Bankstown. At 30 June 2017, \$2.4 billion has been spent on this project from Restart NSW.

Other significant projects funded by Restart NSW include a \$1.8 billion contribution to WestConnex and reserved funding of \$1 billion towards the State's Major Stadia Network program.

	<b>ALL PROCEEDS (2012-2017)</b> Proceeds from disposal of government business or asset sales	<b>45.2b</b>
	<b>LESS PAYMENTS</b> Including repayment of borrowings	<b>21.7b</b>
	<b>NET PROCEEDS</b>	<b>23.5b</b>

	<b>OTHER PROCEEDS (2012-2017)</b>	
	Windfall tax revenue	<b>3.6b</b>
	Asset recycling incentives	<b>1.0b</b>
	Other	<b>1.7b</b>
		<b>6.3b</b>

	<b>RESTART NSW FUND</b>	<b>29.8b</b>
	<b>BUDGET SPENDING</b>	<b>17.5b</b>
	Includes Rebuilding NSW	<b>11.9b</b>
	<b>RESERVED FUNDING</b>	<b>12.1b</b>
	Includes Rebuilding NSW	<b>8.1b</b>
	<b>TOTAL SPEND UP TO JUNE 2017</b>	<b>6.8b</b>

## To date, 19.2 per cent of payments from Restart NSW have gone to infrastructure projects in rural and regional areas.

Section 9 of the *Restart NSW Fund Act 2011* requires the following information to be included in Restart NSW's financial report:

- total Fund payments for infrastructure projects in rural and regional areas outside metropolitan Sydney, Newcastle and Wollongong
- whether the payments represent at least 30 per cent of total payments from the Fund for infrastructure projects.

In 2016-17, 14 per cent of Restart NSW Fund payments were directed to infrastructure projects in rural and regional areas outside metropolitan Sydney, Newcastle and Wollongong. Over the past five years of the Restart NSW Fund to 30 June 2017, 19.2 per cent of payments were directed to these areas.

The 2017-18 budget papers include details on how the Government intends to use the Fund.

## ASSET RECYCLING IMPLICATIONS

The sale of government businesses can significantly impact State finances, including:

### The General Government Sector has no Net Debt.

General Government Sector (GGS) Net Debt has decreased from around \$14 billion in 2012 to negative \$9 billion in 2017. This means the financial assets of the GGS now far exceed its financial liabilities. As the Government uses its financial assets on Restart NSW and Rebuilding NSW projects net debt is forecast to increase.

### Revenue from dividends and income tax equivalents has reduced by 58.4 per cent since 2013.

The sale of some of the State's income generating businesses means that income traditionally earned through sale of goods and services as well as the payment of dividends has reduced. Business' that have been disposed collectively paid \$3.1 billion of dividends and income tax equivalents over the past four financial years.

### \$298 million was spent on consultants to sell or lease State assets.

The State spent \$175 million over the past 5 years on consultants for the electricity network and generator transactions. Other significant consulting costs include:

- Ports transactions \$71.6 million
- Disability & Customer Care Services Transfers \$31.1 million
- Land & Property Information \$14.8 million
- Pillar \$5.5 million.

## FUTURE ASSET TRANSACTIONS

### Sale of WestConnex

The new M4-M5 link is expected to be partly funded by a planned sale of at least 51 per cent of Sydney Motorway Corporation (SMC), which is responsible with delivering WestConnex.

The State's investment in SMC is \$3.3 billion at 30 June 2017. It includes the concession deeds for the three components of WestConnex – the M4, the M5 and the new link between the two motorways.

The Government has launched a process with a call for parties to register their interest in the sale.



### Sale of Snowy Hydro

The Commonwealth Government's budget announced future plans to buy some or all of NSW's 58 per cent stake in the Snowy Hydro power company as part of a major expansion of the historic scheme to include new forms of electricity generation.

The State's investment in Snowy Hydro is \$4.2 billion at 30 June 2017.





# In focus:

## Financial Management Transformation program

The Treasury initiated the **Financial Management Transformation (FMT) program** with the aim of changing and improving financial governance, budgeting and reporting arrangements of the New South Wales public sector.

FMT aims to deliver better outcomes for the people of New South Wales and focuses on transparency and accountability for expenditure, and better value for money.

## New Financial Management system

PRIME is the Information Technology (IT) solution component of the FMT program, replacing several historical systems. PRIME will provide both financial and performance information within one IT platform for all agencies in the NSW public sector.

It is expected to give Government more timely information to plan and deliver its policy priorities and the budget.



Independent assurance over the budget process would improve confidence in the reliability of the State's financial information.

### PROGRESS IN 2017

## The 2017-18 budget was prepared using the PRIME IT system.

**The 2017-18 budget, tabled in June 2017, was the first budget generated using the new PRIME system.**

The PRIME system continues to be released with five modules to be deployed by the end of November 2017.

The Treasury will spend \$9.9 million in 2017-18 to:

- modify PRIME for improvements identified by user agencies
- increase PRIME'S ability to support new budget processes through strategic planning, data analytics and program reviews.

Previously, the Audit Office provided independent assurance over the budget processes by being engaged to review the reasonableness of estimates and forecasts used by The Treasury in preparing the budget papers relating to the 2013-14 to 2016-17 budget years.

