Education: 2016–17 results of financial audits

Report 15: 2017–18

Queensland Audit Office

Better public services

Queensland Audit Office
Better public services

The Honourable C Pitt MP
Speaker of the Legislative Assembly
Parliament House
BRISBANE QLD 4000

Your ref:
Our ref: 11889

16 May 2018

Dear Speaker

Report to parliament

This report is prepared under Part 3 Division 3 of the *Auditor-General Act 2009* and is titled Education: 2016–17 results of financial audits (Report 15: 2017–18).

In accordance with s.67 of the Act, would you please arrange for the report to be tabled in the Legislative Assembly.

Yours sincerely

Brendan Worrall
Auditor-General

Contents

Summary

Introduction

This report summarises the results of our financial audits of the education sector entities that sit within the portfolio of responsibility for the:

- Minister of Education and Minister for Industrial Relations
- Minister for Employment and Small Business and Minister for Training and Skills Development.

These include:

- the Department of Education
- TAFE Queensland
- the seven Queensland public universities and the entities they control
- the eight Queensland grammar schools
- other statutory bodies and controlled entities that provide specific and specialised education services.

Appendix C lists the Queensland public education sector entities and their responsibilities.

Our report focuses on the audit results of these entities at the end of each of their reporting periods (their balance dates). For the Department of Education, TAFE Queensland and some statutory bodies this was 30 June 2017, while for universities, grammar schools and some other statutory bodies this was 31 December 2017.

Results of our audits

In the education sector, we issued unmodified opinions for all 35 reporting entities by their statutory deadlines. We were satisfied that entities prepared financial statements in accordance with the relevant legislative requirements and standards, and that readers can rely on the results in the financial statements.

Education entities generally use good financial reporting practices and produce their financial statements in a timely manner. However, there were some delays in the provision of draft financial statements.

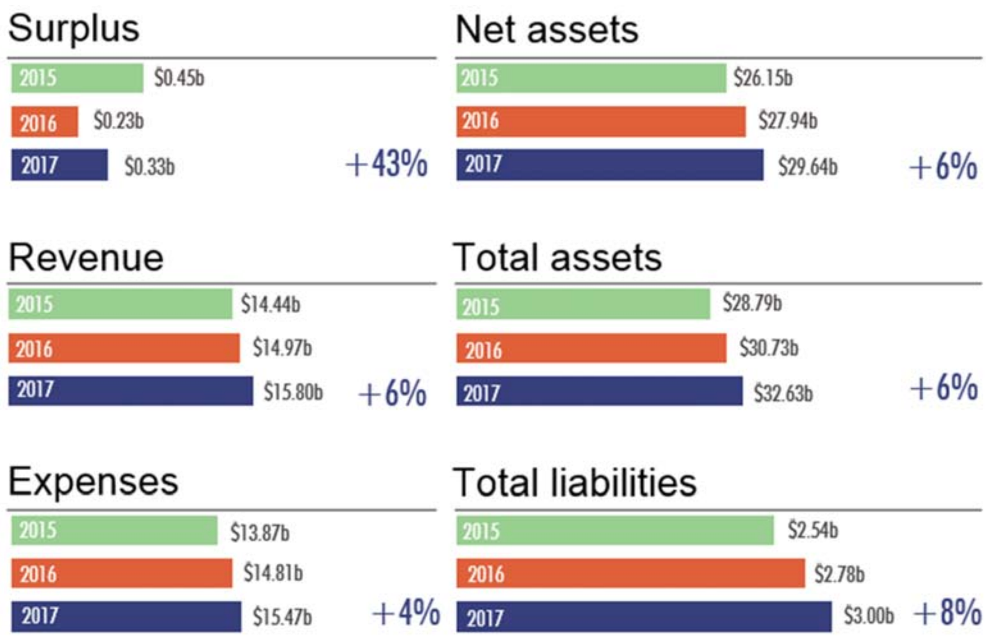
The quality of the financial statements varied across the sector, with some adjustments being made in relation to the valuation of property, plant and equipment, and the capitalisation of expenses. This indicates there is room for some entities to improve their quality assurance processes over the review of their financial statements.

We express an *unmodified opinion* when the financial statements are prepared in accordance with the relevant legislative requirements and Australian accounting standards.

We express a *modified opinion* when financial statements do not comply with the relevant legislative requirements and Australian accounting standards, and they are not accurate and reliable.

Financial performance, position, and sustainability

Figure A
Education sector—financial snapshot



Note: Figure A represents year end balances for all entities in the education sector, at their respective balance dates.

Source: Queensland Audit Office.

Understanding financial performance

Collectively, the financial performance of education entities has improved from last year. Apart from two universities, all entities reported a surplus. The combined net surplus for the sector was $325.5 million. This has increased by $98.3 million since last year.

Most entities in the sector continue to rely heavily on Australian and Queensland government funding. While this funding has increased since last year, entities need to be aware of risks that may potentially reduce their major sources of revenue. For example, the Australian Government recently introduced a two-year freeze on Commonwealth grants scheme funding. This restriction will limit the funding available to universities and may influence the number and types of courses offered by universities. For students, this could potentially limit their course options and reduce the number of places available in each course.

Most entities in the sector have managed to contain their total expenses to a level that is lower than their revenue; however, any increases in revenue have been partly offset by an increase in expenses. The most significant expense for each entity continues to be employee expenses due to the service nature of the entities.

New accounting standards for revenue (AASB15 *Revenue from Contracts with Customers* and AASB1058 *Income of Not-for-Profit Entities*) will see substantial changes in how entities recognise grants and account for contracts. Given the variety of revenue sources in the education sector, entities need to take action now to understand the accounting requirements and determine the financial impact to ensure revenue is treated correctly.

Understanding financial position

The net asset position across the sector continues to be positive, totalling $29 billion at the respective balance dates of each entity. The sector remains capable of meeting its short-term debt.

Capital expenditure across the sector continues to decrease for most entities. It has been limited by reduced capital funding from government grants. This restricts each entity's capacity to fund capital projects and building programs.

The new accounting standard AASB16 *Leases* is likely to have an impact on most entities' net financial position. Under the new standard, most leases previously not reported as assets and liabilities will be reported on the balance sheet in future. The timing of expense recognition will also change.

Internal controls

This year, we identified two significant deficiencies in control activities at the Queensland University of Technology. Both related to the university not following established procedures for making changes to the vendor masterfile (the collection of all records relating to vendors) and for managing user access. Management is addressing these significant deficiencies and implementing processes to strengthen related controls.

Otherwise, we observed that internal control environments across the remaining entities were generally effective. This means that we were able to rely on the internal control systems used to produce financial statements.

Most entities have resolved or are on track to resolve issues we have identified within the agreed timeframes. However, we have identified some long-outstanding issues that entities need to address. Some of these deficiencies date back to 2013. It is critical that the affected entities address these deficiencies immediately, as they can increase the risk of fraud and error.

In April 2018, a fraud was successfully perpetrated at an education sector entity. It involved a fraudulent request to change an existing supplier's bank account details and divert payments to the illegitimate bank account. We recommend management reinforce the need to verify bank account changes independent of the change request. For example, this can be done through a phone call to the supplier using a contact number obtained from an independent source, such as the supplier's website or the phone directory.

Recommendations

We recommend that all education entities:

1. continue to manage their ongoing costs, including by developing strategies and cost-saving initiatives, to counteract the risks associated with changes in government funding arrangements and external market factors
2. take prompt action to address internal control deficiencies, particularly focusing on those that remain outstanding from prior years, to mitigate the risk of fraud or error
3. reinforce the need to verify bank account changes independent of change requests.

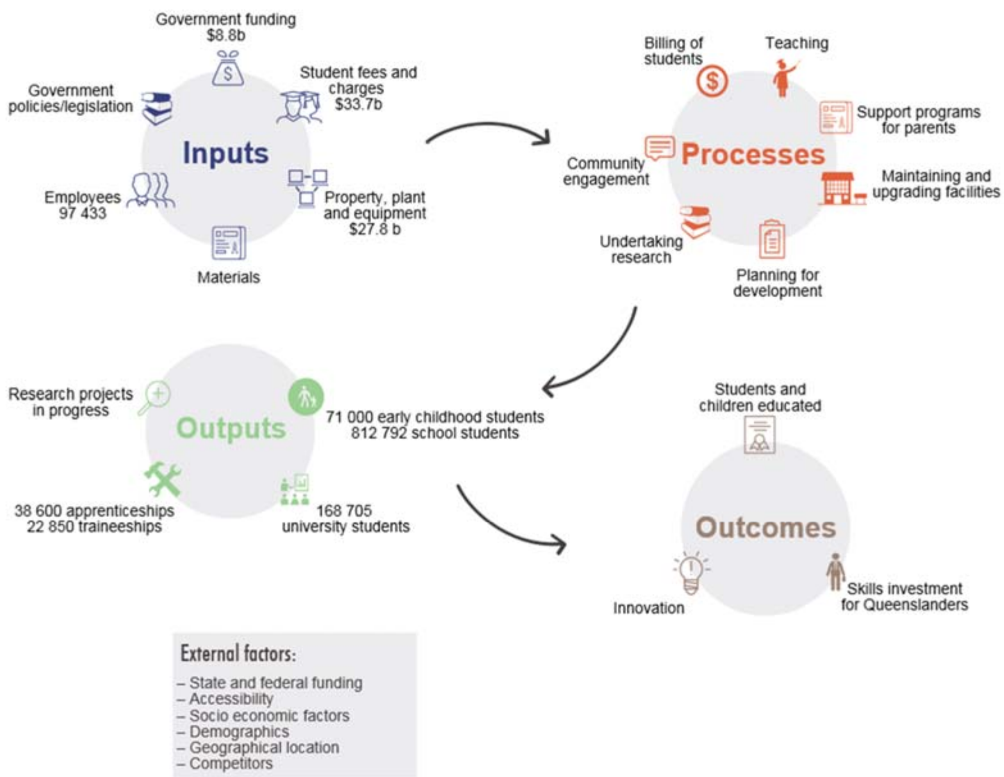
1. Sector overview

This chapter provides a sector overview to assist readers in understanding the audit findings and conclusions.

The intent of entities within the Queensland public education sector is to deliver world class education and training services. Collectively, the sector aims to help individuals make positive transitions from early childhood through to all stages of schooling, providing them with the knowledge and skills to prepare them for further education, training, or the workforce. The overarching goal of the sector is to develop individuals who can successfully participate in the economy and make valuable contributions to the broader community.

The education sector provides a variety of services and uses substantial resources to deliver these services. Figure 1A details the major inputs, activities, outputs, and outcomes for the education sector.

Figure 1A
Function level inputs, processes, activities, outputs, and outcomes



Source: Queensland Audit Office.

Influences shaping the education sector

Various stakeholders and industry groups influence the education sector. They include:

- commercial and joint venture partners
- funding bodies
- the local and wider community
- Australian and Queensland governments
- regulators
- employer groups and unions
- registered training organisations
- domestic and overseas competitors.

Education providers face continual challenges in shaping their business and positioning themselves to remain sustainable.

Figure 1B identifies some of the significant challenges the sector faces.

Figure 1B
Sector challenges

Source: Queensland Audit Office.

These challenges impact on the education sector's financial performance, sustainability, and current financial position. They can affect enrolment numbers, fee setting, the mode of learning, and the reputation of Australian schools and universities.

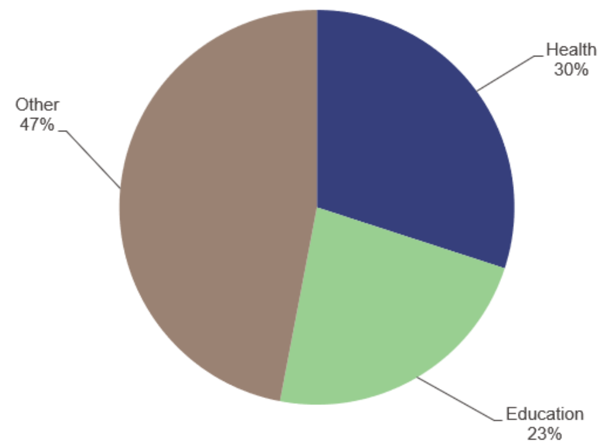
Education budget

Significance of the education sector to the Queensland Government budget

In 2016–17, total expenses for the Queensland Government's general government sector (GGS) were $53.4 billion. The GGS provides public services that are for the collective benefit of the community. The Queensland Government finances these services by way of taxes, fees, and other compulsory charges.

Of the GGS expenses, over $12.3 billion related to the state education sector. (This figure does not include universities and grammar schools, which are not part of the general government sector.) The education sector is second only to the health sector in terms of its level of expenses.

Figure 1C
Education sector's proportion of GGS expenses—2016–17

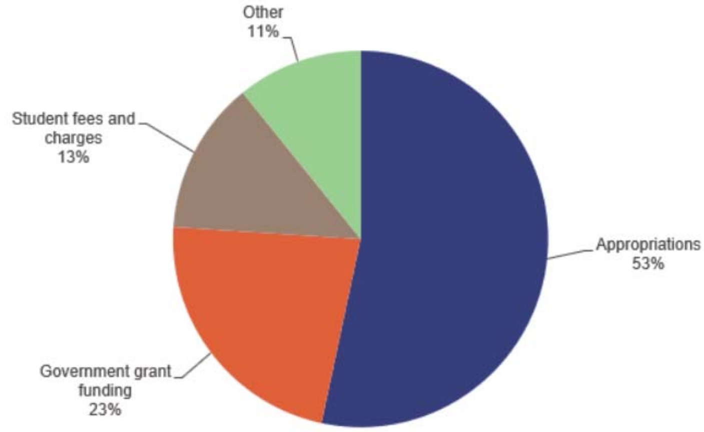


Source: Queensland Government's consolidated financial statements—2016–17.

Revenue recognised by entities within the education sector

Much of the funding for the education sector comes from Queensland Government appropriations, Australian and Queensland government grant funding and student fees and charges. Figure 1D provides a breakdown of revenue within the education sector.

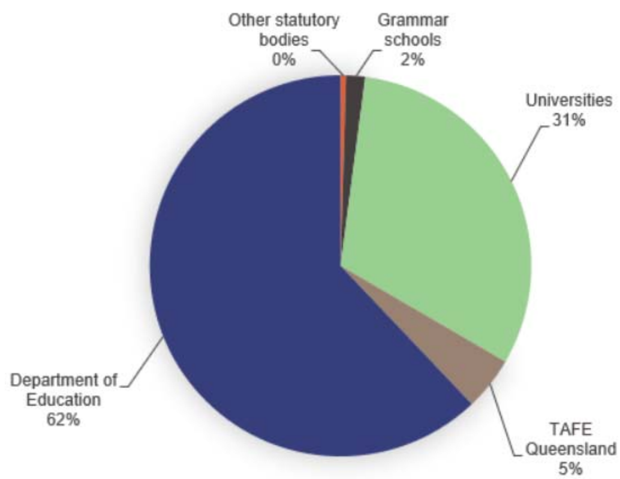
Figure 1D
Types of revenue recognised within the education sector



Source: Queensland Audit Office.

