
New South Wales Auditor-General's Report
Financial Audit

Volume Five 2016

Report on Finance, Services and Innovation
(including Insurance)



The role of the Auditor-General

The roles and responsibilities of the Auditor-General, and hence the Audit Office, are set out in the *Public Finance and Audit Act 1983*.

Our major responsibility is to conduct financial or 'attest' audits of State public sector agencies' financial statements. We also audit the Total State Sector Accounts, a consolidation of all agencies' accounts.

Financial audits are designed to add credibility to financial statements, enhancing their value to end-users. Also, the existence of such audits provides a constant stimulus to agencies to ensure sound financial management.

Following a financial audit the Audit Office issues a variety of reports to agencies and reports periodically to parliament. In combination these reports give opinions on the truth and fairness of financial statements, and comment on agency compliance with certain laws, regulations and government directives. They may comment on financial prudence, probity and waste, and recommend operational improvements.

We also conduct performance audits. These examine whether an agency is carrying out its activities effectively and doing so economically and efficiently and in compliance with relevant laws. Audits may cover all or parts of an agency's operations, or consider particular issues across a number of agencies.

Performance audits are reported separately, with all other audits included in one of the regular volumes of the Auditor-General's Reports to Parliament – Financial Audits.

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The Legislative Council
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Pursuant to the *Public Finance and Audit Act 1983*,
I present Volume Five of my 2016 report.

A handwritten signature in black ink, appearing to read 'Margaret Crawford'.

Margaret Crawford
Auditor-General
10 November 2016

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Section One

Finance, Services and Innovation



Executive Summary

This report analyses the results of the financial statement audits of the Finance, Services and Innovation cluster entities for the year ended 30 June 2016. The table below summarises key observations.

Financial performance and reporting

Audit reports

Unqualified audit opinions were issued on cluster agencies' reports.

Early close

Some cluster agencies did not prepare all supporting documents and clear significant accounting issues by due dates.

Funding ratio for New South Wales insurance schemes fell

The funding ratios for the schemes continued to better the target levels.

Insurance data quality

Insurance and Care NSW should address data quality issues impacting claims' valuations.

Financial controls

Ineffective internal controls at service providers

Clients of ServiceFirst and GovConnect were unable to rely on service providers' internal controls increasing the risks of fraud, error and inappropriate access to data.

Significant breakdowns in the transition from ServiceFirst to GovConnect

The Department of Finance Services and Innovation (DFSI) should re-examine the significant transition breakdowns and apply learnings to projects currently being transitioned to the private sector.

Deficient security access

Some agencies should strengthen user access to critical financial systems and data.

Governance

Risk management across the cluster is inconsistently applied

DFSI should review how risk management at an agency level is reported and monitored at the cluster level.

Risk culture is fundamental to effective risk management

Agencies should develop key performance indicators to measure and assess risk culture.

Service delivery

Rental Bonds held in trust

The Rental Bond Board should seek the necessary legislative or other mechanism to confirm its accounting treatment of rental bonds.

Sustainability of the home warranty scheme

The scheme requires urgent strategies to address the funding shortfall or strengthen oversight processes to reduce claim costs.

Financial performance and reporting

Unqualified audit results

Unqualified audit opinions were issued for all cluster agencies' 30 June 2016 financial statements. Sufficient audit evidence was obtained to conclude the financial statements were free of material misstatement.

Agencies substantially completed early close procedures

The statutory deadlines for completing early close procedures and submitting financial statements were met. Cluster agencies substantially complied with early close and year-end procedures. However, some agencies did not resolve all accounting issues as part of early close procedures. Some agencies that use the services of GovConnect NSW (GovConnect) did not provide supporting work papers by the due dates.

Recommendation

Cluster agencies should ensure all supporting documents for early close and year-end are ready by the due dates. All significant accounting issues should be resolved as part of the early close procedures.

Budgeting needs improvement

Some cluster agencies' financial results varied more than five per cent from budget.

Recommendation

Cluster agencies should review the 2015–16 budget variances and identify opportunities to improve future year budgets.

Insurance funding ratios declined slightly following the 2015 Reforms

The combined funding ratio for New South Wales insurance schemes (comprising Workers' Compensation Nominal Insurer and New South Wales Self Insurance Corporation) fell to 119 per cent this year (from 126 per cent last year). The funding ratios are still exceeding target. The funding ratios of similar interstate workers' compensation schemes were 116 per cent for the Victorian WorkCover Authority and 162 per cent for WorkCover, Queensland.

The actuaries identified issues with the quality of data provided by the schemes

The actuaries of the Workers' Compensation Nominal Insurer and New South Wales Self Insurance Corporation identified areas where data quality could be enhanced. Addressing these issues would reduce uncertainty in the valuation by improving the quality of assumptions. High quality data also assists with monitoring and management of the schemes.

Recommendation

Insurance and Care NSW (icare) should address the data quality issues identified by the schemes' actuaries.

Financial controls

Internal controls at GovConnect are ineffective

GovConnect provides information technology and transactional services to agencies within the NSW Public Sector. GovConnect engaged an independent auditor to provide assurance to its customers on the description of controls, their design and operating effectiveness. The independent auditor could not confirm the effectiveness of GovConnect's internal controls over transactions or the security of data.

Recommendation

GovConnect quickly remediate all issues identified in their independent auditor's assurance reports.

Significant Transition breakdowns from ServiceFirst to GovConnect

Mitigating actions taken to manage the transition from ServiceFirst to GovConnect were ineffective in ensuring effective control over client transactions and data was maintained.

Recommendations

DFSI should re-examine the significant transition breakdowns from ServiceFirst to GovConnect and apply learnings to projects currently being transitioned to the private sector.

DFSI resolve any transition issues that remain between ServiceFirst and GovConnect immediately.

Access security for financial systems is an area of weakness

Information systems audits identified 14 issues for agencies within the DFSI cluster in 2015–16. Over 80 per cent of issues identified in 2015–16 were for information security processes.

Recommendation

Some agencies should strengthen user access to critical financial systems and data.

Governance

Risk management across the cluster is inconsistently applied

Agencies within the cluster have their own risk profile and risk management framework. Risk management is performed at an agency and branch level. Within the cluster the maturity of risk management varies across agencies and branches.

Recommendation

DFSI should review how risk management at an agency level is reported and monitored at the cluster level. A more robust system to collate, manage, identify and escalate risk should be introduced.

Culture is fundamental to successful implementation of risk management

Promoting a risk intelligent culture is fundamental in ensuring public sector agencies are effective in service delivery and policy advice options to government. Risk culture is the combination of ethics, values, behaviours and actions of staff that impact decision making and business outcomes. It is an enabler of successful risk management.

Recommendation

Agencies should develop key performance indicators to measure and assess their risk culture.

Outsourcing arrangements require management of risks associated with third party insurance providers

Insurance and Care NSW outsources some of its critical operational functions to third party service providers. The outsourced functions increase the risk of third party non-compliance which requires a greater emphasis on internal controls, governance, data security and privacy. The outsourced functions should be included in the scope of business continuity management (BCM).

Recommendations

icare should review the outsourcing risks associated with the current transformation program to set up a strong risk governance framework and address key outsourcing risks early in the program.

icare should develop a business continuity management (BCM) policy that is consistent with the group's risk management strategy and framework.

Service delivery

\$1.3 billion rental bonds are held in trust

The Rental Bond Board prepared its financial statements on the basis it holds rental bonds of \$1.3 billion in trust. As a result, it does not record the bonds as assets or a corresponding liability on its balance sheet. In 2012–13, the Crown Solicitor recommended the legislation governing the Rental Bond Board be reviewed and amended to clarify whether the Rental Bond Board holds the bonds in trust or not.