In 2017, the implementation of PRIME represented a major change to the budget process and accordingly, the Audit Office was not requested to undertake a review of the 2017-18 budget process.



## Legislative reform

New legislation aims to establish a single framework for public sector financial management.

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### PROGRESS IN 2017

The Government is preparing draft legislation to replace a number of historical Acts.

**The legislative reform proposes significant change to promote and support the performance, transparency and accountability of government financial agencies and government officials involved in financial management of the State.**

We are supportive of the objects of the proposed reform, without weakening existing safeguards, and believe it is timely to also modernise audit provisions to support these objectives.



Given the increasing role of non-government agencies in the delivery of government programs, and the greater focus on meeting outcomes, we continue to advocate for 'follow the dollar' powers, now broadly available to other Australian audit offices.

## Policy reform

The new PRIME system and legislative reform will enable the Government to move towards an outcome based budget approach.

The policy changes will drive a greater focus on results and effectiveness of State expenditure.

Independent assurance over the appropriateness and accuracy of agency key performance measures and indicators would improve confidence in the reliability of the State's performance data.



### PROGRESS IN 2017

## The Government is transitioning to outcomes based budgeting.

**As part of the 2017-18 budget process, agencies built their financial information around programs they provide to the community.**

These programs are presented in program groups that represent the total service packages provided to the community. Multiple agencies within a cluster can contribute programs to a program group, ensuring the focus is on what Government is trying to achieve for citizens.

We understand the Government will build on this model in the 2018-19 budget, by clearly identifying the outcomes in which the Government is investing, and ensuring that there are robust measures to track performance against these outcomes.

We are supportive of the move towards outcomes based budgeting and tracking performance against those outcomes.

## OUR VISION

Our insights inform and challenge government to improve outcomes for citizens.

## OUR MISSION

To help parliament hold government accountable for its use of public resources.

## OUR VALUES

**Purpose** – we have an impact, are accountable, and work as a team.

**People** – we trust and respect others and have a balanced approach to work.

**Professionalism** – we are recognised for our independence and integrity and the value we deliver.

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Monday to Friday.



## Appendix one: Prescribed entities

Section 45 of the *Public Finance and Audit Act 1983* requires the Auditor-General to perform audits of the financial statements of entities prescribed for the purposes of that section.

The following were prescribed entities as at 30 June 2017:

Entity/Fund	Latest financial statements audited	Type of audit opinion issued
Agricultural Scientific Collections Trust	30 June 2016	Unmodified
AustLII Foundation Limited	31 December 2016	Unmodified
Belgenny Farm Agricultural Heritage Centre Trust	30 June 2016	Unmodified
The Brett Whiteley Foundation	30 June 2016	Unmodified
Buroba Pty Ltd	30 June 2017	Unmodified
C. B. Alexander Foundation	30 June 2016	Unmodified
City West Housing Pty Ltd	30 June 2017	Unmodified
The Commissioner for Uniform Legal Services Regulation	30 June 2017	N/A <sup>(a)</sup>
Cowra Japanese Garden Maintenance Foundation Limited	31 March 2017	Unmodified
Cowra Japanese Garden Trust	31 March 2017	Unmodified
Crown Employees (NSW Fire Brigades Firefighting Staff Death and Disability) Superannuation Fund	30 June 2017	Unmodified
Eif Pty Limited	30 June 2017	Unmodified
Energy Investment Fund	30 June 2017	Unmodified
Central Coast Council Water Supply Authority (formerly Gosford City Council Water Supply Authority)	12 May 2016	Modified with a Disclaimer of Opinion
Home Building Compensation Fund	30 June 2017	Unmodified
The funds for the time being under the management of the New South Wales Treasury Corporation, as trustee	30 June 2017	Unmodified
<ul style="list-style-type: none"><li>• ICNSW Australian Equities Fund</li><li>• ICNSW International Equities Fund</li><li>• ICNSW International Equities Fund (Hedged)</li><li>• Insurers' Guarantee Fund Investment Trust</li><li>• NSW Infrastructure Future Fund</li><li>• NSW Trustee and Guardian Growth Portfolio</li><li>• Parliamentary Contributory Superannuation Fund</li><li>• TCorpIM Australian Bond Fund</li><li>• TCorpIM Australian Share Fund</li><li>• TCorpIM Cash Fund</li><li>• TCorpIM Cyclical Growth Australian Share Fund</li><li>• TCorpIM Cyclical Growth International Share Fund</li><li>• TCorpIM Direct Infrastructure Fund A</li><li>• TCorpIM Direct Investment Fund B</li><li>• TCorpIM Downside Protection Australian Share Fund</li><li>• TCorpIM Medium Term Growth Fund</li><li>• Long Service Corporation Investment Fund</li></ul>		