The analysis in this report focuses on the seventeen entities responsible for 99.5 per cent of revenue within the education sector. These are the Department of Education, TAFE Queensland, seven universities, and eight grammar schools. Figure 1E shows the proportion of total revenue recognised by entities within the education sector. (For the Department of Education, this report includes transactions and balances controlled by the department and deployed at its discretion for the achievement of its objectives. It excludes funds administered on behalf of the State, being transfers to non-government schools, as well as state grants to statutory authorities, peak bodies for non-state schools, and other entities.)

Figure 1E
Revenue recognised by entities within the education sector



Source: Queensland Audit Office.

2. Results of our audits

This chapter delivers the audit opinion results and evaluates the timeliness and quality of reporting. It examines the reliability of information reported by entities that were subjected to audit. We also analyse the quality and timeliness of financial reporting.

Conclusion

All entities have generally effective financial year end close processes, which allows them to produce quality financial statements in a timely manner. Some of the financial statements provided to us by education entities required no adjustments to the values reported. There were some delays in recording values for property, plant and equipment.

We issued unmodified audit opinions for each entity. This means we determined that the financial statements were prepared in accordance with the relevant legislative requirements and standards, and that readers can rely on the results in the financial statements. We completed all audits within legislative deadlines.

Audit opinion results

For the 2017 financial year, we issued unmodified audit opinions for all entities within the legislative deadlines. Appendix E lists the type of audit opinion issued for all entities in the education sector, including the controlled entities.

An *emphasis of matter* is a paragraph included with the audit opinion to highlight an issue of which the auditor believes the users of the financial statements need to be aware. The inclusion of an emphasis of matter paragraph does not modify the audit opinion.

Emphasis of matter

We included an emphasis of matter in our audit reports on nine entities to highlight that only certain accounting standards were used in the preparation of their reports, and that their reports were not intended for other users.

Financial statement preparation

Most entities in the education sector have effective year end close processes, and they have produced timely financial reports. The quality of the financial reports produced varied across the education sector.

Year end close process

14 out of the 17 education entities we assessed completed important year end close processes by the agreed dates.

Three universities experienced delays in finalising their property, plant and equipment valuations.

Property, plant, and equipment represents the largest single item in education sector entities' financial statements. Valuing it requires the most judgement and estimation. The early completion of revaluations allows more time for internal and external review of valuation results and reduces the potential for adjustments to draft financial statements.

Timeliness of draft financial statements

12 out of 17 education entities we assessed completed draft financial statements by the dates agreed with their auditors. The remaining five provided complete draft financial statements shortly after the planned date.

Quality of draft financial statements

The quality of the draft financial statements and supporting working papers provided was satisfactory for eight of the 17 education entities. This indicates there is still capacity for education sector entities to improve the quality of their draft financial statements.

Most adjustments to draft financial statements were minor. Those that were more significant related to incorrect expensing of capital works and recording of asset valuations.

Entities can achieve improvements by implementing effective internal review processes designed to identify and correct errors before draft financial statements are provided to audit.

Key audit matters

The Australian Auditing and Assurance Standards Board has adopted the international standard ISA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* for audits of listed entities. We have voluntarily adopted this standard for nine education entities.

Key audit matters are those areas that, in our professional judgement, pose a higher risk of material misstatement. (A misstatement is material if it has the potential to influence the decisions made by users of the financial statements.) These matters mostly relate to major events and transactions that occur during the period and those areas requiring significant application of judgement and estimation.

We voluntarily included 11 key audit matters in our independent auditor's reports. Of these, 10 of the matters reported related to the valuation of property, plant and equipment. We reported on why the key audit matters were significant and the procedures we performed to address the matters.

The full list of key audit matters reported is detailed in Appendix F.

Major certifications

Some education entities are required to acquit grant funding they receive from third parties including the Australian and Queensland governments. They do this by providing a detailed breakdown of revenue and expenses and (in some cases) information on assets and liabilities to these third parties. We certify that this information is accurate and complete.

In the current year, we issued unmodified opinions for the Australian Government research income returns for 2017 across all seven universities. We have certified they were prepared in accordance with the 2017 Higher Education Research Data Collection (HERDC) specifications for the collection of the 2016 data.

The HERDC specifications control the collection of higher education research data and are designed to ensure the Australian Government's research support and training grants are allocated in a fair and transparent way. The data collected is used to determine the annual allocation to universities for research block grants, which are used to support research and research training.

Entities not preparing financial statements

Not all entities in the Queensland public education sector produce financial statements.

For each state public sector company, other than government owned corporations, the board of directors considers the requirements of the *Corporations Act 2001* to determine whether financial statements need to be prepared. The board must revisit the assessment every three years or whenever a significant change occurs.

When entities are part of a larger group and are secured by a guarantee with other entities in that group to cover debts, Australian Securities and Investments Commission Class Order 98/1418 allows them to not prepare a financial report. In addition, small companies can choose to not prepare financial statements when they meet specific criteria under the *Corporations Act 2001*.

The full list of entities not preparing financial reports and the reasons for this are included in Appendix G.

3. Financial position, performance, and sustainability

This chapter analyses the financial performance, position, and sustainability of the entities.

Introduction

The information in an entity's financial statements describes its main transactions and events for the year. Over time, financial statements also help their users to understand the sustainability of the entity and its sector.

Our analysis helps users understand and use the financial statements by clarifying the financial effects of significant transactions and events. We also use metrics such as ratio analysis to highlight organisational performance issues.

Additionally, our analysis alerts users to future challenges, including the existing and emerging risks the entities face.

In this chapter, we assess the position, performance, and sustainability of the Department of Education (the department or DOE), TAFE Queensland, seven universities, and eight grammar schools.

Conclusion

All the education entities are financially sustainable. They are able to meet their short-term liabilities as and when they fall due, and they are generating sufficient revenue to service the borrowings that they hold.

The overall financial performance of Queensland education entities improved in 2017. There was a significant increase in the operating surplus for universities ($90.5 million or 54.4 per cent) and grammar schools ($8 million or 42.6 per cent).

All but two universities achieved surpluses this year. James Cook University reported an operating deficit of $4.1 million due mainly to a decrease in Australian Government financial assistance. The University of Southern Queensland recorded a minor operating loss of $594 000 due to restructuring costs.

In December 2017, the Australian Government revised its higher education funding model. This model maintains but does not increase the teaching funding provided to universities for 2018 and 2019. The government's intention is to cap growth, then increase funding in 2020.

Factoring in the Australian Government funding reforms, all universities need to consider their current revenue and expense policies to achieve operating surpluses and continue to remain financially sustainable.

All eight grammar schools achieved operating surpluses in 2017, including the Rockhampton Girls Grammar School and Ipswich Grammar School. This was the first time these two schools have reported surpluses in three and nine years respectively. This result was driven by a concerted effort to reduce costs and identify additional sources of revenue. These grammar schools need to closely monitor their financial performance to ensure they remain financially sustainable.

Understanding financial performance

In 2016–17, the department reported an operating surplus of $28.8 million. It received an additional $429.7 million (a 5.1 per cent increase) in Queensland Government appropriation funding in 2016–17. This increase was to cover school enrolment growth, enterprise bargaining agreement (EBA) outcomes and other school-based cost increases. Employee expenses increased by $317.6 million (5.4 per cent) in 2016–17, mainly due to a 2.5 per cent EBA increase for teachers in October 2016 and an increase in staffing levels in line with enrolment growth (2.4 per cent).

In 2016–17, TAFE Queensland reported an operating surplus of almost $20 million—an increase of 66.1 per cent from last year. There was a significant increase in grants and contributions received from the Queensland Government ($32.7 million), as well as increases in fees from students and for training services ($7.8 million). The increase in grants and contributions included additional maintenance funding ($5 million) and a one-off contribution to the Sunshine Coast Health Institute fit-out ($7 million). However, increases in revenue were partly offset by increases in expenses associated with the delivery of training, and with activities to reposition TAFE Queensland in the market. These included an increase in employee expenses ($8.7 million); the engagement of contractors ($14.2 million); and property, information technology support services, and transport ($6.6. million).

The seven universities achieved a combined operating surplus of $256.8 million in 2017—an increase of 54 per cent from last year. There was a significant increase in fees and charges ($165.5 million), increases in Australian Government financial assistance ($20 million), and consultancy and contracts revenue ($17.6 million). However, these were offset by increases in employee expenses ($69.9 million) and other expenses ($66.7 million) including professional and consultant fees, and scholarships and grants.

Five of the seven universities achieved operating surpluses in 2017, with James Cook University and the University of Southern Queensland being the exceptions. James Cook University reported an operating deficit of $4.1 million. This was predominantly due to the decrease in Australian Government financial assistance received by the university in 2017. The University of Southern Queensland recorded a minor operating loss of $594 000. This was mainly due to an increase in employee costs because of a voluntary redundancy program in 2017 ($11.6 million) and the impact of a three per cent EBA increase.

Overall, grammar schools continued to achieve an operating surplus. In 2017, this was $18.8 million, increasing by $8 million (74 per cent) since last year. This was due to an increase of $6.5 million in fees, grants, and donations. While employee expenses also increased by just over $6 million, a reduction in supplies and services and other expenses (of $6.6 million) offset this increase.

Individually, all grammar schools achieved an operating surplus for 2017, with two schools (Rockhampton Girls Grammar School and Ipswich Grammar School) achieving their first positive result in three and nine years respectively. This was largely driven by increased grant funding and donations, and reduced supplies and services costs. With respect to these two schools, significant work was undertaken in 2017 to either reduce costs, including employee expenses, or secure additional sources of revenue. These schools need to continue to develop strategies with a continued focus on sustainability.

Long-term financial sustainability

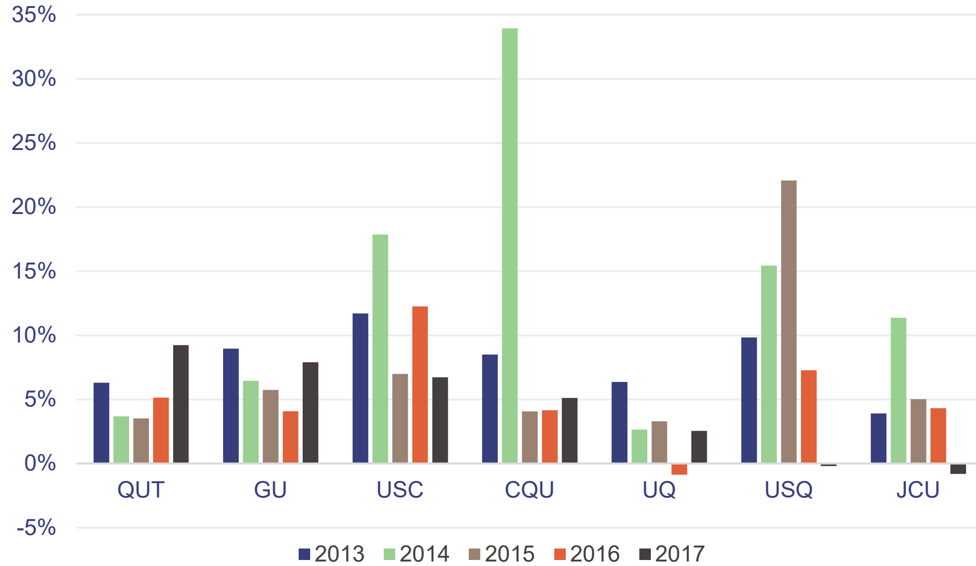
To assess the long-term financial sustainability of Queensland education entities, we calculate their *operating ratio* as an average over time. The operating ratio is the operating result before tax. It is expressed as a percentage of total revenue, measuring the extent to which revenue covers operational expenses. It should be positive over the medium- to long-term if an entity is to remain financially sustainable. A negative or low ratio indicates that the entity needs to ensure sufficient revenue is generated to fund future operating and capital commitments.

This has been the case for the department (with a ratio of less than one per cent over the past five years) and TAFE Queensland (with a ratio of between of two and three per cent over the past two years). However, the department will continue to be funded through Queensland Government appropriations, providing for anticipated growth in student enrolments, EBA outcomes, provision for additional teaching staff, and general maintenance of schools. Given that the department is provided with appropriation funding primarily to cover its costs, a low operating ratio would be expected. TAFE Queensland is highly reliant on funding received from the Australian and Queensland governments, with total funding received in 2016–17 comprising 57.6 per cent of total revenue.

Figure 3A shows the operating ratio of each university over the past five calendar years. It indicates that the sector is in a sound position. However, the ratios for the University of Southern Queensland and James Cook University have deteriorated over the last two and three years respectively. Both universities reported deficits in 2017. Significant peaks in the ratio reflect one-off transactions, for example:

- In 2014, Central Queensland University recognised $120.2 million in income when it received property, plant and equipment for nil consideration as part of the merger with the Central Queensland Institute of TAFE.
- In 2015, the University of Southern Queensland recognised a gain on acquisition for the Ipswich campus of $61 million.

Figure 3A
Operating ratio for universities for 2013–2017



Note: Queensland University of Technology (QUT), Griffith University (GU), University of the Sunshine Coast (USC), Central Queensland University (CQU), University of Queensland (UQ), University of Southern Queensland (USQ), James Cook University (JCU). Controlled entities are included.

Source: Queensland Audit Office.

Revenue

Figure 3B
Major revenue for education entities by type in 2017

Appropriation revenue

Department $8 780m

Government grants

Department $15.1m
Universities $3 207m
TAFE Queensland $391.2m
Grammar schools $76.6m

Student fees and charges

Department $314.9m
Universities $1 401m
TAFE Queensland $275.1m
Grammar school $160.9m

Other

Department $15.1m
Universities $736m
TAFE Queensland $391.2m
Grammar schools $25.6m

Note: Amounts quoted above are as at the respective balance dates (the end of each of their reporting periods); that is, 30 June 2017 for the department and TAFE Queensland, and 31 December 2017 for the universities and grammar schools.

Source: Queensland Audit Office.

In 2016–17, the department reported total revenue of $9.4 billion. It received the majority of its funding in the form of an appropriation from Queensland Treasury (93.8 per cent of total revenue), student fees and charges, and grants and contributions.

Revenue received by the universities mainly consists of Australian Government financial assistance and student fees and charges. Together, these made up 84.2 per cent of the total revenue of $5.4 billion in 2017.

Revenue received by TAFE Queensland and the grammar schools mainly consists of student fees and charges and Australian and Queensland government grant funding.

Events and transactions affecting revenue this year

Events and transactions affecting university revenue this year included the following:

- Following the Central Queensland University's merger with the Central Queensland Institute of TAFE in 2014, the Queensland Government agreed to fund the cash losses of the vocational education and training (VET) component for a three-year period. As a result, the Department of Education provided a grant to the university in 2017 of $18.466 million.
- While Australian Government financial assistance to universities remained relatively stable in 2017, there was an increase in student fees and charges of $165.5 million (13.4 per cent) and more specifically, an increase in fees paid by onshore overseas students of $167.1 million (17.5 per cent). This was due to an increase in international student numbers of 6.2 per cent across the university sector.
- In 2017, investment income increased at the Queensland University of Technology by $24.2 million and at Griffith University by $7 million. This was due to improved performance in managed investment funds in domestic and international equities markets.