Recommendation

The Rental Bond Board should seek the necessary legislative or other mechanism to confirm its accounting treatment of rental bonds.

Performance reporting for 'return to work' programs is unclear

One of the key features of the reforms introduced by the *Workers' Compensation Legislation Amendment Act 2012* focused on assisting and encouraging workers to return to work after an injury. The existing performance information does not provide trends and benchmarks to assess the success of the return to work program on whether the initiatives are improving outcomes for employees.

Recommendation

icare should design appropriate measures to assess whether programs implemented after the 2012 Workers' Compensation legislation improve workers' return to work.

Sustainability of the home warranty scheme

Home warranty premiums were consistently less than the expected cost of claims since the commencement of the scheme.

Recommendation

The home warranty scheme requires a strategic review to address the gap between premiums and expected claims.

Some agencies are not complying with the digital information security policy

In 2012, the NSW Government issued the Digital Information Security Policy. The policy establishes digital information security requirements for the NSW public sector and the Department of Finance, Services and Innovation (DFSI) monitors it.

Thirteen of 108 agencies required to attest to having a minimum set of information security controls did not do so in their 2015 annual reports.

Recommendation

All agencies should submit their attestation to DFSI annually and this should be monitored by DFSI.

Some agencies' IT strategic plans do not sufficiently address IT risks

IT strategic plans and IT risk registers are key elements of effective governance frameworks. The NSW Government has established an overarching IT strategy to improve service delivery and derive better value from its investments.

Recommendations

Agencies' IT strategic plans should address IT risks.

All agencies should have an IT risk register which aligns with the agency-wide risk register and assign risks to individual owners.

Introduction

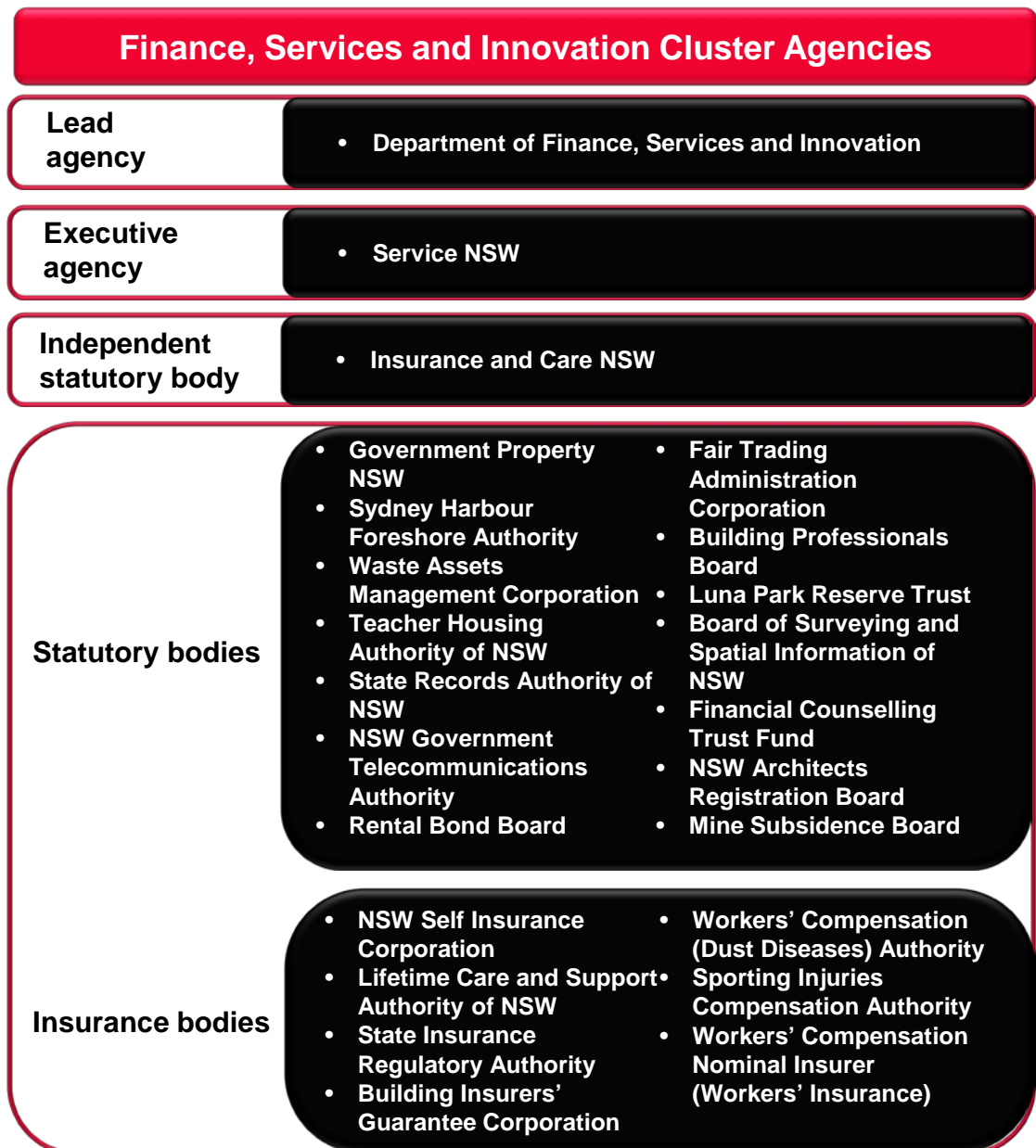
This report provides Parliament and other users of the Finance, Services and Innovation cluster agencies' financial statements with audit results, observations, conclusions and recommendations in the following areas:

- Financial Performance and Reporting
- Financial Controls
- Governance
- Service Delivery.

The cluster formed on 1 July 2015. This is the first report on the cluster.

The Finance, Services and Innovation cluster is responsible for customer and government service delivery, property and asset management, regulation and insurance services, revenue administration, and ICT, digital government and innovation.

Snapshot of the cluster



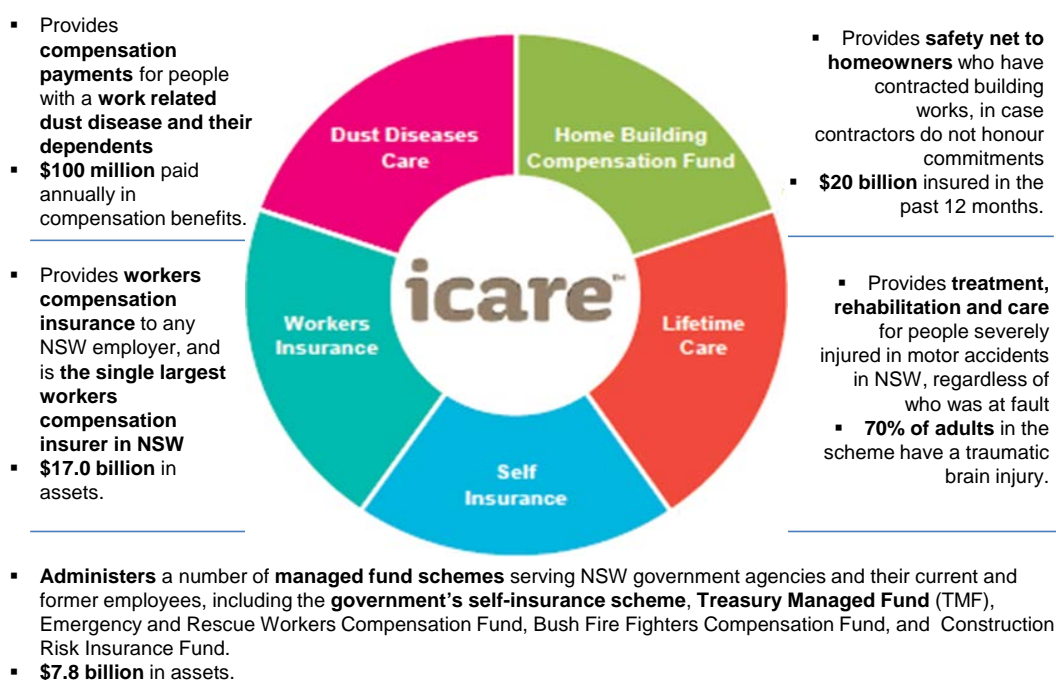
The Department of Finance, Services and Innovation (DFSI) is the lead agency in the cluster. The Secretary of the Department can issue directions to most cluster agencies. The exception is Insurance and Care NSW (icare), which operates as an independent agency.