Entity/Fund	Latest financial statements audited	Type of audit opinion issued
<ul style="list-style-type: none"> <li>• TCorpIM Downside Protection International Share Fund</li> <li>• TCorpIM Emerging Markets Share Fund</li> <li>• TCorpIM Global Credit Fund</li> <li>• TCorpIM Indexed Australian Share Fund</li> <li>• TCorpIM Indexed International Share Unhedged Fund</li> <li>• TCorpIM International Bond Fund</li> <li>• TCorpIM International Share Hedged Fund</li> <li>• TCorpIM International Share Unhedged Fund</li> <li>• TCorpIM Liquidity Cash Fund</li> <li>• TCorpIM Listed Property Fund</li> <li>• TCorpIM Multi-Asset Class Fund</li> <li>• TCorpIM Specialist Emerging Markets Share Fund</li> <li>• TCorpIM Strategic Cash Fund</li> <li>• TCorpIM Unlisted Infrastructure Fund</li> <li>• TCorpIM Unlisted Property Fund</li> <li>• TCorpIM Long Term Growth Fund</li> <li>• Treasury Managed Fund Investment Portfolio</li> </ul>		
The Illawarra Health and Medical Research Institute Limited	30 June 2016	Unmodified
The Legal Services Council	30 June 2017	Unmodified
Macquarie University Professorial Superannuation Scheme	30 June 2017	Unmodified
Minister administering the <i>Environmental Planning and Assessment Act 1979</i> (a corporation)	30 June 2017	Unmodified
Minister administering the <i>Heritage Act 1977</i> (a corporation)	30 June 2016	Unmodified
National Art School	31 December 2016	Unmodified
Networks NSW Limited	(b)	N/A
NSW Fire Brigades Superannuation Pty Limited	30 June 2017	Unmodified
Parliamentary Contributory Superannuation Fund	30 June 2016	Unmodified
The superannuation fund amalgamated under the <i>Superannuation Administration Act 1991</i> and continued to be amalgamated under the <i>Superannuation Administration Act 1996</i> (known as the SAS Trustee Corporation Pooled Fund)	30 June 2017	Unmodified
The trustees for the time being of each superannuation scheme established by a trust deed as referred to in section 127 of the <i>Superannuation Administration Act 1996</i>	30 June 2017	Unmodified
The trustees for the time being of The Art Gallery of New South Wales Foundation	30 June 2016	Unmodified
Trustee of the Home Purchase Assistance Fund	30 June 2017	Unmodified
Trustees of the Farrer Memorial Research Scholarship Fund	31 December 2016	Unmodified
United States Studies Centre	31 December 2016	Unmodified
Universities Admissions Centre (NSW and ACT) Pty Limited	30 June 2016	Unmodified

Entity/Fund	Latest financial statements audited	Type of audit opinion issued
University of Sydney Professorial Superannuation System	31 December 2016	Unmodified
Valley Commerce Pty Ltd	30 June 2017	Unmodified

a Included as part of the Legal Services Council.

b Deregistered 3 August 2016.





## Appendix two: Legal opinions

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The Auditor-General is required by section 52(2) of the *Public Finance and Audit Act 1983* (PF&A Act) to publish any requests for a legal opinion submitted to the Attorney General or the Crown Solicitor under section 33 of the PF&A Act.

Two legal opinions were received since my last report in Volume Four 2016, which was released on 6 October 2016. The first opinion relates to the Auditor-General's obligations with regard to auditing of 'council entities' pursuant to the *Local Government Act 1993*. The second relates to the Auditor-General's functions in relation to Norfolk Island.



### Advice

#### Audit of council entities

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**Prepared for:** AUD018 Auditor-General of NSW  
**Date:** 31 August 2017  
**Client ref:** Steven Martin  
**CSO ref:** 201702268 T08 Sally Johnston/Lea Armstrong

## 1. Summary of advice

- 1.1 You seek my advice as to the Auditor-General's obligations with regard to auditing of "council entities" pursuant to the *Local Government Act 1993* ("the Act"). Pursuant to s. 415(4), a council's auditor (who is the Auditor-General: s 422) must, in auditing the financial reports of a council, audit the financial reports of any council entity and report on same as part of the report on the council. You have proposed an interpretation of this provision for my comment.
- 1.2 In my view, it is clear that the obligation to audit a council entity in s. 415(4) forms a part of the audit of the council. As to what such "audit" involves, the preferable interpretation must take account of both the lack of any obligation in the Act for council entities to prepare financial reports, and the functions and powers of the Auditor-General in relation to the audit of such entities in the Act. Whilst the Auditor-General's audit functions in relation to councils in Div. 3 of Pt. 3 of Ch. 13 are extended to council entities, the accounting and financial reporting obligations of councils generally in Divs. 1 and 2 of that Part are not so extended. Given the diverse range of bodies which may constitute a "council entity", whether or not such an entity has prepared a financial report will depend on statutory obligations elsewhere arising and, in my view, where no financial report of a council entity exists, the obligation to audit that entity in s. 415(4) does not arise. Where the obligation does arise, it may necessarily be limited by the nature of the council entity in question and the financial reports which it does prepare.
- 1.3 For those reasons, to the extent that your proposed construction of the duty in s. 415(4) is that the Auditor-General (as the council auditor) is required to perform "those audit procedures on a council entity considered necessary to form an opinion on the council's consolidated general purpose financial report", I think that is a reasonable and open interpretation of the duty, where it arises.
- 1.4 Insofar as your proposed construction of the duty in s. 415(4) also suggests that "any matters as appropriate in respect of a council entity are included in the report on the conduct of the audit of the council's financial report required pursuant to s. 417(1) of the Act", I agree to the extent that the duty in s. 415(4) is discharged by the auditor reporting on the council entity audit in the auditor's report on the council, which is a reference to the two reports to be issued under s. 417(1).
- 1.5 Please note this is a summary of the central issues and conclusions in my advice. Other relevant or significant matters may be contained in the advice, which should be read in full.