Future challenges and emerging risks

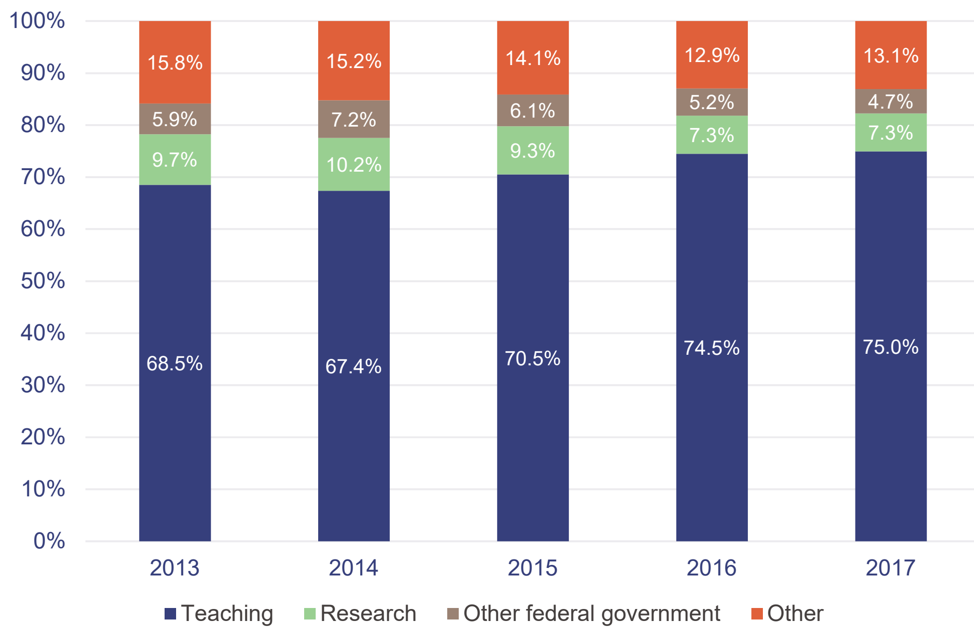
Universities face future challenges in terms of continuing to attract and retain students and dealing with reductions in government funding.

Composition of revenue

Teaching revenues have consistently grown over the past five years, increasing by 27.8 per cent between 2013 and 2017. Teaching revenues now represent approximately 75 per cent of total university revenues, which is consistent with the national trend.

Figure 3C shows revenue across the Queensland university sector by revenue source.

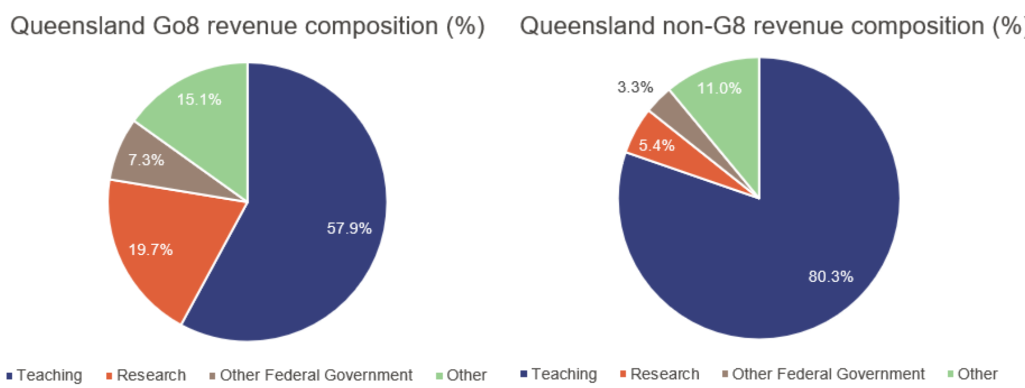
Figure 3C
Operating income composition for 2013–2017



Source: Queensland Audit Office.

Figure 3D shows the difference between Go8 (University of Queensland) and non-Go8 universities in Queensland. Similar differences occur nationally. (The Go8 refers to the Group of eight—the eight most research-intensive universities in Australia.)

Figure 3D
Revenue composition by G08 and non-Go8 universities in 2017



Source: Queensland Audit Office.

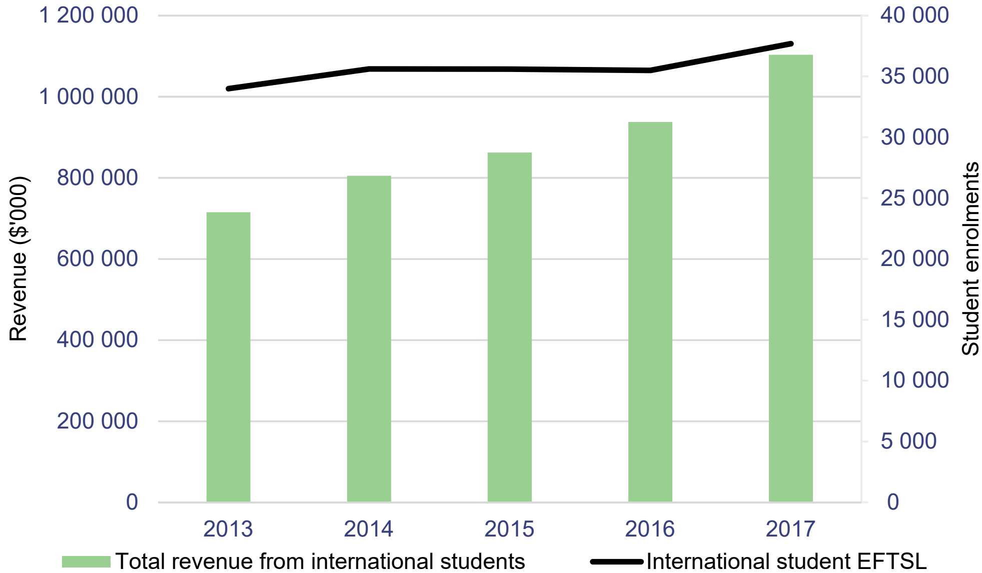
Non-Go8 universities rely more heavily on teaching revenue, while G08 universities generate a greater proportion of their revenue from research and other funding sources.

International student numbers and student revenue

Universities face an emerging risk with regards to their increasing reliance on international student numbers. This can be the most profitable element of a university's business, and a downturn in the market would have an impact on the universities' operating result and long-term financial sustainability.

Figure 3E shows revenue generated from international students and the number of international students enrolled.

Figure 3E
International students—revenue and enrolments for 2013–2017



Note: Equivalent full-time student load (EFTSL) is a representation of the amount of the study load a student would have if studying full-time for one year.

Source: Queensland Audit Office.

The revenue from international students has consistently increased over the last five years. This is due to increases in average international student fees, along with the increasing proportion of international students undertaking postgraduate courses. (These attract higher fees than undergraduate courses.) The average international student fee for Queensland universities increased from $21 041 in 2013 to $29 276 in 2017—an increase of 28.1 per cent.

Some universities rely more on international student revenue now than they did five years ago. Factors impacting on international student numbers can include foreign exchange movements, international competition, and visa requirements. The risk is not as high for the Go8 universities as a greater proportion of their revenue earned is sourced from research activities.

The international student market is currently strong in Queensland, based mainly on our reputation, brand, and economic strength. However, Queensland universities will need to closely monitor factors that may impact on this.

Research performance

Some research-intensive universities have identified a risk in terms of the potential failure of their universities to grow. They stress the need to develop an effective research capacity and maintain their research reputation. The main driver of research revenue is research performance. A decline in research revenue and the resulting outcomes could impact on the reputation of some universities and have a flow-on effect on student numbers.

Changes to Australian Government financial assistance

In 2017, the Australian Government proposed changes to the higher education funding model which would result in reduced funding for education entities. This included implementing of efficiency dividends and making a portion of the grant funding provided contingent on entities meeting certain performance criteria. These proposed changes were subsequently not supported by the Senate.

However, reforming the higher education system remains a government priority to ensure future funding arrangements remain sustainable. In December 2017, the Australian Government revised its proposed changes to the higher education funding model. The changes include:

- providing no increases in Commonwealth grants scheme funding for the next two years
- making students repay their loans in a timelier manner
- capping the number of student places available in future.

To counteract this, universities have focused on increasing the revenue derived from other sources to reduce their current level of dependence on Australian Government financial assistance. Given that this assistance represents approximately 60 per cent of university sector revenue, these changes to the government funding model will need to be factored into universities' future operational plans.

Case study 1 demonstrates the likely effect of these funding changes on the University of the Sunshine Coast.

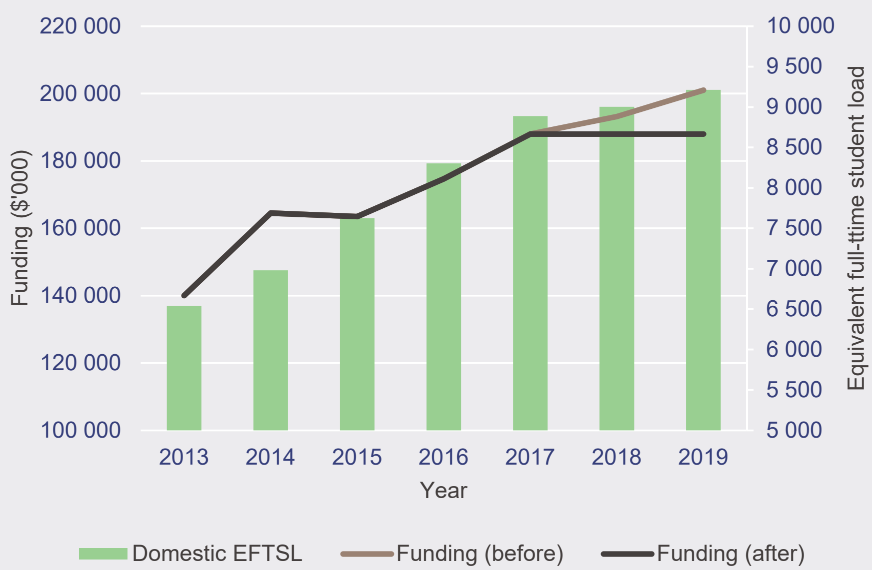
Case study 1

Budgeted impact on the University of the Sunshine Coast

These funding changes are likely to have a more significant effect on regional universities, particularly where domestic student numbers are forecasted to grow. These universities are heavily reliant on Australian Government financial assistance for teaching domestic students, while metropolitan universities usually have more diversified revenue sources, including income from international students and research activities.

The University of the Sunshine Coast received approximately 61 per cent of its revenue from Australian Government financial assistance for teaching domestic students in 2017. This revenue was budgeted to increase further in 2018 and 2019 with expected growth in domestic student numbers across all campuses, particularly following the transfer of the Caboolture campus to the university in January 2018.

Following changes to Australian Government financial assistance, in 2018 and 2019, the costs of providing courses to additional domestic students beyond 2017 levels will be absorbed by the university. The university has estimated that, based on forecast increases in domestic student numbers in those years, Australian Government funding foregone could be up to $18 million.



In response to this, while continuing with expansion in the Moreton Bay region, the university has reviewed budgeted costs over future years and identified various saving measures. Similar cost saving initiatives have been undertaken by other universities.

A potential impact is that universities may feel it is not feasible to fund domestic student places internally, positions in courses will be capped, or higher cost courses will not be offered, limiting the availability of higher education to domestic students.

The consequence for universities of the 2007 introduction of the preparatory (Prep) year

Universities are preparing for a potential reduction in revenue because of reduced domestic student loads in 2020. It is anticipated that there will be a reduced cohort of university-eligible students in 2020. This is because, with the introduction of the Prep year in 2007, some children who were due to go into Grade 1 went to Prep instead.

This means that students who would have been choosing a university for 2020 will instead be completing Year 12. The universities have undertaken detailed analysis to accurately forecast the expected impacts and to develop strategies and cost-saving initiatives to counteract this risk.

Contestable market for TAFE Queensland

The vocational education and training (VET) sector has experienced significant change in recent years. The National Partnership Agreement on Skills Reform, signed in April 2012, encouraged a more open and competitive training market and provided for changes to the VET FEE-HELP (VFH) scheme under the Australian Government's Higher Education Loan Program. This saw significant growth in the VET sector. The number of registered training organisations approved as VFH providers (public and private) across Australia increased from five to 282 between 2008 and 2016, with 85 per cent being private providers.

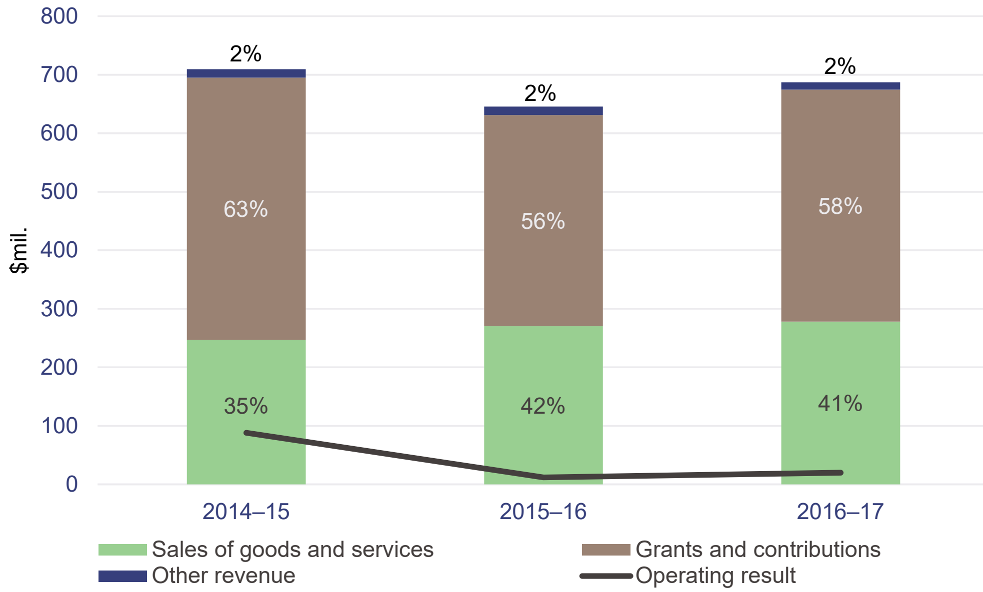
Reforms since 2015 have sought to strengthen provider requirements, and the new VET Student Loans (VSL) program that was implemented from 1 January 2017 has seen a number of providers exit the sector.

TAFE Queensland has been the public provider for 135 years, but it was established as a statutory body on 1 July 2013 to allow it to exist more openly within this new contestable market. TAFE Queensland has additional challenges as a public provider, as it addresses the needs of industry, students, and the general community, including providing training in regional areas and resource-intensive industries at a higher cost.

For the 2016–17 financial year, TAFE Queensland achieved a $19.96 million operating surplus, which was an increase of $8 million (66 per cent) from last year. The increased surplus was largely due to an increase in payments from the Queensland Government for additional maintenance funding ($5.0 million) and a one-off contribution to the Sunshine Coast Health Institute fit-out ($7.0 million). Overall revenue increased by $41.7 million (6.5 per cent), ahead of an increase in expenses of $33.3 million (5.3 per cent).

Figure 3F shows the composition of revenue and the operating result for TAFE Queensland for the past three years.

Figure 3F
Operating income composition for TAFE Queensland—2015–2017



Source: Queensland Audit Office.