DFSI is a service provider and regulator. It supports government finances, major public works and maintenance programs, government procurement, information and communications technology, corporate and shared services, consumer protection, workplace health and safety, administration of State taxation and revenue collection, and NSW land and property administration.

The Administrative Arrangements (Administrative Changes - Public Service Agencies) Order 2015, which was effective from 1 July 2015, changed the name of the former Office of Finance and Services to the Department.

Insurance and Care NSW (icare), State Insurance Regulation Authority (SIRA) and SafeWork (a division of DFSI), were created when the *State Insurance and Care Governance Act 2015* commenced on 1 September 2015.

A snapshot of insurance agencies for the year ended 30 June 2016 is shown below.



Source: icare's Statement of Business Intent 2016–17.

icare was established to provide insurance and compensation benefits in New South Wales following the separation of the regulatory and operational functions of the former WorkCover Authority. SIRA was established to take over responsibility for the workers' compensation regulatory function. SIRA is also responsible for SafeWork NSW for health and safety regulation.

icare is one of the largest insurance providers in Australia managing \$32.6 billion in assets and \$27.0 billion in liabilities.

Financial Performance and Reporting

This chapter outlines our audit observations, conclusions or recommendations related to the financial performance and reporting of agencies in the Finance, Services and Innovation (DFSI) cluster for 2015–16.

Financial reporting

Observation - Finance and Services

All audit reports on cluster agencies' financial statements were unqualified. The financial statements of two agencies noted significant uncertainty in the measurement of outstanding claims provisions and their related expenses.

Cluster agencies substantially complied with early close and year-end procedures. However, some agencies did not resolve all accounting issues and provide all supporting working papers by the due dates.

Conclusion or recommendation

The unqualified audit opinions of the two agencies included an 'Emphasis of Matter' paragraph on the significant uncertainty.

Recommendation: Cluster agencies should ensure all supporting documents for early close and year-end are ready by the due dates. All significant accounting issues should be resolved as part of the early close procedures.

Observation - Insurance

Data quality continued to be one of the main issues of concern to the insurance schemes' actuaries.

Work Injury Damages, the entitlement to common law for injured workers, continue to be the third largest payment type and a key risk to the insurance schemes.

Conclusion or recommendation

Addressing data quality issues is a major part of icare's transformation project, including the opportunity to use data to drive efficiency and effectiveness of service delivery outcomes.

Recommendation: Insurance and Care NSW should address the data quality issues identified by schemes' actuaries.

Recommendation: Trends in Work Injury Damages should be monitored to avoid increases in common law claims.

Financial performance

Observation - Finance and Services

Significant variances were found between actual financial performance and budget estimates for some cluster agencies.

Conclusion or recommendation

Recommendation: Cluster agencies should review the 2015–16 budget variances and identify opportunities to improve future year budgets.

Observation - Insurance

Insurance agencies recorded \$6.0 billion in revenue in 2015–16. Total assets were \$32.6 billion and liabilities, \$27.0 billion at 30 June 2016. The agencies recorded a combined operating loss of \$0.9 billion in 2015–16 (\$2.3 billion surplus in 2014–15).

Conclusion or recommendation

The combined operating loss of \$0.9 billion was primarily due to the impact of increased benefits arising from the 2015 Workers' Compensation Insurance and Regulation Reform Package.

The combined funding ratio for New South Wales insurance schemes fell from 126 per cent in 2014–15 to 119 per cent in 2015–16.

Premiums collected are below target break-even premium rates.

Premiums collected continued to exceed claim payments.

The schemes' funding ratios continued to exceed the target levels.

Recommendation: Premium rates should be reviewed annually for all insurance types to ensure long-term financial sustainability of the schemes.

Claim payments are expected to increase in future years following benefit reforms undertaken in 2015. Whilst premiums collected exceeded claim payments in recent years, the increasing future claims' estimates require monitoring.

Quality of financial reporting

All agencies received an unqualified audit opinion

Unqualified audit opinions were issued for all cluster agencies' 30 June 2016 financial statements. Sufficient audit evidence was obtained to conclude the financial statements were free of material misstatement.

Two unqualified audit opinions included an 'Emphasis of Matter' paragraph

- Building Insurers' Guarantee Corporation's financial statements disclosed a \$39.9 million provision for outstanding claims liability. Whilst the liability was calculated using a standard actuarial approach, the actuary noted significant uncertainty associated with the measurement of the provision and related expense item. The actual future claims liability may be materially different to what was reported in the financial statements at 30 June 2016. The uncertainty arises because of:
 - limitations in the reliability of case estimates
 - the complexity of remaining claims
 - the potential impact of the settlement of individual large claims
 - the potential impact of individual court decisions.
- Lifetime Care and Support Authority of NSW's financial statements disclosed a \$2.9 billion provision for participants' care, support services and related expense. Whilst the liability was calculated using a standard actuarial approach, the actuary noted significant uncertainty associated with the estimate of the liability and related expense item because of limited claims experience. The actual future claims liability may be materially different from what was reported in the financial statements at 30 June 2016.

Timeliness of financial reporting

Agencies substantially completed early close procedures

Recommendation

Cluster agencies should ensure all supporting documents for early close and year-end are ready by the due dates. All significant accounting issues should be resolved as part of the early close procedures.

The statutory deadlines for completing early close procedures and submitting financial statements were met. Cluster agencies substantially complied with early close and year-end procedures. However, some agencies did not resolve all accounting issues as part of early close procedures. Some agencies that use the services of GovConnect NSW did not provide supporting work papers by the due dates.

For further details on GovConnect NSW, please refer to section 'Financial Controls' of this report.

Key financial information – Department of Finance and Services and Innovation (DFSI)

Machinery of government changes impacted DFSI's financial operations

The change of the former Office of Finance and Services to the Department significantly impacted the financial results of the Department. Revenue and expenses of the Department increased by 51 per cent and 53 per cent respectively mainly due to appropriation funding received and provided to budget dependent cluster agencies and the first time inclusion of revenue and expenses relating to SafeWork NSW.

Grants expense for the Department's Job Action Plan Payroll Tax Rebates Scheme increased by \$193 million from the prior year's \$64.1 million. The Crown Entity provided additional funding to cover the increased expenses.

The Department's total assets decreased primarily due to the transfer of \$87.6 million of properties to Government Property NSW (GPNSW) and the transfer of \$176 million of personnel services receivables relating to unfunded defined benefits superannuation liabilities recoverable from other agencies. The Crown Entity assumed this liability from 1 July 2015.

Total liabilities of the Department decreased due to the transfer of \$856 million of unfunded defined benefits superannuation liabilities to the Crown Entity.

Appendix 2 provides a summary of financial information of each major cluster agency.

Performance against Budget

Recommendation

Cluster agencies should review the 2015–16 budget variances and identify opportunities to improve future year budgets.

The majority of cluster agencies' financial results varied to budget by more than five per cent. Appendix 3 provides a summary of performance against budget of each major budget dependent cluster agency.