## 2. Background

- 2.1 By operation of the *Local Government Amendment (Governance and Planning) Bill 2016*, the Act was amended and ss. 415(4) and (5) were inserted. Section 415(4) relates to auditing of a "council entity" and s. 415(5) defines such entities. Your request for advice arises in the context where this provision has come into effect but no audits have yet been completed pursuant to it.
- 2.2 I note that conferences to discuss the background, issues and question for advice have been conducted between your officers and my officers on 21 July 2017 and 11 August 2017.

## 3. Advice sought

- 3.1 By letter dated 26 July 2017, you seek my advice as to whether:

"In acquitting my responsibility under the Act, is it reasonable to interpret that I will satisfy my obligations under the Act if, when auditing the financial report of a council, I perform those audit procedures on any Council Entity considered necessary to form an opinion on the council's consolidated general purpose financial report and include any matters I consider appropriate in respect of Council Entities in my report on the conduct of the audit of the council's financial report required under s. 417(1) of the Act?"

## 4. Advice

- 4.1 Chapter 13 of the Act is entitled "How are councils made accountable for their actions?", with Pt. 3 addressing "Financial management" and Div. 2 of that Part "Accounting records, financial reports and auditing". Section 415 provides:

### "415 Auditing of financial reports

- (1) A council's auditor must audit the council's financial reports as soon as practicable (having regard to the requirements of section 416 (1)) after they are referred for audit.
- (2) A council's financial reports must be audited in accordance with the requirements of:
  - (a) the publications issued by the Australian Accounting Research Foundation, on behalf of the Australian Society of Certified Practising Accountants and the Institute of Chartered Accountants in Australia, under the titles *Statements of Auditing Standards* and *Statements of Auditing Practice*, as in force for the time being, subject to the regulations, and
  - (b) such other standards as may be prescribed by the regulations.

- (3) The regulations may prescribe matters that an auditor must consider and provide comment on in auditing a council's financial reports.
- (4) In auditing the financial reports of the council, a council's auditor must also audit the financial reports of any council entity and report on that audit as part of the report on the council by the auditor.
- (5) In this Part:  
*council entity* means:
  - (a) a partnership, trust, corporation, joint venture, syndicate or other body (whether or not incorporated) that a council has formed or participated in forming or has acquired a controlling interest in, other than an entity of a class prescribed by the regulations, or
  - (b) any other entity of a class prescribed by the regulations."

### **"Council entity"**

- 4.2 In considering the scope of the duty in s. 415(4), it is first necessary to understand the nature of a "council entity", to which that duty relates. A "council entity" is defined for purposes of Pt. 3 of Ch. 13 of the Act in s. 415(5), as extracted above. There are currently no regulations made pursuant to s. 415(5)(a) or (b). In my view, the ordinary meaning and effect of the definition in s. 415(5)(a) is that a wide and diverse range of bodies may constitute a "council entity".
- 4.3 The definition operates by reference to factual matters. First, whether the entity in question is a "partnership, trust, corporation, joint venture, syndicate" or other type of body, and second, whether the council has "formed or participated in forming" or acquired a "controlling interest" in that body, both of which are questions of fact. To that end, I note that the phrase "controlling interest" is used in other relevant statutory regimes, particularly taxation contexts<sup>1</sup>. Whether a council has a "controlling interest" in relation to some other entity will usually be a factual test adapted to the particular type and nature of the entity in question. In the context of audit of financial statements, the Auditor-General would typically refer to Australian Accounting Standards AASB 10 'Consolidated Financial Statements' for guidance on what constitutes a "control".
- 4.4 It is clear that a "council entity" is potentially a very broad concept. There are a diverse range of entities which may constitute council entities, from unincorporated bodies or associations to large corporations. In turn, these bodies may be subject to different legislative regimes which impact upon their financial management, record keeping and

<sup>1</sup> See, for example, the *Payroll Tax Act 2007*. In the companies context, the phrase has a generally settled meaning of control of a majority of voting power at meetings of the board of management/ meeting of directors, power to appoint more than 50% of the members of a board of management/ directors, or direct or indirect exercise of control of more than 50% of the voting power attached to voting shares or a class of voting shares issued by a company (as applicable).

auditing. For example, no relevant statutory provisions may exist in relation to a small unincorporated body and such a body may not keep or generate financial statements etc. By contrast, a corporation may be subject to the provisions in the *Corporations Act 2001 (Cth)* which include record keeping and accounting obligations consistent with the standards made by the Australian Accounting Standards Board. This diversity in the potential range of bodies constituting "council entities" has implications for the practical operation of s. 415(4), as discussed below.