TAFE Queensland is heavily reliant on subsidised training fees and grant revenue to remain financially sustainable. The state provides most government grants, although some come from the Australian Government. TAFE Queensland receives a VET Purchasers grant, which funds the gap between what public and private providers pay for staffing costs.

While TAFE Queensland continues to be the state's largest public provider of vocational education and training, with the increase of private providers in the market, TAFE Queensland's market share is at risk. It is under increased pressure to ensure that training fees and grant revenue cover increasing staffing and operating expenses, while continuing to compete with private providers. The VET sector of Central Queensland University experiences these same market pressures.

New revenue accounting standards

From 1 January 2019, the revenue and income of education sector entities will be affected by the new Australian accounting standard AASB15 *Revenue from Contracts with Customers* and AASB1058 *Income of Not-for-Profit Entities.* These standards are more complex and include more judgements than the current equivalent standards.

Queensland education entities have various sources of revenue and income. Entities will need to take action to understand the new accounting requirements and analyse each of their sources of revenue to determine what changes will be required. The most contentious area under current standards is accounting for grants and similar arrangements. This is likely to continue to be contentious under the new standards. While the standards include scope to defer the recognition of revenue to when expenses are incurred, the circumstances are restricted.

The sources of revenue for universities include course fees and charges (domestic and international), Australian Government financial assistance, Australian Research Council grant funding, consultancy fees, contracts research agreements with the public and private sectors, donations, and royalties.

Universities may have a significant number of grants, depending on the amount of research they undertake. If the requirements for revenue recognition deferral are met, contracts may have to be accounted for on an individual basis, with consequential effects on accounting systems and resources.

The new standards include various transitional provisions to ease the burden on initial adoption. The main relief is for revenue from grants or arrangements that were previously accounted for up front. Under the new standards, some of these may be deferred.

Given the variety of sources of revenue and income, the large number of contracts, and the complexity of the new standards, Queensland education entities should not underestimate the effort required to prepare themselves. Preparation may require changes in systems, processes, accounting policies, and in some instances, contracts.

Some entities (in particular the universities) have been proactive in engaging with consultants to assist them in the implementation of the new accounting standards.

Expenses

Figure 3G
Major expenses for education entities by type in 2017

Supplies and services

Department $1 322.7m
Universities $1 267.7m
TAFE Queensland $250.2m
Grammar schools $55.4m

Employee expenses

Department $6 248.7m
Universities $2 974.2m
TAFE Queensland $398m
Grammar schools $159.6m

Grants and subsidies

Department $1 104.8m

Consultants and contractors

Department $131.5m
Universities $217.8m

Scholarships, grants and prizes

Universities $267.2m

Depreciation and amortisation

Department $522.3m
Universities $395.7m
TAFE Queensland $12m
Grammar schools $17.1m

Note: Amounts quoted above are as at the respective balance dates; that is, 30 June 2017 for the department and TAFE Queensland, and 31 December 2017 for the universities and grammar schools.

Source: Queensland Audit Office.

Events and transactions affecting expenses this year

In 2016–17, the department spent $9.3 billion mainly purchasing goods and services and employing people to provide education services to Queenslanders. This was an increase of $453.1 million (5.1 per cent) from last year, mainly due to a 2.5 per cent EBA increase provided to teachers in October 2016 and an increase in staffing numbers (2.4 per cent) from last year.

In 2017, the seven universities reported expenses of over $5.1 billion, an increase of $145 million (2.9 per cent) from last year. Some of the events and transactions affecting this were as follows:

- Academic and non-academic employee expenses are the most significant expense types, collectively representing approximately $3 billion or 57.6 per cent of total university sector expenses. Together, these expense types increased by $69.9 million in 2017 (2.4 per cent) from last year due to increasing staff numbers. The increasing employee costs will continue to be an important focus for universities.
- As a result of the Australian Government funding reforms, universities have cost-saving initiatives in place. Internal restructures and a review of activities not aligned with university strategic plans are expected to result in additional funds being made available for employee expenses and capital expenditure.
- Depreciation expenses remained generally constant across the sector with an increase of $11.7 million (three per cent) from last year. This mainly related to acquisitions, upwards movements in asset values, and revised useful lives following strategic asset planning that determined the future use and redevelopment of university campuses.
- Other expenses reported in the financial statements increased by $66.7 million in 2017 (4.6 per cent) from last year, mainly due to increases in scholarships and professional fees—including the engagement of consultants to deliver on universities' strategic objectives.
- Universities in metropolitan locations (the University of Queensland, Queensland University of Technology, and Griffith University) accounted for 71.1 per cent of the total expenses by universities.

Understanding financial position

The financial position of the Queensland education entities is measured by their net assets—the difference between total assets and total liabilities. Over time, the financial position can indicate whether an entity's financial health is improving or deteriorating. A growing net asset position indicates that an entity has greater capacity to meet an increase in future service demands.

At 30 June 2017, the department reported a net asset position of $19.1 billion, an increase of $956.2 million (5.3 per cent) from last year. This was mainly due to increases in cash amounts and property, plant and equipment (PPE). The increase in cash balances ($229.8 million) was due to funding set aside to cover future capital works and grant payments, and reductions in prepayments relating to the Queensland Schools–Plenary public–private partnership (PPP). The increase in PPE ($956.2 million) was mainly due to an upward movement in asset values, and increased capital acquisition costs. These were offset by an increase in annual depreciation costs.

The department does not hold any liabilities, apart from short-term debts to suppliers and the interest-bearing liability arising mainly from PPPs for the Southbank Education and Training Precinct (with Axiom Education Queensland Pty Ltd), South-East Queensland Schools (with Aspire Schools Pty Ltd), and Queensland Schools–Plenary (with Plenary Schools Pty Ltd).

A *public–private partnership (PPP)* is when a government service is funded and operated by government and a private sector body.

The financial position of all seven universities remains strong, with combined net assets of $9.6 billion at 31 December 2017. The value of total net assets increased by $671 million (7.5 per cent) in 2017 across the seven universities due to:

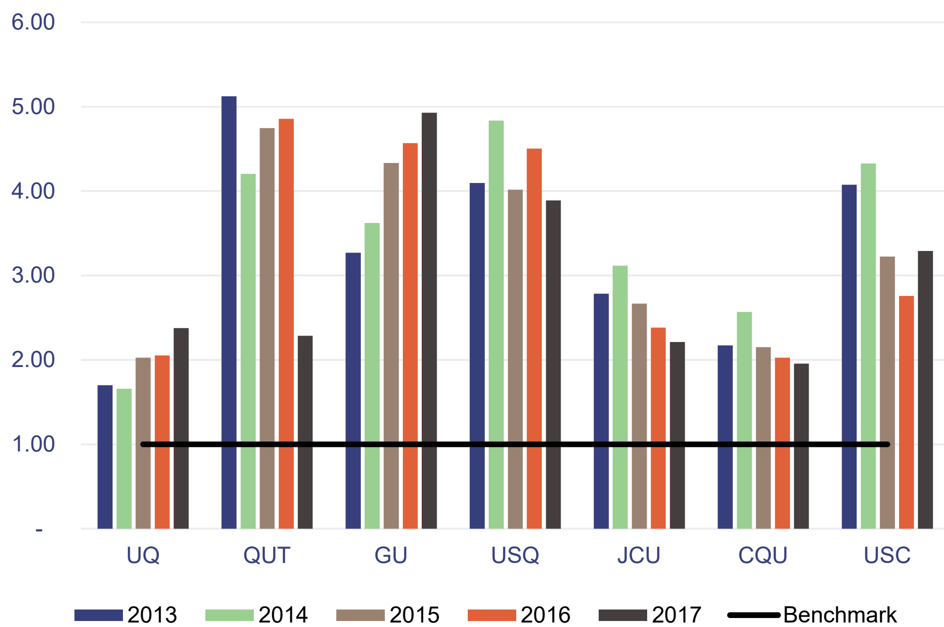
- the recognition of a $358 million upward movement in PPE values
- an increase of $313 million, predominantly in investment funds managed by the Queensland Investment Corporation (QIC)
- an increase in cash amounts of $52.4 million.

At 31 December 2017, the universities held cash balances of $976.5 million (a 5.7 per cent increase from last year) and other financial assets of $1.7 billion (a 22 per cent increase)—predominantly investment funds managed by QIC on their behalf, and term deposits.

Current ratio

The *current ratio* measures an entity's ability to pay short-term obligations as and when they fall due (its 'liquidity'). A ratio of greater than one is acceptable. This ratio includes obligations and provisions expected to be settled within the next 12 months. Figure 3H shows the current ratio over the past five years for each university.

Figure 3H
Current ratio by university for 2013–2017



Note: UQ—University of Queensland; QUT—Queensland University of Technology; GU—Griffith University; USQ—University of Southern Queensland; JCU—James Cook University; CQU—Central Queensland University; USC—University of the Sunshine Coast.

Source: Queensland Audit Office.

The results show that all universities have adequate liquidity to meet their short-term liabilities as they fall due. Given their strong position, the universities should always be alert to the effective use of their cash. It is acknowledged that most universities use QIC for investing purposes.

In 2017, the Queensland University of Technology revised its investment strategy, aligning its managed investment funds with QIC to the university's long-term investment strategy, resulting in their reclassification from current to non-current assets of $320 million.

Assets

Figure 3I
Major assets for education entities by type in 2017

Land

Department $5 665.8m
Universities $906.5m
Grammar schools $126.6m

Buildings

Department $12 195.1m
Universities $5 201.1m
TAFE Queensland $1.5m
Grammar schools $464.6m

Other financial assets

Universities $1 743.2m
TAFE Queensland $8 m
Grammar schools $24m

Plant and equipment

Department $226.2m
Universities $427.2m
TAFE Queensland $32.4m
Grammar schools $9.4m

Other property, plant and equipment

Department $1 093.2m
Universities $1 142.2m
TAFE Queensland $1.6m
Grammar schools $35.2m

Cash and cash equivalents

Department $972.8m
Universities $976.5m
TAFE Queensland $216.2m
Grammar schools $56.0m

Note: amounts quoted above are as at the respective balance dates; that is, 30 June 2017 for the department and TAFE Queensland, and 31 December 2017 for the universities and grammar schools.

Source: Queensland Audit Office.

At their respective balance dates (the end of their reporting period), the department and the universities reported a total of $31.5 billion of assets, consisting primarily of property, plant and equipment (86.1 per cent), cash and cash equivalents (6.2 per cent), and other financial assets (5.5 per cent).

Events and transactions affecting assets this year

Measuring the value of assets

Education entities must ensure that the carrying value of their assets as reported in their financial statements is reflective of their fair value. These entities measure the fair value of their assets in two ways—market value or current replacement cost.

Using the market value approach, fair value is determined by what a buyer would be willing to pay for an asset after considering any restrictions imposed through government regulation. This approach is used for valuing land and non-specialised buildings such as residential properties. Current replacement cost is used to measure the fair value of specialised buildings such as universities and schools, because there is no active market for buying and selling such assets.

Land, buildings, infrastructure assets, heritage and cultural assets, leased assets, and library and art collections are recorded at fair value, whereas plant and equipment and leasehold improvements are reported at cost.

When the department and universities report their assets at fair value, they revisit the amounts recorded each year to ensure they continue to be accurately reported.

The department reported $19.2 billion in PPE at 30 June 2017, representing an increase of $960.5 million (5.2 per cent) from last year. The increase was mainly due to:

- an upward movement in land, building, and leased asset values ($912 million)
- increased capital acquisitions under the Queensland Government's *Advancing Queensland State Schools* and accelerated capital works programs ($578.8 million).

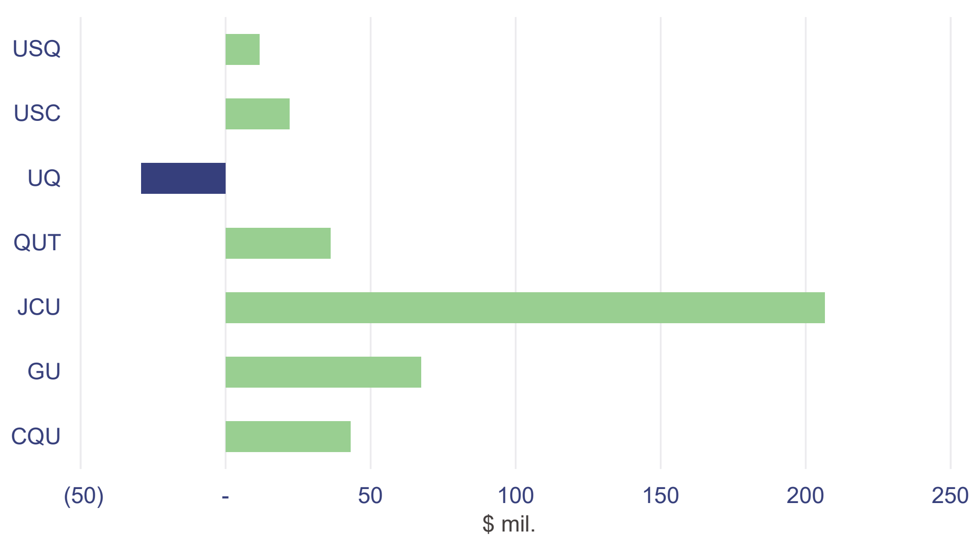
The increase was offset by annual depreciation charges of $509.5 million.

At 30 June 2017, the department's training and skills service area recorded $1.4 billion in PPE. This includes campuses used by TAFE Queensland. These assets transferred to the newly established Department of Employment, Small Business and Training as part of the machinery-of-government changes effective 12 December 2017.

TAFE Queensland reported $42.1 million in PPE and $28.1 million in intangible assets at 30 June 2017, representing increases of $13.4 million (46.8 per cent) and $12.7 million (45 per cent) respectively. This was attributed to significant acquisition and upgrade of assets associated with its new Student Management System.

The universities reported $7.9 billion in PPE at 31 December 2017. The total increased by $357.6 million (4.7 per cent) from last year. This result continues the trend of increases over previous years. Figure 3J shows a breakdown of this movement by university.

Figure 3J
Movement in PPE by university in 2017



Source: Queensland Audit Office.

The increase was mainly due to the recognition of an upward movement in asset values ($382 million) and acquisitions ($359.1 million), offset by depreciation expense ($374.6 million) across the seven universities.

The University of Queensland's PPE reduced by $29.1 million in 2017 due to:

- an increase in annual depreciation expense, as the remaining useful lives for 12 buildings were revised to one year. This was following approval for these buildings to be demolished in 2018 as part of the university's capital management plan
- strategic decisions made by the university. With the increasing uncertainty about government reforms, the university took a conservative approach to capital expenditure between 2014 and 2017, with an average spend of $100 million per annum over that period. This has allowed the university to increase its available cash reserves and to increase its capital program over the coming years—to align with its strategic initiatives and plans. Several future projects have received approval, including a new student residences project (a $251 million building to be fully debt financed) and a Sustainable Futures Building ($165 million).

James Cook University's PPE increased by $206.5 million in 2017, mainly due to an upward movement in the valuation of its buildings and infrastructure assets. These asset classes were subject to a comprehensive revaluation in 2017. This incorporated a reassessment of useful lives associated with these assets following development of its *Campus Master Plan 2017–2065*. Acquisitions included completion of the Science Building project in Townsville in 2017 ($79 million) and the ongoing student accommodation project in Cairns.