Statement of Comprehensive Income

The Department's net deficit of \$68.5 million was \$52.4 million higher than the \$16.1 million budget due to:

- increased grants and subsidies of \$215 million mainly from the Department's Job Action Plan Payroll Tax Rebates Scheme
- additional redundancy provision of \$15.8 million from ongoing reforms
- assets of \$15.5 million decommissioned following reforms
- SafeWork expenses of \$72.5 million (first time inclusion)
- offset by increased appropriations and government contributions by \$161 million and SafeWork revenue of \$129 million (first time inclusion).

Service NSW's net result exceeded budget by \$16.0 million (20.4 per cent) primarily due to:

- additional capital grants received to accelerate key technology components of the Accelerated Distribution Strategy, the Easy to do Business program and the Digital Licence program

- increased expenses from the opening of new service centres which were offset by decreased grants to Roads and Maritime Services (RMS) as Motor Registries transitioned from RMS to Service NSW
- increased acceptance by the Crown Entity of employee benefit liability from the year-end net present value adjustment.

GPNSW's net deficit was unfavourable to budget by \$203 million due to grants expenses to the Restart NSW Fund of \$200 million which was not included in the budget. Other comprehensive income was largely unbudgeted and mainly reflected the \$82.0 million increase in the property values of GPNSW.

Statement of financial position

The Department's net assets were \$125 million (23.5 per cent) lower than budget due to:

- transfer of properties to GPNSW
- increased liabilities relating to SafeWork
- liabilities relating to the Public Works restructure
- lower investment in plant and equipment.

Service NSW's net assets were \$18.8 million (10.9 per cent) higher than budget primarily due to:

- increased cash due to delays in receiving high-value invoices and other large capital orders in respect of project work
- higher GST receivables
- increased non-current assets due to additional funding
- offset by employee benefits of staff transferred from other agencies.

GPNSW's total assets of \$1.2 billion were \$209 million (21.1 per cent) more than budget due to:

- \$48.3 million increase in cash due to deferral of budgeted remediation works into 2016–17
- \$52.1 million increase in assets held for sale not sold by 30 June
- \$110 million increase in property, plant and equipment from vesting of various properties in 2015–16.

GPNSW's total liabilities were \$63.4 million (21.9 per cent) higher than budget due to:

- \$49.6 million higher land remediation provision due to deferral into 2016–17 of remediation works and revised cost estimates
- \$15.0 million increase in other liabilities relating to deposit monies received on the sale of properties which will not settle until July 2018.

Administered revenues

The Service Delivery chapter of this report and Volume 4 of the Auditor-General's Report to Parliament 2016 contain further details on Administered Revenue.

Key financial information - Insurance

Insurance and compensation agencies		
Nominal Insurer	NSW Self Insurance Corporation	Others
Revenues	Revenues	Revenues
\$3.4 billion (2015: \$3.6 billion)	\$1.3 billion (2015: \$2.3 billion)	\$1.3 billion (2015: \$1.0 billion)
Expenses	Expenses	Expenses
\$4.0 billion (2015: \$2.1 billion)	\$1.8 billion (2015: \$1.8 billion)	\$1.1 billion (2015: \$0.7 billion)
Assets	Assets	Assets
\$17.9 billion (2015: \$17.1 billion)	\$8.3 billion (2015: \$8.5 billion)	\$6.4 billion (2015: \$5.9 billion)
Liabilities	Liabilities	Liabilities
\$14.6 billion (2015: \$13.1 billion)	\$7.5 billion (2015: \$7.2 billion)	\$4.9 billion (2015: \$4.6 billion)

Source: Financial statements (audited).

In 2015–16, insurance agencies recorded \$6.0 billion (\$6.9 billion in 2014–15) in revenue and a net deficit of \$0.9 billion (\$2.3 billion surplus). The value of assets grew to \$32.6 billion (\$31.5 billion) and liabilities increased to \$27.0 billion (\$24.9 billion).

The two largest insurance agencies reported operating deficits

The Workers Compensation Nominal Insurer (Nominal insurer) and the New South Wales Self Insurance Corporation (SiCorp) reported net losses of \$638 million and \$513 million respectively for the year ended 30 June 2016.

The operating result of the Nominal Insurer was impacted by the increases in claims provisions of \$1.1 billion because of the Workers' Compensation 2015 reforms. The reforms restored some of the benefits to injured workers that had been reduced by earlier reforms in 2012. However, it achieved a seven per cent return on investments which minimised the overall negative result.

The operating deficit of the SiCorp was mainly impacted by:

- hindsight payments to member agencies of \$183 million as incentives for improved claims performance
- increases to the claims provision of \$162 million caused by the 2015 reforms
- lower investment returns, falling \$744 million from 12 per cent in 2015 to 2 per cent in 2016.

Other issues

The actuaries identified issues with the quality of data provided by the schemes

Recommendation

Insurance and Care NSW should address the data quality issues identified by schemes' actuaries.

The actuaries of the Nominal Insurer and SiCorp schemes identified areas where data quality could be enhanced. In particular, they noted that some data were either not collected or when collected, were not comparable from year to year to ensure the quality of assumptions used in claims' liability calculations.

Whilst attempts were made to address some of the concerns raised by the actuaries, data quality issues remained. Addressing these issues would reduce uncertainty in the valuation process and assist with monitoring and the schemes' claims liability management.

Work Injury Damages remain a key risk to workers compensation liabilities

The June 2012 and 2015 workers' compensation reforms did not specify any changes to Work Injury Damages. However, changes in the reforms which limit periodic benefits may increase the utilisation of common law benefits as claimants seek higher compensation through other avenues. There is a high degree of uncertainty regarding how common law activity will emerge in the future. In 2016, Work Injury Damages represented 21 per cent and 19 per cent of the Nominal Insurer's and SiCorp's total liabilities for outstanding claims respectively.

Recommendation

Trends in Work Injury Damages should be monitored to avoid increases in common law claims.

There are risks that Work Injury Damages experience may deteriorate because reforms in other areas have increased the likelihood of these claims. Deterioration in worker injury damages experience may offset benefits realised from reforms in other parts of the scheme.

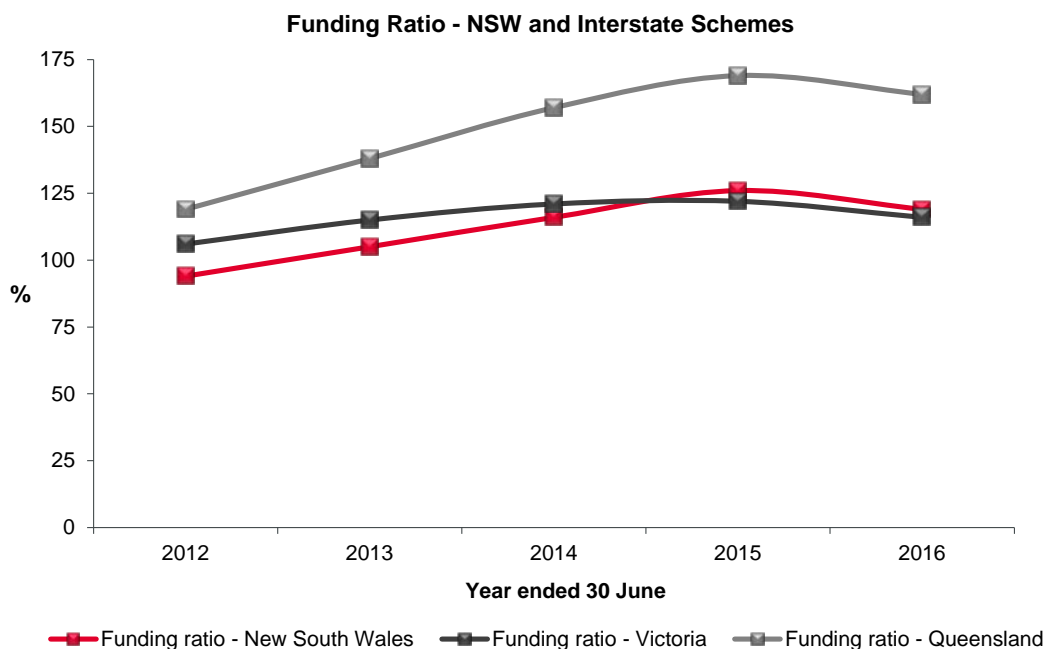
Key risks associated with Work Injury Damages include:

- Tightening of entitlements to weekly and medical benefits for less-seriously injured claimants may result in the use of Work Injury Damages to supplement or extend claim benefits
- Reductions in legal activity for statutory lump sum benefits may result in legal firms focusing their attention on Work Injury Damage claims
- Claimants with a lower whole person impairment (WPI) score may find it more beneficial to make a Work Injury Damage claim
- Follow-up WPI assessments, as a result of the introduction of the Worker Assistance Program, could cause an increase in follow-up assessment scores resulting in more Work Injury Damages' claims.