- 4.5 I also note that a comparable concept, although not expressly defined as a "council entity", is referred to in s. 358 of the Act. That section provides:

**"358 Restrictions on formation of corporations and other entities**

- (1) A council must not form or participate in the formation of a corporation or other entity, or acquire a controlling interest in a corporation or other entity, except:
- (a) with the consent of the Minister and subject to such conditions, if any, as the Minister may specify, or
  - (b) as provided by this Act.
- ...
- (4) In this section, *entity* means any partnership, trust, joint venture, syndicate or other body (whether or not incorporated), but does not include any such entity that is of a class prescribed by the regulations as not being within this definition."

- 4.6 In my view, s. 358 (particularly s. 358(1) and (4)), adopt the same concepts as those in s. 415(5), namely "formation or participation in formation" and acquiring a "controlling interest" in relation to a corporation or "entity". In that way, the sections are equivalent in material elements and should be understood as encompassing the same entities. Indeed, in my view, one practical way of identifying which entities constitute "council entities" for purposes of s. 415(5) would be to consider those entities which have been subject to Ministerial review pursuant to s. 358. Having said that, it is not my view that an entity does not constitute a "council entity" for purposes of s. 415 merely because it has not been subject to review pursuant to s. 358 (for example, in the situation where there has been non-compliance with the requirement for Ministerial approval in s. 358).

**Nature of obligation in s. 415(4)**

- 4.7 I note that the Auditor-General is the auditor for a council: s. 422(1). In that capacity, the duty imposed on the Auditor-General pursuant to s. 415(4) is that:

"In auditing the financial reports of the council, a council's auditor must also audit the financial reports of any council entity and report on that audit as part of the report on the council by the auditor."

- 4.8 The duty in s. 415(4) arises and falls upon the Auditor-General in her capacity as the council's auditor. The Act does not appoint the Auditor-General (or any other person) as the independent statutory auditor of a council entity. Indeed, a council entity may have its own auditor. Rather, a duty to "audit the financial reports" of the council entity arises in the Auditor-General in her capacity as the *council's* auditor.
- 4.9 That being said, a duty to "audit the financial reports" of a body, in this case a council entity, is ordinarily the duty of that body's auditor. So too I understand that an "audit of a financial report" usually entails an auditor issuing an opinion on that financial report, *qua* auditor of the body. There is a clear tension in s. 415(4) between the fact that the Auditor-General is not the auditor of the council entity and yet is required to "audit" its financial report.
- 4.10 As a result, the scope and nature of the duty to "audit" the financial reports of a council entity pursuant to s. 415(4) is open to doubt. Nonetheless, I think the following points can be made about the preferable interpretation of that duty.
- 4.11 I note that "audit" is not a defined term in the Act (although pursuant to s. 421A it "includes examination and inspection"), nor does it have a clearly settled meaning in law generally. Rather, legislation typically sets the framework for auditing in relation to particular bodies. For example, the Auditor-General's role in auditing councils is detailed in s. 417, which provides for matters such as inclusions in the auditor's financial report and matters on which the opinion or statement of the Auditor-General is required.
- 4.12 It is clear, from the introductory words of s. 415(4) "*in auditing* the financial reports of the *council...*" (emphasis added), that the "audit" of the financial reports of a council entity forms part of the process of, or is a corollary to, the audit of the council. However, it is presumably not equivalent to the audit of the council, which is addressed in ss. 415(1)-(3), or the terms of s. 415(4) would be rendered otiose. For example, it must presumably go beyond the audit of financial transactions between the council and council entity which would already be encompassed by the terms of the audit of the council pursuant to ss. 415(1)-(3).
- 4.13 The apparent purpose of s. 415(4) is to provide that council entities must be considered or examined in conducting the audit of a council. As noted in the second reading speech for the amending bill<sup>2</sup> which introduced the now s. 415(4) and (5):

"The bill... support(s) the financial transparency of councils... under the amendments introduced by the bill, councils will become subject to oversight by the Auditor-General for their general audits and those of their subsidiary entities..."<sup>3</sup>

<sup>2</sup> *Local Government Amendment (Governance and Planning) Bill 2016*.

<sup>3</sup> NSW Legislative Assembly, *Hansard*, 22 June 2016, Second Reading speech, Mr Paul Toole (Minister for Local Government).

("Subsidiary entities" apparently being used to refer to "council entities".)