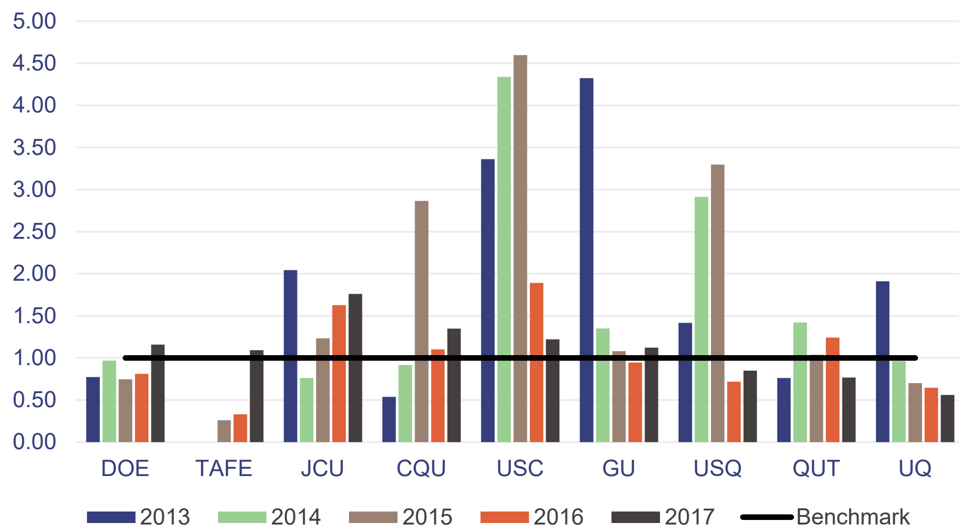
Capital replenishment

The *capital replenishment ratio* estimates the extent to which an entity is replacing its assets as they reach the end of their useful lives. The ratio compares the annual net expenses on PPE to annual depreciation. An average ratio below one, over time, indicates that assets are not being built or replaced at least at the same rate as existing assets are being depreciated. This may result in an entity having reduced ability to deliver services in the future.

This ratio is affected by the timing of each entity's building program. Asset acquisitions initially increase payments for PPE, and in future years, increase depreciation expense.

Figure 3K shows the capital replenishment ratio for the department and each university over the past five years, and for TAFE Queensland since its establishment in 2013.

Figure 3K
Capital replenishment ratio for 2013–2017



Note: DOE—Department of Education; TAFE—TAFE Queensland.

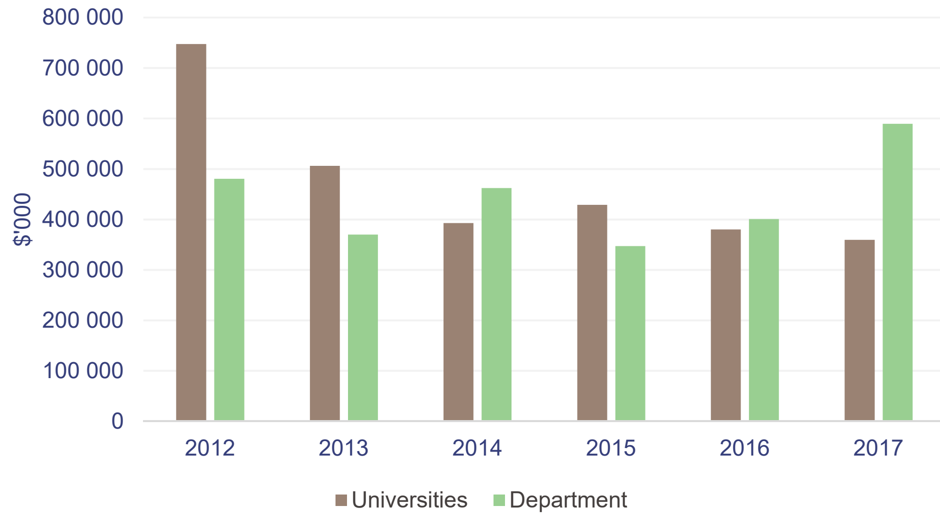
Source: Queensland Audit Office.

The University of Queensland, Queensland University of Technology, and University of Southern Queensland each had a ratio of less than one in 2017. Continuation of this trend over time will require increased investment in future years by the universities to maintain service potential.

We note the University of Queensland has had conservative capital expenditure in recent years, which has contributed to its ratio being less than one since 2014. It has approved a significant increase in its capital program from 2018 to align with its strategic initiatives and plans.

Figure 3L shows payments made by the department and the seven universities for PPE over the last six years.

Figure 3L
Payments for property, plant and equipment for 2012–2017



Source: Queensland Audit Office.

Capital expenditure across the university sector has decreased by 52 per cent over the past six years, restricted mainly to the University of Queensland (61 per cent), Griffith University (60 per cent), Queensland University of Technology (66 per cent) and the University of Southern Queensland (77 per cent). Capital expenditure is affected directly by reduced government capital funding.

The department's significant increase in 2017 ($188.7 million or 47.1 per cent) was attributed to capital acquisitions associated with the *Advancing Queensland State Schools* and accelerated capital works programs.

Future challenges and emerging risks

Government's capital investment

The department, universities, and other education entities must ensure they efficiently manage their capital resources to meet the needs of students. This includes undertaking regular maintenance activities and renewal of their asset portfolio.

The department has an extensive budgeted capital program ($580.6 million) in place for the 2017–18 financial year, including additional capital funding associated with the Queensland Government's *Significant Regional Infrastructure Projects Program*, as well as the construction and upgrading of school halls, land acquisitions for new schools, and the acceleration of works as part of the *Advancing Queensland State Schools* program. This investment is targeted to address catchment areas with a current and anticipated increase in student enrolments.

Within the university sector, domestic and international student numbers have consistently increased since 2012. Over this period, we have seen a decrease in capital funding provided by Australian and Queensland governments. Universities need to plan their asset maintenance and renewal activities, so they align with future student demand and their budget profile.

As noted previously, the University of Queensland will increase its capital program from 2018, including a new student residences project and a Sustainable Futures Building.

James Cook University has developed its *Campus Master Plan 2017–2065* in response to the changing needs of its students, the community, its strategic objectives, and technological enhancements. The vision is to establish a world class health, learning, and teaching facility, while maintaining and preserving connections to the environment and the traditional owners of the land.

The University of the Sunshine Coast (USC) has made strategic decisions to expand into new geographical areas and meet the demands of its increasing student numbers. The Moreton Bay campus at Petrie is its largest capital development project. The campus is due to open in 2020 and is expected to grow to 10 000 students over a 10-year period. Full utilisation of this campus will be important to ensure sufficient revenue is realised from this investment.

Other developments at USC have included the transfer of the Queensland University of Technology's Caboolture campus to the university in January 2018 and the acquisition of the Fraser Coast campus from the University of Southern Queensland in February 2016.

The Central Queensland University has several large-scale infrastructure projects in various stages of development and approval over the next three years, with an approved capital spend of $42 million in its 2018 budget. This increased capital expenditure is due to the required customisation following the university's strategic decision to become a dual sector (university and TAFE) education provider.

New lease accounting standard

The introduction of the new accounting standard AASB16 *Leases*, for reporting periods beginning on or after 1 January 2019, will introduce a single lease accounting model for lessees. This will result in almost all leases being recognised in the statement of financial position, as the distinction between operating and finance leases will be removed. Under the new standard, most leases previously not reported as assets and liabilities will be recognised in the future.

The timing of the recognition of expenses will also change as entities will need to start accounting for depreciation on leased assets and charging interest to reduce the lease liability. Combined, these expenses will be higher at the start of the lease period and reduce as entities repay the lease liability. When calculating lease payments, entities need to consider any changes to the lease, such as increases in the consumer price index, and account for these in the calculation.

In 2016–17, the department reported operating lease expenses of approximately $32.5 million and operating lease commitments of $149 million in its financial statements. These operating leases are entered into as a means of acquiring access to office accommodation and storage facilities.

In 2017, five universities collectively reported operating lease commitments of approximately $460 million in their future commitments as lessees. These included leases over campus buildings, office space, research facilities, and plant and equipment. A portion of this amount will be brought onto the statement of financial position as an asset (right of use) upon implementation of the new standard.

The department and the universities are most likely to be affected by the financing effect on their operating result, by the increased liabilities, and by the complexity of calculations.

Liabilities and equity

Figure 3M
Major liabilities and equity for education entities by type in 2017

Trade payables

Department $310.5m
Universities $274.2m
TAFE Queensland $42.3m
Grammar schools $11.3m

Interest bearing liabilities

Department $615.3m
Universities $472.4m
Grammar schools $89.6m

Provisions

Department $235.9m
Universities $565.7m
TAFE Queensland $19m
Grammar schools $22m

Reserves

Department $19 132m
Universities $3 958m
Grammar schools $275.5m

Contributed equity

Department $4 645m
TAFE Queensland $170.1m

Retained surplus

Department $187.2m
Universities $5 632m
TAFE Queensland $120m
Grammar schools $324.1m

Note: amounts quoted above are as at the respective balance dates; that is, 30 June 2017 for the department and TAFE Queensland, and 31 December 2017 for the universities and grammar schools.

Source: Queensland Audit Office.

Events and transactions affecting debt and equity this year

The department's debt is serviced through Queensland Treasury Corporation (QTC) borrowings and finance lease liabilities associated with the private provision of public infrastructure agreements (public–private partnerships—PPPs). At 30 June 2017, the department held $615.3 million in debt, an increase of $30.2 million (5.2 per cent) from last year. This was primarily due to the completion of additional stages for three schools under the Queensland Schools–Plenary PPP.

TAFE Queensland continues to hold no debt with all its initiatives and operating costs funded through retained surplus and working capital.

University debt is sourced through borrowings from QTC. At 31 December 2017, the universities held $472.4 million in debt, with 96 per cent attributed to four universities (the University of Queensland, James Cook University, Griffith University, and the Queensland University of Technology).

Borrowings across the seven universities increased by $19 million (4.2 per cent) in 2017. Some of the reasons are outlined below:

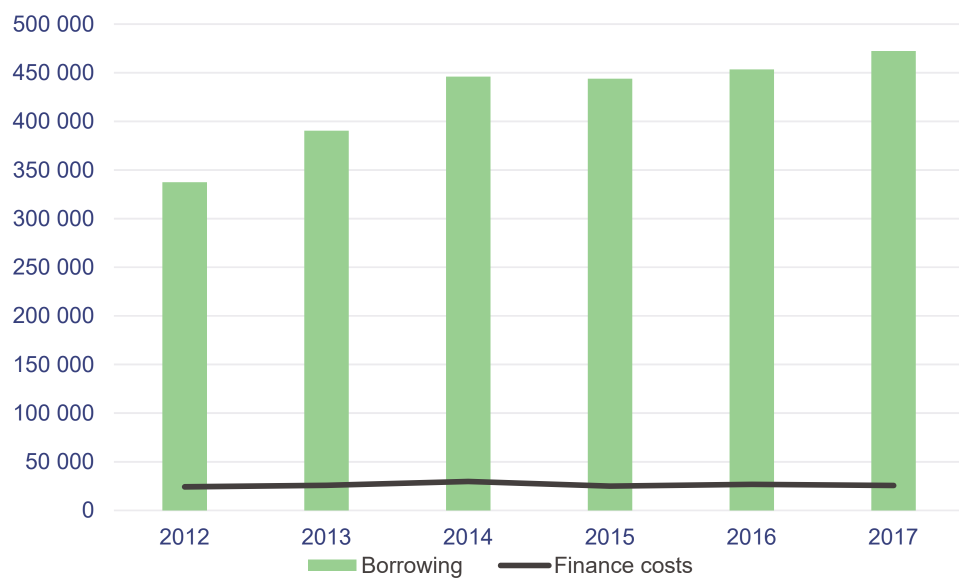
- The University of Queensland is currently constructing a student residences project ($251 million) that will be fully funded through a 20-year loan from the QTC. In 2017, it took out a new loan amounting to $8.835 million to fund this project.
- In 2017, James Cook University established a new loan of $40 million to construct its Cairns student accommodation project.

Over the past three years, three of the seven universities have reduced their level of debt: Griffith University by $5.8 million (5.2 per cent), the University of the Sunshine Coast by $5.2 million (42.3 per cent), and Central Queensland University by $2.8 million (100 per cent). The reduction of debt reduces borrowing costs, which releases funds for other purposes.

Future challenges and emerging risks

A continuing challenge for universities is funding their future expansion through debt. Figure 3N shows the level of debt and borrowing costs incurred over the past six years across the university sector.

Figure 3N
Universities—debt versus finance (interest) costs for 2012–2017



Source: Queensland Audit Office.

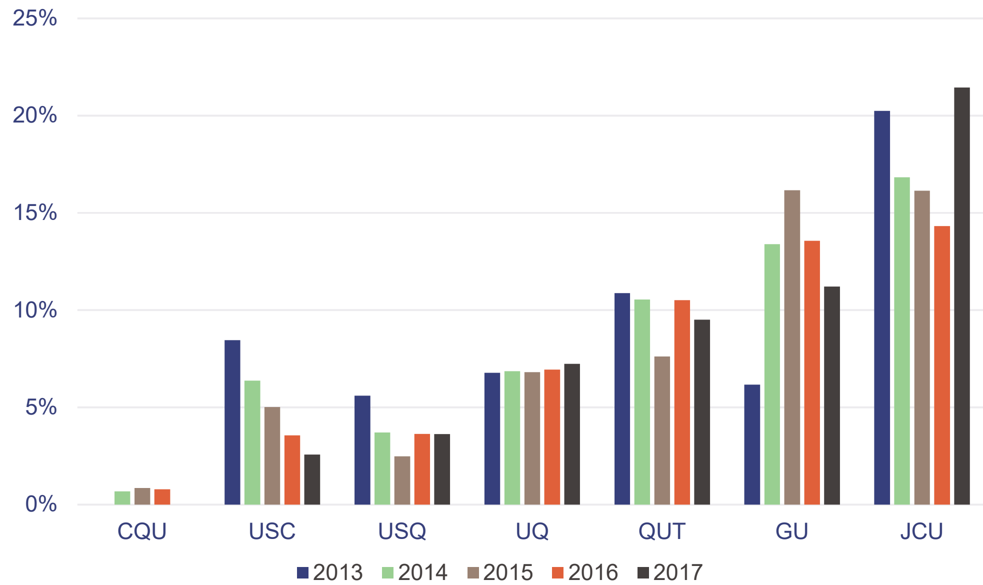
While the costs have remained stable over the period, the level of debt held by the seven universities has significantly increased ($135 million or 40 per cent increase).

Debt to revenue ratio

The *debt to revenue ratio* assesses an entity's ability to pay the principal and interest on borrowings, as and when they fall due, from the funds that the entity generates. This provides an indicator of the affordability and sustainability of debt levels. A lower percentage indicates an entity has a greater ability to repay debt.

Figure 3O shows the debt to revenue ratio for each of the universities over the past five years.