Financial performance

Funding ratios declined slightly following the 2015 Reforms

The movements in surplus (represented by the funding ratio) over the last five years for New South Wales and similar schemes in Victoria and Queensland is shown below.



Source: Financial statements (audited) for Nominal Insurer, New South Wales Self Insurance Corporation, WorkSafe Victoria and WorkCover Queensland.

The combined funding ratio for New South Wales (comprising Nominal Insurer and SiCorp) fell to 119 per cent this year (126 per cent in 2014–15). The funding ratios of similar interstate workers' compensation schemes were:

- 116 per cent for the Victorian WorkCover Authority
- 162 per cent for WorkCover, Queensland.

The decline in the funding ratio in New South Wales was largely due to the 2015 benefit reforms which reversed some of the earlier changes in 2012.

Predicting the funding ratio into the future is difficult because it depends on several factors, some of which are outside of the schemes' control. Key factors impacting on the funding ratio include:

- Investment returns are better (or worse) than expected
- Claims experience is better (or worse) than expected
- Discount rates remain at current low levels or return to a long-term average
- Premium rates remain unchanged.

Premiums collected are below target premium rates

Recommendation

Premium rates should be reviewed annually for all insurance types to ensure long-term financial sustainability of the schemes.

Premiums collected for 2014–15 and 2015–16 were below the target premium rate. The target premium rate is advised by the schemes' actuary at the beginning of the financial year. However, the actual premium rate levied by the schemes may differ to the target rate to maintain a stable premium rate environment for employers.

There is considerable uncertainty in determining the target premium rate including:

- variability in future investment returns
- the impact of the 2012 and 2015 reforms.

Breakeven premium rates need to be closely monitored to ensure the schemes collect sufficient premium to cover costs.

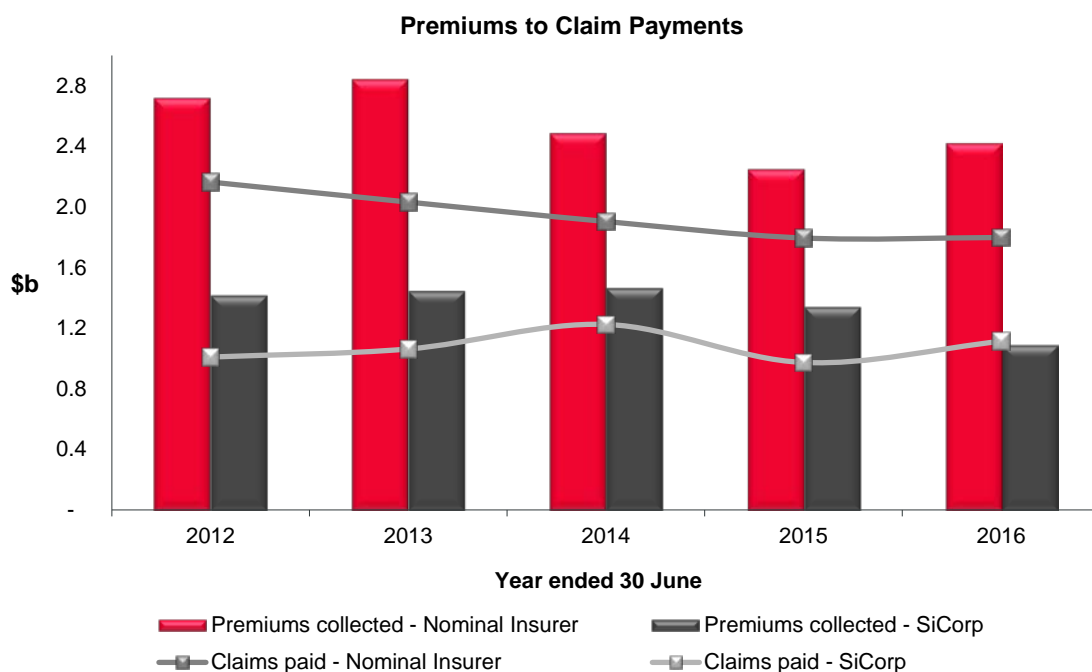
Premiums collected decreased over the last five years

Since 2012, premiums collected by the Nominal Insurer fell by 11 per cent whilst claims fell by 17 per cent. In SiCorp, premiums fell by 23 per cent whilst claims grew by 10 per cent.

Premiums fell in SiCorp in 2015–16 largely due to the hindsight adjustment resulting in \$183 million being refunded to agencies.

The falling trend in premiums collected by the Nominal Insurer largely reflects premium reductions announced by government in 2013 and 2014.

The trends in premiums collected and claims paid for the last five years are shown below.



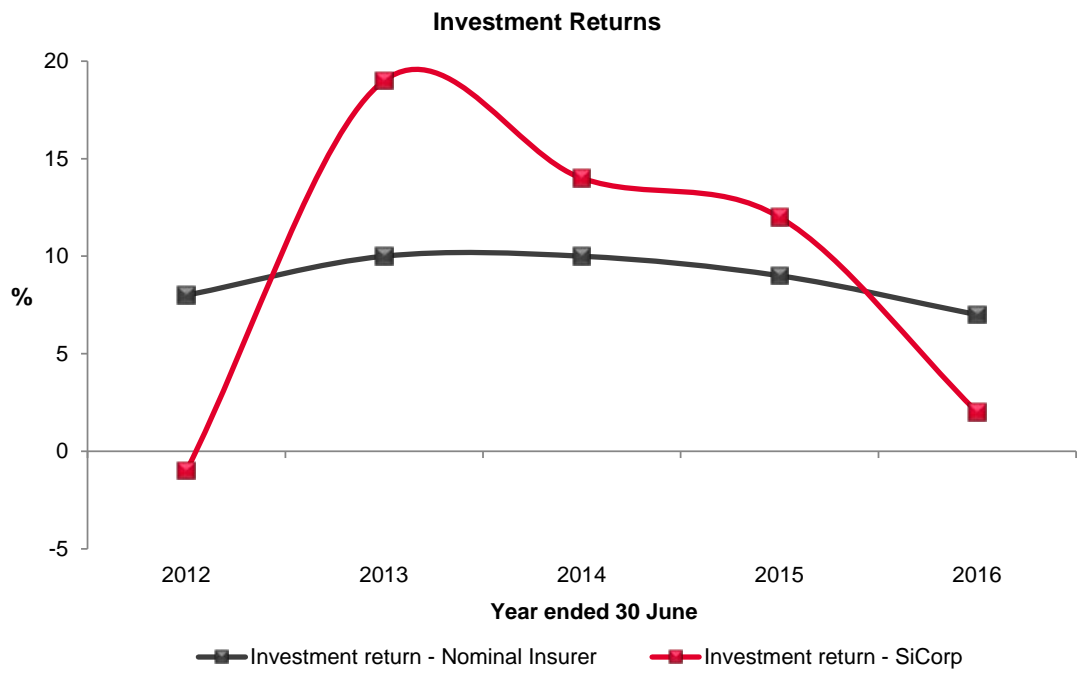
Source: Financial statements (audited).