- 4.14 In that way, the provision mirrors the requirement in s. 358 for Ministerial approval for council establishment of, or involvement in, such entities, by providing for ongoing oversight of the relationship between the council and the council entity, at least in a financial sense. However, as noted above, exactly what the additional obligation, introduced by s. 415(4) is, and how it is to be fulfilled, is unclear and beset with practical difficulties.
- 4.15 Significantly, ss. 423 and 424 support the audit obligation in s. 415(4) by extending to "council entities" as well as councils: see s. 423(6) and 424(3). Pursuant to s. 423, the Auditor-General (or a person authorised by the Auditor-General) is entitled at all reasonable times to full and free access to a council's (or council entity's) accounting records and other records necessary in order to carry out her functions. She may direct persons to produce books, record or other documents in their custody or control, to appear personally and produce such documents, to answer any relevant question, to provide any necessary authorities to gain access to such documents, and to make copies or take extracts from such documents for the purposes of an audit or inspection carried out under the Act.
- 4.16 Pursuant to s. 424, the Auditor-General (or a person authorised by the Auditor-General) may direct an authorised deposit-taking institution or the person in charge of a council (or council entity) account in such an institution to give her a statement of the account or certificate as to the balance of the account and produce to her any relevant book, record or other document in its custody or control. The effect of these provisions is that the Auditor-General's functions and powers under Div. 3 ("Auditors") of Pt. 3 of Ch. 13 of the Act are extended to apply to council entities in the same way they apply to councils. This may suggest an equivalent "audit" function is intended in relation to council entities, as applies to councils.
- 4.17 However, the provisions of Div. 1 ("Funds") and Div. 2 ("Accounting records, financial reports and auditing") of Pt. 3 of Ch. 13 of the Act are not uniformly extended to encompass council entities in the same way as they apply to councils. Of particular significance, ss. 412 and 413, which provide that a council must keep accounting records and prepare financial reports respectively, do not extend to council entities.
- 4.18 For this reason, there is no obligation pursuant to the Act for council entities to prepare financial reports, equivalent to that which applies to councils. To some extent, financial information about council entities may be included in the council's financial reports, which must be prepared in accordance with s. 413. That includes a requirement in s. 413(3)(a) that the financial statement be prepared in accordance with the publications in force issued by the Australian Accounting Standards Board, and would pick up controlled entities pursuant to those standards. Such controlled entities would



presumably also be "council entities" for purposes of s. 415(5) (although only a subset of the range of entities which may be council entities). However, it is for the council to determine appropriate compliance with s. 413 (although the Auditor-General may review this as part of her audit and report under s. 417). Even if, by that means, financial information about council entities is captured in the council's financial report, in my view, this has little application in terms of the s. 415(4) obligation. That is because the s. 415(4) "audit" obligation applies to "financial reports *of the council entity*" (emphasis added) and not the council's financial reports *per se*.

- 4.19 As noted in my discussion above about the diverse range of bodies potentially encompassed by the definition of "council entity", whether or not a council entity has prepared such a financial report will depend upon the nature of the entity and whether it is required to do so pursuant to other statutory regimes. In my view, that necessarily limits the operation of s. 415(4) to only those council entities which have such obligations elsewhere arising or which voluntarily prepare such reports, given the plain words of s. 415(4), that the audit is of "...the *financial reports* of any council entity..." (emphasis added).
- 4.20 In addition, it may limit the Auditor-General's ability to perform audit functions in relation to those financial reports, even where they do exist, depending upon the framework in which they have been prepared. As there is no means to compel a council entity to prepare a financial report in a particular manner pursuant to the Act, in my view the obligation in s. 415(4) upon the Auditor-General to audit the financial reports of a council entity can only extend to that which is reasonably possible having regard to the particular entity. It may be that, in practice, the Auditor-General can only comment on the limitations which apply to her audit.
- 4.21 In summary, it is clear that, whilst there is a diverse range of bodies which may constitute a "council entity", the obligation in s. 415(4) only arises in relation to "financial reports" and so only applies in relation to council entities which do prepare such financial reports. As to the nature of the duty to audit those financial reports, there are indications that s. 415(4) was intended to impose a duty of auditing of council entities which goes beyond that which would flow from proper auditing of the council in accordance with s. 415(2), and yet the scope of that duty is necessarily limited by the statutory context, functions and powers which are available to support it. The statutory language of s. 415(4) in my view reveals an intention to impose a duty on the council auditor in his or her capacity as council auditor (not as auditor of the council entity), and in the context of performing his or her audit of the council. That is, it is not an equivalent duty to that imposed in relation to the council, for which the Auditor-General is the auditor. Rather, the audit of the financial reports of the council entity must form, in some way, a component or part of the audit of the council.

- 4.22 It is, in a practical sense, difficult to articulate precisely what that "audit" duty involves in the context of s. 415(4), beyond noting these features which point to it being less than equivalent to the role of an external auditor of the council entity (or equivalent to the audit of the council itself) and yet more than what would already be encompassed by the audit of the council pursuant to s. 415(1)-(3). What can be said is that the audit of the financial reports of a council entity should be conducted to the fullest extent necessary and possible to provide a report on that audit in the council report, in light of the audit functions and powers which the Auditor-General acquires in relation to both councils and council entities pursuant to Div. 3 of Pt. 3 of Ch. 13, especially ss. 423 and 424, as outlined above.

### **Conclusion re: proposed interpretation**

- 4.23 Given the uncertainties about the scope of the duty in s. 415(4), outlined above, in my view your proposed construction of the duty is both reasonable and open. That is, your suggestion that the duty in s. 415(4) is that the Auditor-General (as the council auditor) is required to perform "those audit procedures on a council entity considered necessary to form an opinion on the council's consolidated general purpose financial report", is a clearly arguable interpretation of the duty, where it arises. I note that, strictly, I would prefer to phrase it as "those audit procedures necessary to form an opinion on the council's financial reports", but given that the report required pursuant to s. 417(1) of the Act is a report as to the council's general purpose financial report, I do not disagree with your phrasing. I also observe that, whilst an "audit of the financial reports" of a body may in other contexts generally be understood to require the issuing of an opinion by the auditor, in my view, the statutory context and fact that the Auditor-General performs the function in s. 415(4) in her capacity as auditor of the council, make it arguable that the duty can be discharged through performing "audit procedures" rather than necessarily requiring the issuance of an opinion by the auditor.
- 4.24 To the extent that your proposed construction of the duty in s. 415(4) also suggests that "any matters as appropriate in respect of a council entity are included in the report on the conduct of the audit of the council's financial report required pursuant to s. 417(1) of the Act", I agree that the duty in s. 415(4) is discharged by the auditor reporting on the council entity audit in the report on the council. The reference in section s. 415(4) to "the report on the council by the auditor" is, in my view, a reference to either of the two reports made under s. 417(1).