Figure 3O
Debt to revenue ratio for 2013–2017



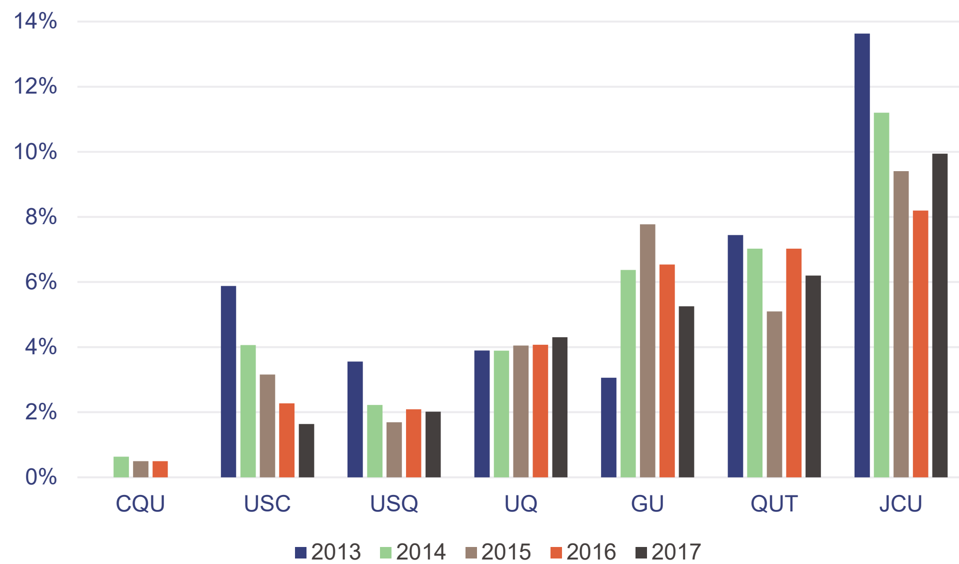
Source: Queensland Audit Office.

While the level of debt has increased over the past five years, six of the seven universities continue to have a relatively low debt to revenue ratio, which indicates they are able to fund future debt obligations and remain financially sustainable. James Cook University has a significantly higher ratio than all other universities, attributed to a new loan of $40 million in 2017 to construct its Cairns student accommodation project.

Debt to equity ratio

The *debt to equity ratio* represents the proportion of debt and equity used to finance an entity's assets. Entities with a higher debt to equity ratio are considered more of a risk to creditors than entities with a lower ratio. Figure 3P shows the debt to equity ratio over the past five years for each university.

Figure 3P
Debt to equity ratio for 2013–2017



Source: Queensland Audit Office.

The universities held $472.4 million in debt at 31 December 2017 and $9.6 billion in equity at 31 December 2017, which is a 4.9 per cent debt to equity ratio. This indicates that they have taken on relatively little debt and hence are lower risk. While James Cook University acquired a new loan of $40 million in 2017 and has had a higher ratio than other universities for the past five years, it has reduced its ratio over the previous three years, with the repayment of debt of $21 million over that period.

4. Internal controls

This chapter assesses the strength of the internal controls designed, implemented, and maintained by entities in the education sector.

Introduction

This chapter evaluates the effectiveness of internal controls as they relate to our audits of entities in the education sector. Our analysis focuses on the Department of Education, TAFE Queensland, seven universities, and eight grammar schools, due to their significance to the Queensland public education sector.

These entities are each responsible for designing, implementing, and maintaining their own internal control environment. State schools also need to implement suitable internal controls; however, the Department of Education is responsible for processing most of their financial transactions and managing the financial information systems that schools use. In contrast, grammar schools rely on their own controls to prevent, or detect and correct, material misstatements in their financial reports.

Through our analysis, we aim to promote stronger internal control frameworks. We also aim to mitigate financial losses and damage to public sector reputation by initiating effective responses to identified control weaknesses.

Conclusion

Across the sector, entities have generally effective control environments. All entities continue to take steps to improve their internal controls and address previously identified deficiencies. We identified two significant control deficiencies at the Queensland University of Technology.

There are still deficiencies that we have raised in prior years that entities are yet to resolve. Some of these deficiencies date back as far as 2013. By not addressing control deficiencies, entities are leaving themselves unnecessarily exposed to a higher risk of fraud, and errors remaining undetected.

In April 2018, a fraud was successfully perpetrated at an education sector entity. It involved a fraudulent request to change an existing supplier's bank account details and divert payments to the illegitimate bank account. We recommend all entities reinforce the need to verify bank account changes independent of the change request. Appendix J outlines the fraud and the required management action.

Our audit of internal controls

We assess the design and implementation of internal controls to ensure clients have designed controls that suitably prevent, or detect and correct, misstatements in the financial report, and achieve compliance with legislative requirements and appropriate use of public resources. Where we identify controls that we plan to rely on, we test how effectively these controls are operating to ensure they are functioning as intended.

We are required to communicate deficiencies in internal controls to management and those charged with governance.

Our rating of internal control deficiencies

A *deficiency* arises when internal controls are ineffective or missing, and are unable to prevent, or detect and correct, misstatements in the financial statements. A deficiency may also result in non-compliance with policies and applicable laws and regulations and/or inappropriate use of public resources.

A *significant deficiency* (a high-risk matter) is a deficiency, or combination of deficiencies, in internal controls that requires immediate remedial action.

Our rating of internal control deficiencies allows management to gauge relative importance and prioritise remedial actions.

We increase the rating from a deficiency to a significant deficiency when:

- we consider immediate remedial action is required
- there is a risk of material misstatement in the financial statements
- there is a risk to reputation
- the non-compliance with policies and applicable laws and regulations is significant
- there is potential to cause financial loss including fraud
- management has not taken appropriate, timely action to resolve the deficiency.

Control deficiencies categorised by COSO component

We categorise internal controls using the Committee of the Sponsoring Organizations of the Treadway Commission (COSO) internal controls framework, which is widely recognised as a benchmark for designing and evaluating internal controls.

The framework identifies five components that need to be present and operating together for a successful internal control system. These components are explained in Appendix I.

In 2017, we identified a total of two significant deficiencies and 43 deficiencies across the education sector. Figure 4A shows the number of control deficiencies (categorised by COSO component) reported to management.

Figure 4A
Number and category of internal control deficiencies for the education sector

Control environment *Structures, policies, attitudes, and values that influence daily operations*	**Risk assessment** *Processes for identifying, assessing, and managing risk*	**Control activities** *Implementation of policies and procedures to prevent or detect errors and safeguard assets*	**Information & communication** *Systems to capture and communicate information to achieve reliable financial reporting*	**Monitoring activities** *Oversight of internal controls for existence and effectiveness*
Five deficiencies identified	No deficiencies identified	Two significant deficiencies and 36 deficiencies identified	One deficiency identified	One deficiency identified

Source: Queensland Audit Office adapted from Committee of the Sponsoring Organizations of the Treadway Commission (COSO) internal controls framework.

Control activities

This year, we identified two significant deficiencies at the Queensland University of Technology in relation to managing user access and changes to the vendor masterfile (the collection of all records relating to vendors). These were as follows:

- The university was not sufficiently monitoring changes to or ensuring appropriate restrictions for user access for some of its users. This increased the risk of unauthorised updates in the system not being detected. Management is investigating the incident and taking action to ensure all changes to super user access and activities of privileged users are suitably monitored.
- A control weakness was identified in the accounts payable process which increased the risk of fraudulent payments not being prevented. Management have revisited procedures to ensure internal controls are operating effectively to mitigate this risk.

In response to these deficiencies, we undertook additional audit work, providing us with reasonable assurance that there were no fraudulent transactions that would result in material misstatement.

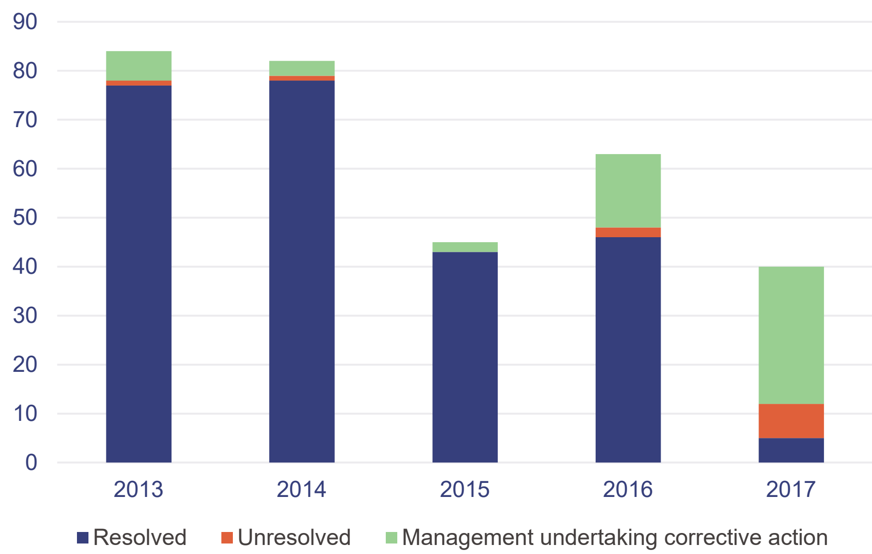
We identified a further 36 deficiencies in control activities across the education sector, with the majority relating to user access, information system controls, and procurement. We did not identify any systemic issues that would indicate the systems of internal control could not be relied upon.

Status of internal control deficiencies

Management and those charged with governance are responsible for the efficient and effective operation of internal controls. Audit committees are in place to assist those charged with governance to obtain assurance over internal control systems. An audit committee is responsible for considering audit findings, management responses to those findings, and the status of audit recommendations.

We have analysed the appropriateness and timeliness of remedial action undertaken to resolve deficiencies we identified across the sector. Figure 4B outlines the status of internal control deficiencies reported over the last five years.

Figure 4B
Status of internal control deficiencies



Source: Queensland Audit Office.

Across the education sector as at 28 February 2018, there were 63 deficiencies and two significant deficiencies for which management is continuing to undertake corrective action.

Most entities have either addressed their control deficiencies or are on track to do so by the agreed dates. However, we observed that there are still 30 (10 per cent) deficiencies from prior years (2013–16) that remain outstanding. Long-outstanding control issues can have a significant impact on entities and can increase the risk of fraud and significant errors.

Where corrective action is underway, we urge audit committees to monitor whether management is meeting the agreed milestone dates for all reported issues. Proactive and timely resolution of control deficiencies indicates a strong control environment.

Appendices

A. Full responses from agencies

As mandated in Section 64 of the *Auditor-General Act 2009*, the Queensland Audit Office gave a copy of this report with a request for comments to the Director-General, Department of Education. We also provided a copy of this report to the following entities and gave them the option of providing a response:

- TAFE Queensland
- Central Queensland University
- Griffith University
- James Cook University
- Queensland University of Technology
- University of Queensland
- University of Southern Queensland
- University of the Sunshine Coast
- Board of Trustees of the Brisbane Girls Grammar School
- Board of Trustees of the Brisbane Grammar School
- Board of Trustees of the Ipswich Girls' Grammar School
- Board of Trustees of the Ipswich Grammar School
- Board of Trustees of the Rockhampton Girls Grammar School
- Board of Trustees of the Rockhampton Grammar School
- Board of Trustees of the Toowoomba Grammar School
- Board of Trustees of the Townsville Grammar School.

We provided a copy of this report to the Premier; the Minister for Education; and the Director-General, Department of the Premier and Cabinet for their information.

We have considered all views provided to us in reaching our conclusions, and these are represented to the extent relevant and warranted in preparing this report.

The heads of these entities are responsible for the accuracy, fairness and balance of their comments.

This appendix contains their detailed responses to our audit recommendations.

Comments received from Director-General, Department of Education

Queensland Government

Office of the
Director-General

Department of
Education

1 1 MAY 2018

Mr Brendan Worrall
Auditor-General
Queensland Audit Office
Email: qao@qao.qld.gov.au

Dear Mr Worrall

I refer to your letter dated 19 April 2018 to Ms Patrea Walton, the then Acting Director-General, Department of Education, in which you provided a draft of your report to Parliament titled *Education: 2016–17 results of financial audits* (the Report) concerning the results of financial audits of education sector entities for the years ended 30 June 2017 and 31 December 2017.

I note you also wrote to the Honourable Grace Grace MP, Minister for Education and Minister for Industrial Relations, on 19 April 2018.

I appreciate the opportunity to review the Report and thank you and your team, led by Mr John Welsh, for the collaborative approach.

If you require further information or assistance, please contact Mr Duncan Anson, Acting Assistant Director-General and Chief Finance Officer, on telephone on

Yours sincerely

Tony Cook

TONY COOK
Director-General

Ref: 18/242683
Your Ref: 11889

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ABN 76 337 613 647

B. The Queensland Audit Office

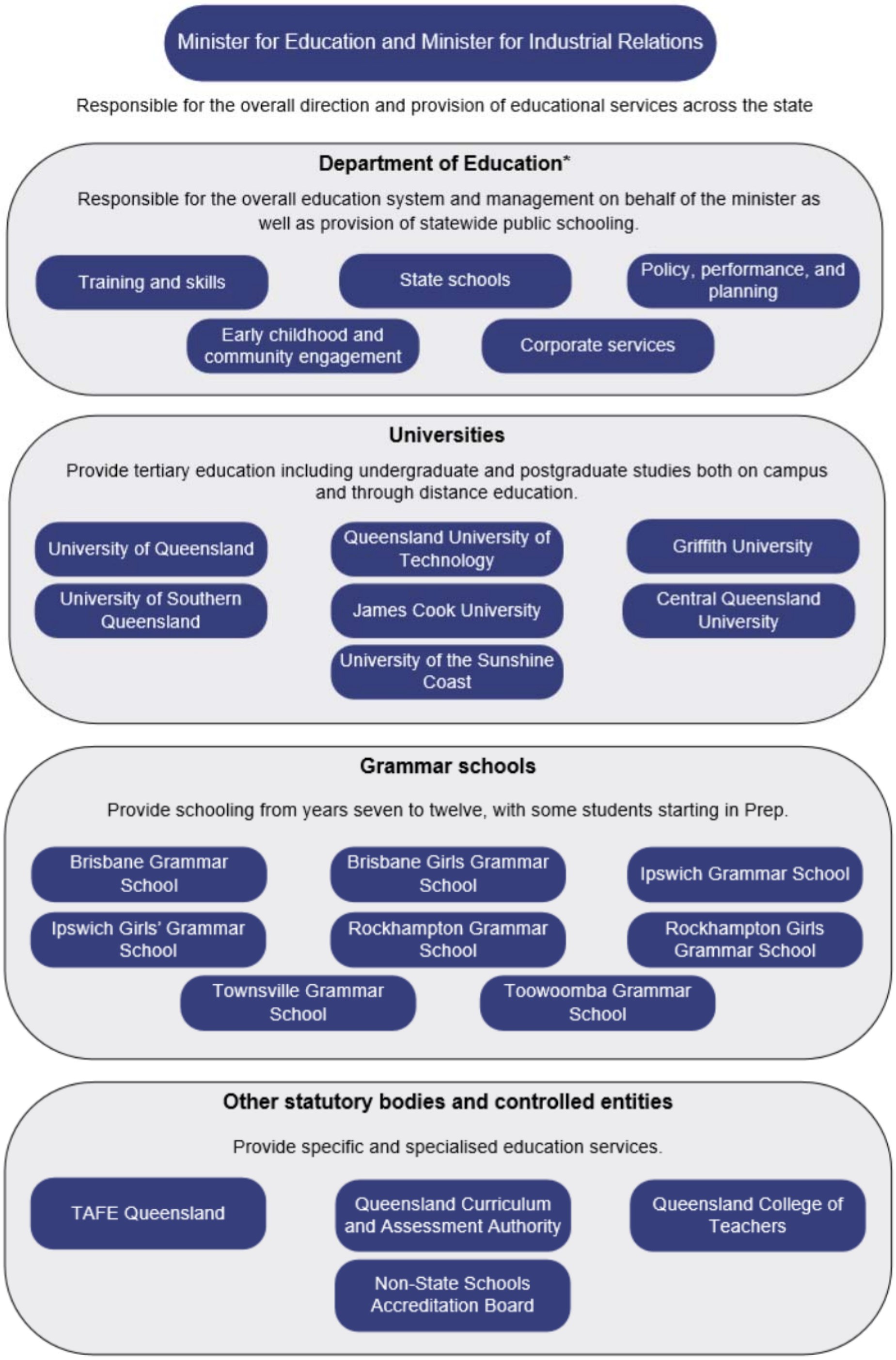
The auditor-general, supported by the Queensland Audit Office, is the external auditor of the state's public sector. Each year, through our financial audit program, we form independent audit opinions about the reliability of financial statements produced by state and local government entities.