Investment returns varied significantly across insurance schemes

The value of the Nominal Insurer's investments grew to \$15.8 billion and SiCorp to \$7.7 billion at 30 June 2016.

Investments of the Nominal Insurer and SiCorp returned 6.6 per cent and 2.2 per cent respectively in 2015–16. Differences in the investment returns reflect the investment styles of each scheme. Nominal Insurer primarily invests in indexed and interest bearing securities, while SiCorp invests in growth assets. Growth assets are subject to higher volatility.

Investment returns for each scheme over the last five years is shown below.



Source: Financial statements (audited).

Financial Controls

This chapter outlines audit observations, conclusions or recommendations related to the financial controls of agencies in the Finance, Services and Innovation (DFSI) cluster for 2015–16.

Financial controls

Observation

Internal controls at ServiceFirst and GovConnect NSW (GovConnect) were ineffective during the 2016 financial year.

Significant breakdowns in the transition from ServiceFirst to GovConnect.

Access security for financial systems is an area of weakness.

Conclusion or recommendation

Clients of ServiceFirst and GovConnect were unable to rely on internal controls increasing the risks of fraud, error and inappropriate access to data.

Recommendations: DFSI resolve any transition issues that remain between ServiceFirst and GovConnect immediately.

GovConnect quickly remediate all issues identified in their independent auditor's assurance reports.

Recommendation: DFSI should re-examine the significant transition breakdowns and apply learnings to projects currently being transitioned to the private sector.

Recommendation: Some agencies should strengthen user access to critical financial systems.

Appropriate financial controls help ensure the efficient and effective use of resources and the implementation and administration of policies. They are essential for quality and timely decision making to achieve desired outcomes.

Internal controls

Internal controls at GovConnect were ineffective in 2015–16

Recommendation

GovConnect quickly remediate all issues identified in their Independent Auditor's Assurance reports.

GovConnect provides information technology and transactional services to agencies within the NSW Public Sector. GovConnect's independent auditor issued qualified assurance reports on the description of controls, their designs and operating effectiveness for the period from 14 December 2015 to 30 June 2016 relating to the following services:

- Information Technology by Infosys and Unisys
- General Ledger by Infosys
- Accounts Receivables by Infosys
- Fixed Assets by Infosys
- Accounts Payable by Infosys.

For payroll services provided by Infosys, GovConnect received an adverse assurance report on the description of controls, their design and operating effectiveness for the same period.

Disclaimer of opinion for the former ServiceFirst

The former ServiceFirst received a disclaimer of opinion on the description of controls of all services, their design and operating effectiveness for the period from 1 July 2015 to 13 December 2015. The independent assurance provider was not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Customers were unable to rely on controls

Customers using these services are unable to rely on controls over financial transactions and information increasing the risk of fraud, error and inappropriate access to information. This increased audit risks, resources and costs in auditing the financial statements of user agencies.

Chief Financial Officers of agencies relying on these service providers may be unable to certify the effectiveness of internal controls and agencies may be in breach of section 11 of the *Public Finance and Audit Act 1983*.

Transition breakdowns to GovConnect

Recommendations

DFSI should re-examine the significant transition breakdowns from ServiceFirst to GovConnect and apply learnings to projects currently being transitioned to the private sector.

DFSI resolve any transition issues that remain between ServiceFirst and GovConnect immediately.

Mitigating actions taken to manage transition risks from ServiceFirst to GovConnect were ineffective in ensuring effective control over client transactions and data was maintained. DFSI will need to closely monitor GovConnect's remedial actions to achieve unmodified audit opinions in 2016–17.

No high risk internal control issues

Except for GovConnect issues (as above), there were no other high risk matters reported across the cluster as a result of the 2015–16 financial audits. It was noted that the number of repeat findings from previous years had decreased.

Common internal control issues noted across the cluster included:

- lack of review of vendor master file changes
- non-compliance with *Public Authorities (Financial Arrangements) Act 1987* approvals
- employees with excess annual leave balances
- inadequate legal compliance frameworks
- lack of service level agreements between GovConnect and user agencies.

Some minor observations around reconciliations and compliance with delegations were also noted.

Information technology

Information systems audits identified 15 issues for the agencies within the DFSI cluster in 2015–16.

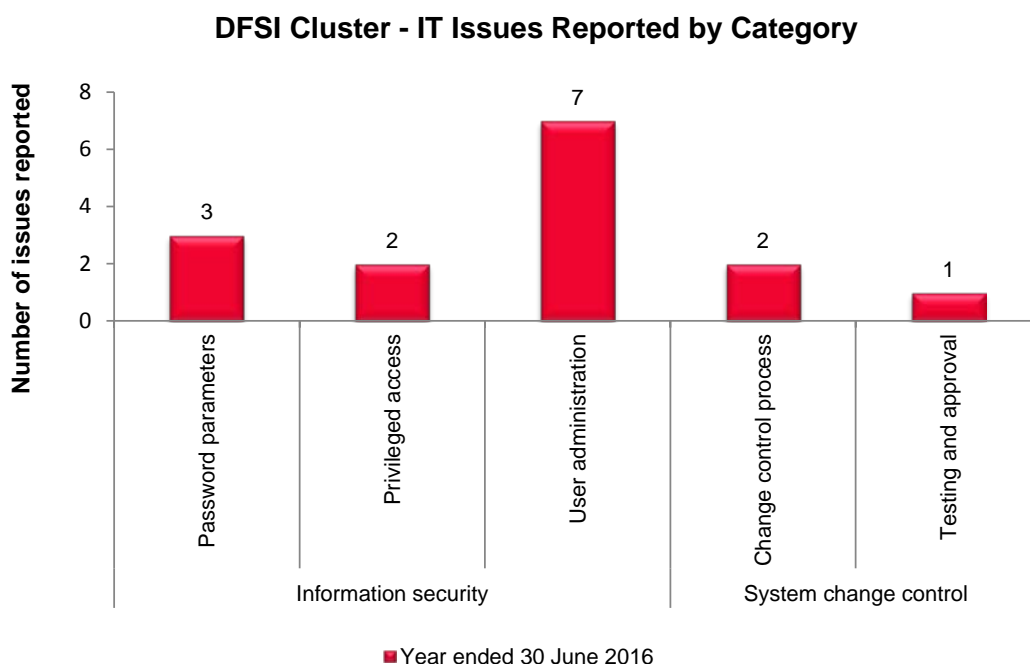
Access security for financial systems is an area of weakness

Recommendation

Some agencies should strengthen user access to critical financial systems.

Information Technology (IT) processes and controls support the integrity of financial data used to prepare the financial statements. Processes and controls reduce the risk of unauthorised access, security attacks, data breaches and identity theft.

The graph below categorises each IT issue identified and shows the frequency.



Source: Information Technology audit findings and recommendations identified for the DFSI cluster.

Eighty per cent of issues identified in 2015–16 were for information security processes. User administration is the largest IT issue in agencies. Weak user administration processes increase the risk of excessive or unauthorised access to systems. This can be compounded where privileged access is not monitored. These compromise the integrity and security of data residing in these systems.

Asset valuations

No significant issues were identified in asset valuations

In Volume 4 of the Auditor-General's 2016 report, we identified that 'opportunities exist for improvements, particularly in the area of asset revaluations'.