### **Comment: possible means to resolve uncertainty**

- 4.25 The relevant provisions of the Act contain several powers for matters to be prescribed by regulation, which could assist to resolve the uncertainty and practical difficulties surrounding the operation of s. 415(4). The preparation and promulgation of regulations is a matter on which Parliamentary Counsel's advice should be sought, but I note the powers of regulation contained in s. 415(5)(a) and (b) as a potential means to clarify or limit the scope of the definition of "council entity", and the power in s. 415(3)

to regulate what matters an auditor must consider and provide comment on in auditing a council's financial reports, which could in turn assist to clarify the scope of the audit required pursuant to s. 415(4), given that such audit is performed as part of the audit of the council financial reports.

Signed:



Lea Armstrong  
**Crown Solicitor**



**CROWN SOLICITOR**  
NEW SOUTH WALES

# Advice

## Auditor-General functions in relation to Norfolk Island

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**Prepared for:** AUD018 Audit Office of NSW

**Date:** 24 August 2017

**Client ref:** D1714913

**CSO ref:** 201702270 T01 Jeremy Southwood/Lea Armstrong

## 1. Summary of advice

- 1.1 You seek my advice concerning the Auditor-General's responsibilities in relation to the Norfolk Island Regional Council, including in respect of performance audits and reporting to Parliament.
- 1.2 The Auditor-General does not presently have any functions or obligations with respect to the Norfolk Island Regional Council.
- 1.3 Please note this is a summary of the central issues and conclusions in my advice. Other relevant or significant matters may be contained in the advice, which should be read in full.

## 2. Background

- 2.1 You instruct me that you are aware of the following matters:
  - On 1 July 2016, the *Norfolk Island Legislation Amendment Act 2015* [(Cth)] established the [Norfolk Island Regional Council]
  - The *Norfolk Island Act 1979* [(Cth)] provides for the application of the *Local Government Act 1993* (NSW) to the Council
  - In October 2016, the *Local Government Act 1993* (NSW) was amended to provide my mandate to audit NSW councils
  - On 27 January 2017, the Commonwealth Minister (the Minister) for Local Government and Territories delegated the functions of the Auditor-General to the Administrator of the Council or the Secretary of the Commonwealth Department of Infrastructure and Regional Development (Norfolk Island (Local Government Act 1993 (NSW) (NI) Direction and Delegation 2017 (No. 1))
  - The Council tendered and approved the appointment of a private firm of Chartered Accountants, Pitcher Partners, as its external auditor on 15 March 2017".
- 2.2 You note that, in addition to the audit of a New South Wales council's financial report, the *Local Government Act 1993* ("the *NSW LG Act*") empowers you to:
  - conduct performance audits on the activities of NSW councils (Section 421B)
  - report annually on any local government sector-wide matters (Section 421C)
  - table ... reports before the NSW Parliament (Section 421D)".

## 3. Advice sought

- 3.1 By letter dated 3 August 2017, and in light of the Commonwealth Minister's delegation made on 27 January 2017, you seek my advice concerning the Auditor-General's

responsibilities in relation to the Norfolk Island Regional Council, including in respect of performance audits and reporting to Parliament.

#### 4. Advice

- 4.1 You seek my advice concerning the responsibilities of the Auditor-General in relation to the Norfolk Island Regional Council, including in respect of performance audits and reporting to Parliament (that is, the kinds of matters provided for in ss. 421B, 421C and 421D of the *NSW LG Act*).
- 4.2 To answer this question, it is necessary to consider both the provisions of the *NSW LG Act* (that is, the *Local Government Act 1993* operating as a law of New South Wales) and the provisions of the *Local Government Act 1993* operating as an applied law in force in Norfolk Island ("the *NI LG Act*"). The operation of the *NI LG Act* as a (Commonwealth) law in force in Norfolk Island follows from ss. 15(e) and 18A of the *Norfolk Island Act 1979* (Cth) ("the *NI Act*"), as well as the *Norfolk Island Applied Laws Ordinance 2016* (Cth) ("the *NIAL Ordinance*"). As noted further below, Sch. 4 of the *NIAL Ordinance* sets out various amendments to the text of the *Local Government Act 1993* for the purpose of its applying as the *NI LG Act*. Other than as amended by the *NIAL Ordinance*, the text of the *NI LG Act* will be the same as that of the *NSW LG Act*.
- 4.3 I shall consider first the provisions of the *NSW LG Act*, then those of the *NI LG Act*.
- 4.4 The *NSW LG Act* contains no provisions applying to the Norfolk Island Regional Council. A "council" to which (relevantly) the auditing provisions in Pt 3 of Chap. 13 of the *NSW LG Act* apply, "means the council of an area, and includes an administrator" (see the Dictionary to the *NSW LG Act*). An "area" "means an area as constituted under Part 1 of Chapter 9" of the *NSW LG Act* (see again the Dictionary), and s. 204(1) of the *NSW LG Act* (the first provision in Pt 1 of Chap. 9) makes clear that only a "part of New South Wales" may be constituted as an "area". Of course, no part of the Commonwealth territory of Norfolk Island is in New South Wales, such that no part of Norfolk Island could be, or has been, constituted as an "area" for the purposes of the *NSW LG Act*. As a consequence, no "council" will have been constituted for such an "area" by force of s. 219 of the *NSW LG Act*. The result is that none of the provisions of the *NSW LG Act* conferring functions on the Auditor-General with respect to a "council" or "councils", will apply to the Norfolk Island Regional Council.
- 4.5 By contrast, the *NI LG Act* clearly does apply to the Norfolk Island Regional Council. While the terms "council" and "area" are defined for the purposes of the *NI LG Act* in the same way as they are defined for the purposes of the *NSW LG Act*, and while s. 204(1) forms part of the *NI LG Act* (including insofar as it refers to New South Wales), an additional s. 204A has been inserted into the *NI LG Act* (by item 4 of Sch. 4 to the *NIAL Ordinance*), and that section provides:

**"204A Constitution of Norfolk Island as an area**

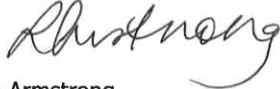
- (1) The island of Norfolk Island is constituted as an area.
  - (2) Subsection (1) has effect regardless of any requirements in this Act or any other law in force in the Territory of Norfolk Island for the constitution of an area."
- 4.6 Other than this "area" constituted by s. 204A(1), I am not aware of any other "area" that has been constituted under the *NI LG Act*. The effect of s. 219 of the *NI LG Act* (as modified by item 6 of Sch. 4 to the *NIAL Ordinance*) is to constitute a "council" for the "area" referred to in s. 204A(1). The further effect of s. 221(3) of the *NI LG Act* (inserted by item 9 of Sch. 4 to the *NIAL Ordinance*) is that the name of that "council" is the "Norfolk Island Regional Council". For completeness, I note that this body has also been declared to be the "Norfolk Island Regional Council" for the purposes of the *NI Act* (see s. 4(1) of the *NI Act* and cl. 6 of the *Norfolk Island Regional Council Declaration Ordinance 2016* (Cth)).
- 4.7 The result is that, where provisions of the *NI LG Act* (including the auditing provisions in Pt 3 of Chap. 13) refer to a "council", this will be a reference to the Norfolk Island Regional Council, and, to my understanding, only to that "council".
- 4.8 The auditing provisions in Pt 3 of Chap. 13 of the *NI LG Act* are in the same terms as the equivalent provisions of the *NSW LG Act*, not having been amended by the *NIAL Ordinance*. Part 3 of Chap. 13 therefore contains a number of provisions conferring functions on the "Auditor-General".
- 4.9 The effect of s. 18B(2) of the *NI Act* is that the functions conferred on the "Auditor-General" in Pt 3 of Chap. 13 of the *NI LG Act* will have been vested in the responsible Commonwealth Minister (currently the Minister for Local Government and Territories) instead of the "Auditor-General". Where a power is so vested in the Commonwealth Minister, the Commonwealth Minister may direct that the power also be vested in a specified person or authority (s. 18B(3)(a) of the *NI Act*), or delegate the power to a specified person (s. 18B(3)(b) of the *NI Act*).
- 4.10 As noted in your instructions, the Commonwealth Minister has made such a direction and delegation in relation to the powers conferred under the *NI LG Act*. The relevant instrument being in the *Norfolk Island (Local Government Act 1993 (NSW) (NI)) Direction and Delegation 2017 (No. 1)* (Cth) ("the *Cth Direction*"). Item 1.02 of the Table in Sch. 2 to the *Cth Direction* provides that all powers in the *NI LG Act* that are expressed to be powers of the "Auditor-General" are delegated to the Administrator of Norfolk Island, the Secretary and any Deputy Secretary of the Commonwealth Department of Infrastructure and Regional Development ("the Department"), and any Commonwealth Senior Executive Service Band 2 employee within the Local Government and Territories Division of the Department. For completeness, I note that item 1.04 of the Table in Sch. 1 to the *Cth Direction* provides that all powers in the *NI LG Act* that



are expressed to be powers of an "auditor" are vested in an auditor appointed s. 422(2) of the *NI LG Act*.

- 4.11 The Commonwealth Minister has not made any direction or delegation (including any deemed direction pursuant to s. 18B(5) of the *NI Act*) to the Auditor-General of any power in the *NI LG Act*, including in Pt 3 of Chap. 13. Because of that, the Auditor-General does not presently have any functions under the *NI LG Act*, including under Pt 3 of Chap. 13, with respect to the Norfolk Island Regional Council.
- 4.12 For these reasons, I think that the Auditor-General does not presently have any functions or obligations with respect to the Norfolk Island Regional Council.

Signed:



Lea Armstrong  
**Crown Solicitor**