We provide independent assurance directly to parliament about public sector finances. We also help the public sector meet its accountability obligations. Our role and the work we do is critical to the integrity of our system of government.

The auditor-general must prepare reports to parliament on each audit conducted. These reports must state whether the financial statements of a public sector entity have been audited. They may also draw attention to significant breakdowns in the financial management functions. This report satisfies these requirements.

C. Education sector entities

Figure C1
Entities within the education sector



Note: *Following machinery of government changes, the former Department of Education and Training was renamed to the Department of Education, and its training and skills service area transferred to the newly established Department of Employment, Small Business and Training.

Source: Queensland Audit Office.

D. Legislative context

Framework

Education entities prepare their financial statements in accordance with the following legislative frameworks and reporting deadlines.

Figure D1
Legislative frameworks for education sector

Entity type	Entity	Legislative framework	Legislated deadline
Department	Department of Education	• *Financial Accountability Act 2009* • Financial and Performance Management Standard 2009	31 August 2017
Statutory bodies	Seven universities Eight grammar schools Queensland College of Teachers	• *Financial Accountability Act 2009* • Financial and Performance Management Standard 2009 • *Statutory Bodies Financial Arrangement Act 1982* • *Australian Charities and Not-for-profits Commission Act 2012* • Australian Charities and Not-for-profits Commission Regulation 2013 • *Higher Education Support Act 2003*	28 February 2018
Statutory bodies—other	TAFE Queensland Queensland Curriculum and Assessment Authority Non-State Schools Accreditation Board	• *Financial Accountability Act 2009* • Financial and Performance Management Standard 2009 • *Statutory Bodies Financial Arrangement Act 1982*	31 August 2017
Controlled and jointly-controlled entities	11 entities controlled by universities Three jointly-controlled entities	• *Corporations Act 2001* • Corporations Regulation 2001	30 April 2018
Trust	Translational Research Institute Trust	• Trust deed	31 March 2018

Source: Queensland Audit Office.

Accountability requirements

The *Financial Accountability Act 2009* applicable to the education sector entities requires these entities to:

- achieve reasonable value for money by ensuring the operations of the statutory body are carried out efficiently, effectively, and economically
- establish and maintain appropriate systems of internal control and risk management
- establish and keep funds and accounts that comply with the relevant legislation, including Australian accounting standards.

Queensland state government financial statements

Each year, Queensland state public sector entities must table their audited financial statements in parliament.

These financial statements are used by a broad range of parties including parliamentarians, taxpayers, employees, and users of government services. For these statements to be useful, the information reported must be relevant and accurate.

The auditor-general's audit opinion on these entities' financial statements assures users that the statements are accurate and in accordance with relevant legislative requirements.

We express an *unmodified opinion* when the financial statements are prepared in accordance with the relevant legislative requirements and Australian accounting standards. We *modify* our audit opinion when financial statements do not comply with the relevant legislative requirements and Australian accounting standards and are not accurate and reliable.

Sometimes we include an *emphasis of matter* in our audit reports to highlight an issue that will help users better understand the financial statements. This does not change the audit opinion.

University and grammar school entities

In Queensland, universities provide tertiary education including undergraduate and postgraduate studies. Universities and their subsidiaries carry out research and other activities in line with university objectives.

Most grammar schools provide schooling from years seven to twelve, but some start at Prep.

University classification

To allow for more effective comparisons, we benchmarked the universities' results both across Queensland and against national available data, broken down where possible between metropolitan and regional areas (and the Group of eight (Go8) large Australian research universities. Please refer to Figure D2).

Figure D2
University classification

Metropolitan	Regional
University of Queensland* Queensland University of Technology Griffith University	James Cook University Central Queensland University University of Southern Queensland University of the Sunshine Coast

Note: * Member of the Go8.

Source: Queensland Audit Office.

University funding and regulation

Universities obtain funding mainly through government grants and student fees. Grants are based on student enrolments and the amount of research undertaken at each university. In Queensland, 85 per cent (2015: 83 per cent) of university funding comes from federal and state government grants and student fees and charges. Federal funding is mainly recurrent, with state government grants generally non-recurrent in nature.

The federal budget details how much funding is provided to universities per course.

Grammar school funding and regulation

Grammar schools obtain funding through Australian and Queensland government grants and tuition and boarding fees. In Queensland, 90 per cent (2015: 89 per cent) of grammar school funding comes from these sources.

The grammar schools are statutory bodies formed under the *Grammar Schools' Act 1975*. They operate as independent schools in Queensland.

Department of Education

The Department of Education is a Queensland Government department established under the *Public Service Act 2008*. It provides direction and oversight to the education sector in Queensland. The department delivers services for early childhood and education. Up until recently, the department also delivered training services; however, following recent machinery of government changes, the responsibility for this portfolio was transferred to the newly established Department of Employment, Small Business and Training (DESBT).

Department of Education funding and regulation

The Department of Education receives appropriation revenue that includes funding from both the Australian and Queensland governments. The department shares this funding across its service areas of early childhood education and care, and school education. Prior to machinery of government changes, the department also used it to fund training and skills. This funding will now transfer to DESBT.

Other education entities

TAFE Queensland

TAFE Queensland is the state's largest provider of practical, industry-relevant training. It was established as a statutory body under the *TAFE Queensland Act 2013* on 1 July 2013. TAFE Queensland is a not-for-profit entity governed by an independent board.

TAFE Queensland's income is largely attributable to grants and contributions. To recognise TAFE Queensland's cost disadvantage in the market, the entity also receives a VET Purchasers grant from the Queensland Government, which funds the difference in staffing costs between public and private training providers.

Queensland Curriculum and Assessment Authority

The Queensland Curriculum and Assessment Authority (QCAA) is a statutory body that was established on 1 July 2014, replacing the Queensland Studies Authority. It provides the syllabuses for all schooling from kindergarten to Year 12. It also provides guidelines, assessment, reporting, testing, and certification services for Queensland schools. QCAA revises syllabuses and guidelines and offers services and resources to help teachers implement them.

Most of QCAA's income relates to administered grant funding from the Queensland Government.

Queensland College of Teachers

The Queensland College of Teachers is responsible for registering teachers for Queensland schools, and for providing accreditation for preservice teacher education programs. It is a statutory body that ensures teachers meet Australian education standards and act ethically.

The biggest contributors to the college's income are its teacher registration and application fees.

Non-State Schools Accreditation Board

The Non-State Schools Accreditation Board works with non-state school governing bodies in the areas of accreditation and funding eligibility. The board is a statutory body established under the *Education (Accreditation of Non-State Schools) Act 2001*.

While the board receives grant funding, most of its income is actually from contributed services. These are corporate services that the Department of Education provides, which it recognises at fair value.

E. Entities preparing financial reports

The table below details the types of audit opinion issued in accordance with Australian auditing standards for the 2017 financial year.

Figure E1
Audit opinions issued

Entity	Date audit opinion issued	Type of audit opinion issued
Departments		
Department of Education*	24.08.2017	Unmodified
Universities and their controlled entities		
Central Queensland University	26.02.2018	Unmodified
• Australian International Campuses Trust	23.02.2018	Unmodified
• C Management Services Pty Ltd	21.02.2018	Unmodified
• CQU Travel Centre Pty Ltd	21.02.2018	Unmodified
Griffith University	27.02.2018	Unmodified
James Cook University	28.02.2018	Unmodified
Queensland University of Technology	27.02.2018	Unmodified
• Creative Industries Precinct Pty Ltd	26.02.2018	Unmodified—EOM
• QUT Enterprise Holdings Trust	26.02.2018	Unmodified—EOM
• qutbluebox Pty Ltd	26.02.2018	Unmodified—EOM
• qutbluebox Trust	26.02.2018	Unmodified—EOM
The University of Queensland	28.02.2018	Unmodified
• University of Queensland Foundation Trust	23.02.2018	Unmodified—EOM
• UQ Holdings Pty Ltd	23.02.2018	Unmodified
• UQ Investment Trust	23.02.2018	Unmodified—EOM
• UQH Finance Pty Ltd	23.02.2018	Unmodified—EOM
University of Southern Queensland	23.02.2018	Unmodified
University of the Sunshine Coast	26.02.2018	Unmodified

Entity	Date audit opinion issued	Type of audit opinion issued
Grammar schools		
Board of Trustees of the Brisbane Girls Grammar School	26.02.2018	Unmodified
Board of Trustees of the Brisbane Grammar School	21.02.2018	Unmodified
Board of Trustees of the Ipswich Girls' Grammar School	27.02.2018	Unmodified
Board of Trustees of the Ipswich Grammar School	28.02.2018	Unmodified
Board of Trustees of the Rockhampton Girls Grammar School	28.02.2018	Unmodified
Board of Trustees of the Rockhampton Grammar School	28.02.2018	Unmodified
Board of Trustees of the Toowoomba Grammar School	28.02.2018	Unmodified
Board of Trustees of the Townsville Grammar School	27.02.2018	Unmodified
Statutory body		
TAFE Queensland*	24.07.2017	Unmodified
Queensland College of Teachers	15.02.2018	Unmodified
Queensland Curriculum and Assessment Authority*	29.08.2017	Unmodified
Non-State Schools Accreditation Board*	07.08.2017	Unmodified
Jointly controlled entities		
International WaterCentre Joint Venture	04.04.2018	Unmodified—EOM
Queensland College of Wine Tourism	19.03.2018	Unmodified—EOM
Queensland Cyber Infrastructure Foundation Ltd	29.03.2018	Unmodified
Audited by arrangement		
Translational Research Institute Trust	26.03.2018	Unmodified—EOM

Note: *Opinion also included in the Queensland state government: 2016–17 results of financial audits (Report 11: 2017–18).

Source: Queensland Audit Office.

The auditor-general approved exemptions from audit for the following entities.

Figure E2
Entities exempt from audit by the Auditor-General
(s.30A *Auditor-General Act 2009*—small in size and low in risk)

Entity	Audit firm	Date audit opinion issued	Type of audit opinion issued
Universities—Controlled entities of James Cook University			
James Cook University Pte Ltd	Baker Tilly TFW	14.02.2018	Unmodified
James Cook Holdings Pte Ltd	Baker Tilly TFW	14.02.2018	Unmodified

Source: Queensland Audit Office.

F. Key audit matters

This table summarises the key audit matters reported on for the entities in the education sector.

Figure F1
Key audit matters

Key audit matter	Entity
Freehold buildings valuation	University of Southern Queensland
Specialised buildings and heritage buildings valuations	Queensland University of Technology
Building valuations	The University of Queensland
Land valuations	The University of Queensland
Valuation of financial assets measured at fair value through profit and loss	UQ Holdings Pty Ltd
Specialised buildings valuation	Griffith University
Land valuations	Griffith University
Building valuations	Central Queensland University
Specialised buildings valuation	James Cook University
Specialised buildings valuation	The University of the Sunshine Coast
Valuation of buildings and leased assets	Department of Education

Source: Queensland Audit Office.

G. Entities not preparing financial reports

The auditor-general will not issue audit opinions for the following controlled public sector entities for the 2017 financial year, as they were not required to produce financial statements.

Figure G1
Non-reporting and dormant entities

Public sector entity	Reason for not preparing financial statements
Universities—Controlled entities of the University of Queensland	
Cloevis Pty Ltd (de-registered 18 June 2017)	Non-reporting
Cyclagen Pty Ltd	Non-reporting
Dendright Pty Ltd	Non-reporting
Global Change Institute Pty Ltd	Dormant
IMBcom Asset Management Co Pty Ltd	Non-reporting
IMBcom Asset Trust	Non-reporting
IMBcom Pty Ltd	Non-reporting
JK Africa Mining Solutions Pty Ltd	Non-reporting
JKTech Pty Ltd	Non-reporting
JKTech South America Spa	Non-reporting
Kalthera Pty Ltd	Non-reporting
Leximancer Pty Ltd	Non-reporting
Lucia Publishing Systems Pty Ltd (de-registered 3 December 2017)	Dormant
Metallotek Pty Ltd (de-registered 17 May 2017)	Non-reporting
Neo-Rehab Pty Ltd	Non-reporting
SUSOP Pty Ltd (de-registered 11 June 2017)	Non-reporting

Public sector entity	Reason for not preparing financial statements
Symbiosis Group Pty Ltd	Non-reporting
UniQuest Pty Limited	Non-reporting
UQ College Limited	Non-reporting
UQ Health Care Limited	Non-reporting
UQ Jakarta Office Pty Ltd	Dormant
UQ Sport Ltd	Non-reporting
UWAT Pty Ltd	Dormant
Universities—Controlled entities of James Cook University	
JCU CPB Pty Ltd	Dormant
JCU Early Learnings Centres Pty Ltd	Non-reporting
JCU Enterprises Pty Ltd	Non-reporting
JCU Health Pty Ltd	Non-reporting
JCU Univet Pty Ltd	Non-reporting
JCU College Pty Ltd (formerly JCU Pathways Pty Ltd)	Non-reporting
North Queensland Commercialisation Company Pty Ltd	Dormant
Tropical Queensland Centre for Oral Health Pty Ltd	Non-reporting
The JCU Asset Trust	Non-reporting
The CPB Trust	Non-reporting
Universities—Controlled entities of the Queensland University of Technology	
Brisbane Business School Pty Ltd	Dormant
QUT Enterprise Holdings Pty Ltd	Non-reporting
Universities—Controlled entities of the University of Southern Queensland	
University of Southern QLD (South Africa) (Pty) Ltd	Dormant
Universities—Controlled entities of the Central Queensland University	
Australian International Campuses Pty Ltd	Non-reporting
Health Train Education Services Pty Ltd	Non-reporting
Mask-Ed International Pty Ltd	Dormant

Public sector entity	Reason for not preparing financial statements
Universities—Controlled entities of Griffith University	
Gold Coast Innovation Centre Limited	Dormant
Universities—Controlled entities of the University of Queensland and Griffith University	
International WaterCentre Pty Ltd	Non-reporting
Universities—Controlled entities of the University of the Sunshine Coast	
USC Capital and Commercial Pty Ltd	Non-reporting
Innovation Centre Sunshine Coast Pty Ltd	Non-reporting
Thompson Institute Pty Ltd	Non-reporting

Source: Queensland Audit Office.