The following agencies in the cluster performed a comprehensive valuation of their assets or part of their assets in the current year:

- Department of Finance Services and Innovation
- Sydney Harbour Foreshore Authority
- Teacher Housing Authority
- Government Property NSW.

Independent experts were appropriately engaged. Our review of expert's reports did not identify any significant exceptions.

Governance

Governance refers to the high-level frameworks, processes and behaviours established to ensure an entity performs by meeting its intended purpose, and conforms with legislative and other requirements, and meets expectations of probity, accountability and transparency.

Good governance promotes public confidence in government and its agencies. Sound governance is paramount to service delivery and the economic and efficient use of taxpayers' money.

Governance

Observation – Finance and Services

The Department of Finance Services and Innovation (DFSI) cluster was established 1 July 2015.

Risk management across the Cluster is inconsistently applied.

A strong risk culture is fundamental to the success of an effective risk management in the organisation.

Conclusion or recommendation

Significant machinery of government changes transformed both the department and management of the State's insurers and regulators.

Recommendation: DFSI should review how risk management at an agency level is reported and monitored at the cluster level. A more robust system to collate, manage, identify and escalate risk should be introduced.

Recommendation: Agencies should develop key performance indicators to measure and assess their risk culture.

Observation - Insurance

Whilst icare is not an APRA regulated entity its governance structure is in line with APRA's best practice guidelines.

icare is in the planning phase of implementing its Risk Management framework and strategy. A Chief Risk Officer was appointed to drive the process.

A number of operational functions are outsourced to third party providers.

Conclusion or recommendation

icare's governance structure is robust and geared towards meeting its purpose, vision and business objectives.

icare is currently developing its risk management framework and strategy including capital management policies to protect its capital. A gap analysis against APRA's prudential standards was performed to design a best practice risk management framework and processes.

Recommendations: icare should review the outsourcing risks associated with the current transformation program to set up a strong risk governance framework and address key outsourcing risks early in the program.

icare should develop a business continuity management policy that is consistent with the group's risk management strategy and framework.

Governance across the DFSI Cluster

Machinery of government changes transformed the cluster

The cluster was formed following machinery of government changes announced within the Administrative Arrangements (Administrative Changes—Public Service Agencies) Order 2015.

The *State Insurance and Care Governance Act 2015*, created Insurance and Care NSW (icare), the State Insurance and Regulatory Authority and SafeWork NSW.

Transformation

Transformation across DFSI is extensive

DFSI is undergoing significant transformational change across businesses, personnel, systems and governance.

During 2016 the following businesses were being transformed:

- StateFleet will no longer maintain a motor vehicle fleet to service the demands of the sector
- NSW Public Works Construction Services Group was sold and other services are being rationalised
- a long term concession for the management of titling and registry services business of Land and Property Information is being offered
- Decommissioning of ServiceFirst and commissioning of GovConnect.

Governance changes

Many executive governance team members are new to the cluster

Governance changes have been significant with the appointment of new senior governance executives and independent audit and risk committee members. There remains a heightened level of risk while new governance team members gain a fuller understanding of operations.

Structure

Cluster arrangements

Cluster arrangements are not defined, accountability is unclear

The definition of the cluster has never been sufficiently established within the legislation. Lacking definition creates significant issue over control, responsibility and accountability. The role of the Cluster Secretary, Cluster CFO, Cluster CIO and the Cluster CRO has not been addressed. Some independent bodies can report directly to their minister bypassing cluster governance protocols.

Volume Six of the Auditor-General's 2016 report will further discuss this issue.

Risk management

Risk management across the cluster is inconsistently applied

Recommendation

DFSI should review how risk management at an agency level is reported and monitored at the cluster level. A more robust system to collate, manage, identify and escalate risk should be introduced.

Agencies within the cluster have their own risk profile and risk management framework. Risk management is performed at an agency and branch level. Within the cluster the maturity of risk management varies across cluster agencies and branches.

DFSI should review how risks at an agency level are captured and escalated to a cluster level so they can be managed, treated and reported. Current risk management tools are basic and manual, the risk culture throughout the agencies is inconsistent, though developing.

Effective risk management can improve decision making and lead to significant efficiencies and cost savings. By embedding risk management directly into processes and culture, agencies can derive additional value from their risk management programs. The more mature

an agency's risk management, the stronger its culture in balancing the tension between value creation and protection.

Risk culture

Culture is fundamental to successful implementation of risk management

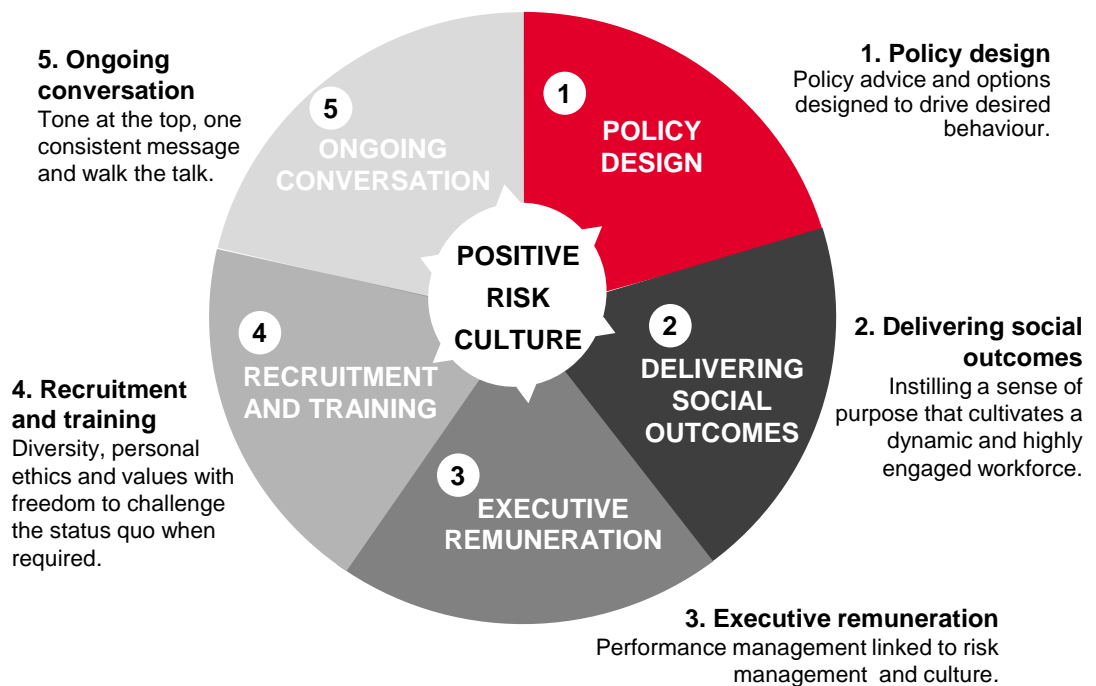
Recommendation

Agencies should develop key performance indicators to measure and assess their risk culture.

Culture is one of the five critical assessment criteria in the Audit Office's assessment of risk maturity in the published Risk Management Maturity Assessment Tool.

Promoting a risk intelligent culture is fundamental in ensuring public sector agencies are effective in service delivery and policy advice options to government. Risk culture is the combination of ethics, values, behaviours and actions of staff that impact decision making and business outcomes. It is an enabler of successful risk management.

Key elements of risk culture in the public sector



Assessing risk culture in an organisation can be challenging and difficult. However, some practical ways of gauging an organisation's risk culture include:

- conducting culture surveys and workshops
- organising focus groups of staff at various business units and at different levels
- using established assessment services in the market
- documenting internal audit and risk management units' views on risk culture through observations during routine engagements.