H. Our assessment of financial statement preparation

Our assessment of the effectiveness of financial statement preparation processes involved considering three components—the year end close process, the timeliness of financial statements, and the quality of financial statements.

Result summary

The table summarises our assessment of the financial statement preparation processes across the department and the seven universities.

Figure H1
Financial statement preparation across the Department of Education and universities

Entity	Financial statement preparation		
	Year end close process	Timeliness of draft financial statements	Quality of draft financial statements
Department of Education	🟢	🟢	🟢
Central Queensland University	🟡	🟢	🟢
Griffith University	🟢	🟢	🟢
James Cook University	🟡	🟢	🟢
Queensland University of Technology	🟢	🟢	🟢
University of Queensland	🟡	🟢	🟢
University of Southern Queensland	🟢	🟢	🟢
University of the Sunshine Coast	🟢	🟢	🟢

Note: The Department of Education's ratings are also reported in Report 11: *2017–18: Queensland state government: 2016–17 results of financial audits*. TAFE Queensland and the grammar schools are included in overall assessment but not reported individually.

Source: Queensland Audit Office.

Year end close process

State public sector entities should have a robust year end close process to enhance the quality and timeliness of their financial reporting processes. This year, we assessed processes for year end financial statement preparation against the following target dates.

Figure H2
Target dates for year end financial statement preparation

Process	Target date (entities with 30 June 2017 balance date)	Target date (entities with 31 December 2017 balance date)
Completing non-current asset valuations	31.05.2017	30.11.2017
Preparing complete pro forma financial statements	30.04.2017	31.12.2017
Resolving known accounting issues	30.04.2017	31.10.2017
Completing hard or soft close processes and agreed procedures	As agreed	As agreed
Concluding all asset stocktakes	30.06.2017	31.12.2017

These targets were developed based on advice previously issued by the Queensland Under Treasurer in 2014, and on better practice identified in other jurisdictions.

Figure H3
Assessment criteria—year end close process

Rating scale	Assessment criteria—year end close process
● Fully implemented	All processes completed by the target date
● Partially implemented	Three processes completed within two weeks of the target date
● Not implemented	Less than two processes completed within two weeks of the target date

Timeliness of draft financial statements

We assessed the timeliness of draft financial statements by considering whether entities prepared financial statements according to the timetables set by management.

This includes providing auditors with the first complete draft of financial statements by the agreed date. A complete draft is one that management is ready to sign and where no material errors or adjustments are expected.

Figure H4
Assessment criteria—timeliness of draft financial statements

Rating scale	Assessment criteria—timeliness of draft financial statements
● Timely	Acceptable draft financial statements received on or prior to the planned date
● Generally timely	Acceptable draft financial statements received within two days after the planned date
● Not timely	Acceptable draft financial statements received greater than two days after the planned date

Quality of draft financial statements

We calculated the difference between the first draft financial statements submitted to audit and the final audited financial statements for the financial statement components of total revenue, total expenses, and net assets. Our quality assessment is based on the percentage of adjustments across each of these components.

Figure H5
Assessment criteria—quality of draft financial statements

Rating scale	Assessment criteria—quality of draft financial statements
● No adjustments	No adjustments were required
● No significant adjustments	Adjustments for any of the three financial statement components of total revenue, total expenses, and net assets were less than five per cent
● Significant adjustments	Adjustments for any of the three financial statement components of total revenue, total expenses, and net assets were greater than five per cent

I. Our audit of internal controls

Internal controls are designed, implemented, and maintained by entities to mitigate risks that may prevent them from achieving reliable financial reporting, effective and efficient operations, and compliance with applicable laws and regulations.

In undertaking our audit, we are required under the Australian auditing standards to obtain an understanding of an entity's internal controls relevant to the preparation of the financial report.

We assess the design and implementation of internal controls to ensure they are suitably designed to prevent or detect and correct material misstatements in the financial report, and to achieve compliance with legislative requirements and appropriate use of public resources.

Our assessment determines the nature, timing, and extent of the testing we perform to address the management assertions at risk of material misstatement.

Where we believe the design and implementation of controls is effective, we select the controls we intend to test further by considering a balance of factors including:

- significance of the related risks
- characteristics of balances, transactions, or disclosures (volume, value, and complexity)
- nature and complexity of the entity's information systems
- whether the design of the controls addresses the management assertions at risk and facilitates an efficient audit.

Where we identify deficiencies in internal controls, we determine the impact on our audit approach, considering whether additional audit procedures are necessary to address the risk of material misstatement in the financial statements.

Our procedures are designed to address the risk of material misstatement, so we can express an opinion on the financial report. We do not express an opinion on the effectiveness of internal controls.

Internal controls framework

We categorise internal controls using the Committee of the Sponsoring Organizations of the Treadway Commission (COSO) internal controls framework, which is widely recognised as a benchmark for designing and evaluating internal controls.

The framework identifies five components for a successful internal control system. These components are explained in the following paragraphs.

Control environment

- Cultures and values
- Governance
- Organisational structure
- Policies
- Qualified and skilled people
- Management's integrity and operating style

The control environment is defined as the structures, policies, attitudes, and values that influence day-to-day operations. As the control environment is closely linked to an entity's overarching governance and culture, it is important that the control environment provides a strong foundation for the other components of internal control.

In assessing the design and implementation of the control environment we consider whether:

- those charged with governance are independent, appropriately qualified, experienced, and active in challenging management, ensuring it receives the right information at the right time to enable informed decision-making
- policies and procedures are established and communicated so people with the right qualifications and experiences are recruited, they understand their role in the organisation, and they also understand management's expectations regarding internal controls, financial reporting, and misconduct, including fraud.

Risk assessment

- Strategic risk assessment
- Financial risk assessment
- Operational risk assessment

Risk assessment relates to management's processes for considering risks that may prevent an entity from achieving its objectives, and how management agrees risks should be identified, assessed, and managed.

To achieve appropriate management of business risks, management can either accept the risk, if it is minor, or mitigate the risk to an acceptable level by implementing appropriately designed controls. Management can also eliminate risks entirely by choosing to exit from a risky business venture.

Control activities

- General information technology controls
- Automated controls
- Manual controls

Control activities are the actions taken to implement policies and procedures in accordance with management directives and ensure identified risks are addressed. These activities operate at all levels and in all functions. They can be designed to prevent or detect errors entering financial systems.

The mix of control activities can be categorised into general information technology controls, automated controls, and manual controls.

General information technology controls

General information technology controls form the basis of the automated systems control environment. They include controls over information systems security, user access, and system changes. These controls address the risk of unauthorised access and changes to systems and data.

Automated control activities

Automated controls are embedded within information technology systems. These controls can improve timeliness, availability, and accuracy of information by consistently applying predefined business rules. They enable entities to perform complex calculations in processing large volumes of transactions. They also improve the effectiveness of financial delegations and the segregation of duties.

Manual control activities

Manual controls contain a human element, which can provide the opportunity to assess the reasonableness and appropriateness of transactions. However, these controls may be less reliable than automated elements as they can be more easily bypassed or overridden. They include activities such as approvals, authorisations, verifications, reconciliations, reviews of operating performance, and segregation of incompatible duties. Manual controls may be performed with the aid of information technology systems.

Information and communication

- Non-financial systems
- Financial systems
- Reporting systems

Information and communication controls are the systems used to provide information to employees, and the ways in which responsibilities are communicated.

This aspect of internal control also considers how management generates financial reports, and how these reports are communicated to internal and external parties to support the functioning of internal controls.

Monitoring activities

- Management supervision
- Self-assessment
- Internal audit

Monitoring activities are the methods management uses to oversee and assess whether internal controls are present and operating effectively. This may be achieved through ongoing supervision, periodic self-assessments, and separate evaluations. Monitoring activities also concern the evaluation and communication of control deficiencies in a timely manner to effect corrective action.

Typically, the internal audit function and an independent audit and risk committee are responsible for implementing controls and resolving control deficiencies. These two functions work together to ensure that internal control deficiencies are identified and then resolved in a timely manner.

J. Fraud awareness

9 662

supplier bank account changes made by universities in 2017

$463.96m

payments made by universities to suppliers with bank account changes in 2017

Management is responsible for the systems of internal control designed to prevent and detect fraud within entities.

When suppliers change bank account details, the subsequent payments to these suppliers can be significant. Annually, we report weaknesses with the controls that are meant to be operating over the integrity of this data.

The scam

In late 2016, a malicious fraud scheme targeted public and private sector entities. The scam used fraudulent documents to request changes to an existing supplier's bank account details and divert payments to illegitimate bank accounts.

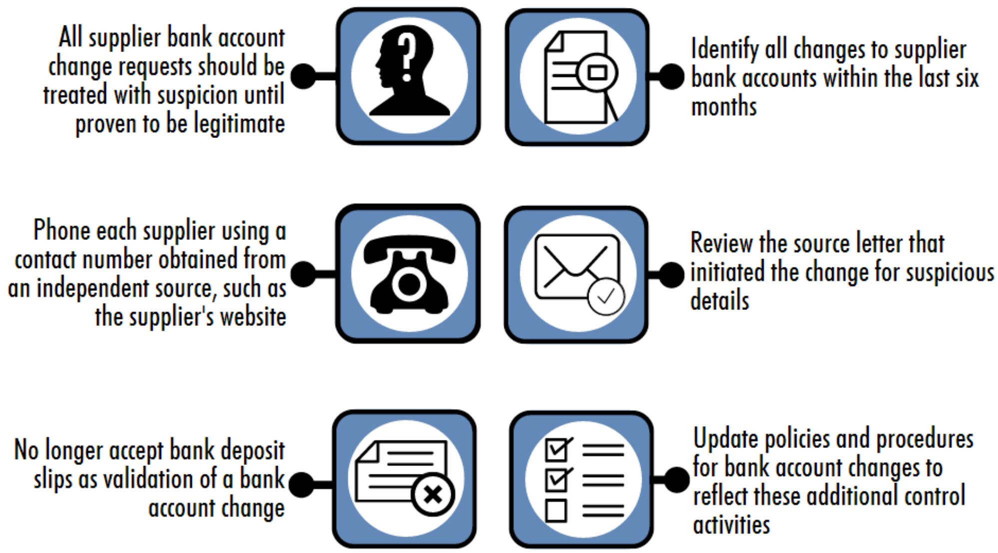
In April 2018, a fraud was successfully perpetrated at an education sector entity using these same techniques.

Our responsibilities

During an audit, we assess the risk of material misstatement due to fraud and respond by developing specific audit procedures to address the risks identified.

Response to fraud

In response to the identified fraud scheme in 2016, we asked all chief financial officers to independently verify their supplier bank account details. We recommended entities exercise increased vigilance over new requests to change supplier bank account details.



This recent fraud emphasises the need for all education sector entities to remain on high alert to this, and other fraudulent schemes, and allocate sufficient resources to their support staff to ensure proper interrogation of documents requesting changes to bank account details.

K. Glossary

Term	Definition
Accountability	The responsibility of public sector entities to achieve their objectives of delivering reliable financial reporting, effective and efficient operations, compliance with applicable laws, and reports to interested parties.
Auditor-General Act 2009	An act of the State of Queensland that establishes the responsibilities of the auditor-general, the operation of the Queensland Audit Office, the nature and scope of audits to be conducted, and the relationship of the auditor-general with parliament.
Australian accounting standards	The rules by which financial statements are prepared in Australia. These standards ensure consistency in measuring and reporting on similar transactions.
Australian Accounting Standards Board (AASB)	An Australian Government agency that develops and maintains accounting standards applicable to entities in the private and public sectors of the Australian economy.
Capital expenditure	Outlays to acquire assets or improve the service potential of existing assets that are capitalised to the balance sheet.
Controlled entities	The capacity of an entity to dominate decision-making, directly or indirectly, in relation to the financial and operating policies of another entity so as to enable that other entity to operate with it in achieving the objectives of the controlling entity.
Deficiency	When internal controls are ineffective or missing, and are unable to prevent, or detect and correct, misstatements in the financial statements. A deficiency may also result in non-compliance with policies and applicable laws and regulations and/or inappropriate use of public resources.
Depreciation	The systematic allocation of a fixed asset's capital value as an expense over its expected useful life, to take account of normal usage, obsolescence, or the passage of time.
Emphasis of matter	A paragraph included with an audit opinion to highlight an issue of which the auditor believes the users of the financial statements need to be aware. The inclusion of an emphasis of matter paragraph does not modify the audit opinion.
Fair value	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties, in an arm’s length transaction.

Term	Definition
Going concern	An entity is expected to be able to pay its debts as and when they fall due, and to continue to operate without any intention or necessity to liquidate or wind up its operations.
Impairment	When an asset's carrying amount exceeds the amount that can be recovered through use or sale of the asset.
Misstatement	A difference between the amount, classification, presentation, or disclosure of a reported financial report item and the amount, classification, presentation, or disclosure that is required for the item to be in accordance with the applicable financial reporting framework. Misstatements can arise from error or fraud.
Modified audit opinion	A modified opinion is expressed when financial statements do not comply with the relevant legislative requirements and Australian accounting standards, and as a result, are not accurate and reliable.
Net assets	Total assets less total liabilities.
Net debt	Total borrowings less cash.
Non-current asset	An entity's long-term investments, where the full value will not be realised within the financial year. These assets are capitalised rather than expensed, meaning that the cost of the asset can be allocated over the number of years for which the asset will be in use, instead of allocating the entire cost to the financial year in which the asset was purchased.
Public–private partnership	Cooperative agreements generally entered into with private sector entities for the delivery of government services.
Qualified audit opinion	An opinion issued when the financial statements as a whole comply with relevant accounting standards and legislative requirements, with the exceptions noted in the opinion. These exceptions could be the effect of a disagreement with those charged with governance, a conflict between applicable financial reporting frameworks, or a limitation on scope that is considered material to an element of the financial report.
Significant deficiency	A deficiency, or combination of deficiencies, in internal control that requires immediate remedial action.
Unmodified audit opinion	An unmodified opinion is expressed when the financial statements are prepared in accordance with the relevant legislative requirements and Australian accounting standards.
Useful life	The number of years the entity expects to use an asset (not the maximum period possible for the asset to exist).

Source: Queensland Audit Office.

Auditor-General reports to parliament

Reports tabled in 2017–18

1.	Follow-up of Report 15: 2013–14 Environmental regulation of the resources and waste industries	September 2017
2.	Managing the mental health of Queensland Police employees	October 2017
3.	Rail and ports: 2016–17 results of financial audits	December 2017
4.	Integrated transport planning	December 2017
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12.	Investing for Success	March 2018
13.	Local government entities: 2016–17 results of financial audits	March 2018
14.	The National Disability Insurance Scheme	May 2018
15.	Education: 2016–17 results of financial audits	May 2018

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