Insurance governance arrangements

Governance arrangement in line with APRA's prudential standards

icare is not regulated by the Australian Prudential Regulatory Authority (APRA), however, to ensure best practice, it set up a governance structure that aligns closely with APRA standards. The Board is accountable to the Minister for Finance, Service and Property.

APRA's publication on the 'Importance of good governance' includes the following areas of focus:

- structure and membership of boards and their committees - quality of board deliberations and the strength of board's 'constructive challenge'
- risk governance - a strong and independent risk management function to ensure risk-taking remains within the board's risk appetite
- effectiveness of risk governance - independent assurance of business units and risk management function
- values and risk culture - meeting customer needs.

The governance structure at icare is robust and geared to meet its purpose and business objectives.

APRA's prudential standard CPS 510 on Governance sets out minimum foundations for good governance. The following table compares key requirements from the standard and icare's governance arrangements against best practice:

CPS 510 Governance	
Best practice	Governance requirements at icare
Board size and composition (minimum five)	The Board comprises nine members including the Chief Executive officer. Eight out of the nine are non-executive directors
Chairperson of the Board is independent director	The Chairperson of the Board is an independent director
Board renewal and assessing Board's performance	The Board has a policy on Board renewal and procedures for assessing Board's performance
Board Remuneration Committee established and Remuneration policy aligns with remuneration and risk management	People and Remuneration Committee is established
Board Audit Committee and Board Risk Committee established	Risk, Compliance and Audit Committee is established and meets at least four times a year

Risk management and compliance

Risk management is in the early stages of implementation

We assessed icare's risk management maturity assessment using the Audit Office's Risk Management Maturity Toolkit. The assessment covered the following key areas of risk management:

- Strategy and Governance
- Monitoring and Review
- Process
- Systems and Intelligence
- Culture.

The outcome of our assessment concluded that icare was in the planning phase of implementing its Risk Management framework.

icare is applying APRA best practice guidelines to improve risk maturity

Applying best practice industry standards will set the tone for business decisions and enhance governance. The requirements of APRA's prudential standard CPS 220 Risk Management in the context of best practice includes the following elements which icare is working to achieve:

CPS 220 Risk Management	
Best practice	Risk management at icare
Business Plan	Statement of Business Intent for 2016–17 finalised which considers material risks associated with its strategic objectives and business plan
Risk Management Strategy (RMS)	Developing its Risk and Governance strategy and its Risk Management Framework
Risk Management policies and procedures	icare is developing its Risk Management policies and procedures
Chief Risk Officer	Chief Risk Officer appointed in December 2015
Risk Management Function	The set-up of the Risk Management function is in progress
Independent reviews	Not commenced
Risk Appetite Statement (RAS)	The RAS for icare was finalised and approved by the Board in June 2016
Internal Capital Adequacy Assessment Process (ICAAP)	Developing its Capital Management Policy building its capital projection model
Scenario Analysis and stress testing	Not commenced
Risk Management information system (MIS)	Reporting of strategic risks to the Board is occurring. The Governance Risk and Compliance system, once in place, is expected to streamline reporting of risks, compliance and governance matters
Annual Risk Management declaration	Currently through the Internal Audit and risk management declaration to Treasury
Reporting significant breaches to the Board	Quarterly risk reporting to Board covers significant issues

Building a successful risk culture

icare is in the process of establishing a strong risk culture. There is a top-down approach to risk management where the Board and senior management set the tone at the top.

Outsourcing risk

Risks associated with third party service providers

Recommendations

icare should review the outsourcing risks associated with the current transformation program to set up a strong risk governance framework and address key outsourcing risks early in the program.

icare should develop a Business Continuity Management policy that is consistent with the group's risk management strategy and framework.

icare outsources critical operational functions to third party service providers.

Insurance management is outsourced to five scheme agents. They provide policy and claim management services in the NSW workers compensation scheme on behalf of the Nominal Insurer and the New South Wales Self Insurance Corporation. icare will in-source its premium collection functions in 2016 for its workers' insurance scheme.

NSW Treasury Corporation (NSW TCorp) is the investment manager for the investment assets. Its performance is monitored against a service level agreement.

The outsourced functions increase the risk of third party non-compliance which requires a greater emphasis on internal controls, governance, data security and privacy. Identifying and addressing outsourcing risks early in the process will ensure greater benefits from these arrangements.

Disruptions to outsourced functions have the potential to have a negative effect on the reputation and operational capacity of the entity. The outsourced functions should be included in the scope of business continuity management (BCM). The BCM should include a Business Continuity Plan (BCP) to support business - level recovery in the event of a major disruption and a Disaster Recovery Plan (DRP) that addresses key information technology systems and applications. icare should ensure the BCP is aligned with its level of risk appetite and risk tolerance.

Ethics

Fraud control

Reporting of allegations of fraud decreased across the cluster

During times of significant change the risk of fraud heightens. There has not been a significant increase in reported fraud across the cluster during the year.

Service Delivery

This chapter outlines our audit observations, conclusions and recommendations related to service delivery by agencies in the Finance, Services (DFSI) and Innovation cluster for 2015–16.

Service Delivery

Observation – Finance and Services

Record administered revenue collected in 2016.

Transformations continue across the Department of Finance, Service and Innovation.

In 2012–13, the Crown Solicitor recommended the legislation governing the Rental Bond Board be reviewed and amended to clarify whether or not the Rental Bond Board holds the bonds in trust.

Some agencies are not complying with the Digital Information Security Policy.

Some agencies' IT strategic plans do not sufficiently address IT risks.

Formulation and mitigation of IT risks is inconsistent amongst agencies.

Shared service provider Service Level Agreements (SLAs) do not adequately address IT security.

Conclusion or recommendation

DFSI collected \$27.3 billion (\$25.0 billion in 2015) in taxes, fines and fees.

StateFleet has ceased leasing motor vehicles. Expressions of interest will be called to operate Land and Property Information (LPI) businesses. Public works no longer focuses on providing infrastructure delivery services.

Recommendation: The Rental Bond Board should seek the necessary legislative or other mechanism to confirm its accounting treatment of rental bonds.

Recommendations: All agencies should submit their attestation to DFSI annually and this should be monitored by DFSI.

Recommendation: Agencies' IT strategic plans should address IT risks.

Recommendations: All agencies should have an IT risk register which aligns with the agency-wide risk register and assign risks to individual owners. Agencies should collaborate when formulating and reviewing IT risks.

Recommendation: Agencies that use shared service providers should ensure their SLAs sufficiently cover IT security risks and controls.

Observation - Insurance

There was no clear reporting process to determine whether the rate of workers returning to work after injury, a key aspect of the 2012 reforms, is improving.

icare is transforming service delivery in insurance and care to enhance customer experience.

Conclusion or recommendation

Recommendation: icare should design appropriate measures to assess whether programs implemented after the 2012 Workers Compensation legislation improve workers' return to work.

Recommendation: icare should design detailed measurable performance objectives for specific outcomes from its strategic plan and report on performance against these measures in its annual report.

New South Wales Green Slips are the most expensive in Australia. The NSW Government announced a major review of the Compulsory Third Party Motor Accident Insurance Scheme (Green Slip).

The NSW Government expects the outcome of the review will include a reduction in the cost of Green Slips in New South Wales and an increase in the proportion of benefits provided to the most seriously injured road users.

The home warranty scheme continued to report a significant funding shortfall because premium collection was not sufficient to cover expected claims costs.

Recommendation: The home warranty scheme requires a strategic review to address the gap between premiums and expected claims.

State Priorities

DFSI has a key role in delivering on 'NSW - Making it Happen', including driving the following priorities:

- Make NSW the easiest state to start a business
- Improve customer satisfaction with government services, every year
- 70 per cent of government transactions conducted via digital channels by 2019.

It also contributes to Premier's and State Priorities through finance and services, regulation and people.

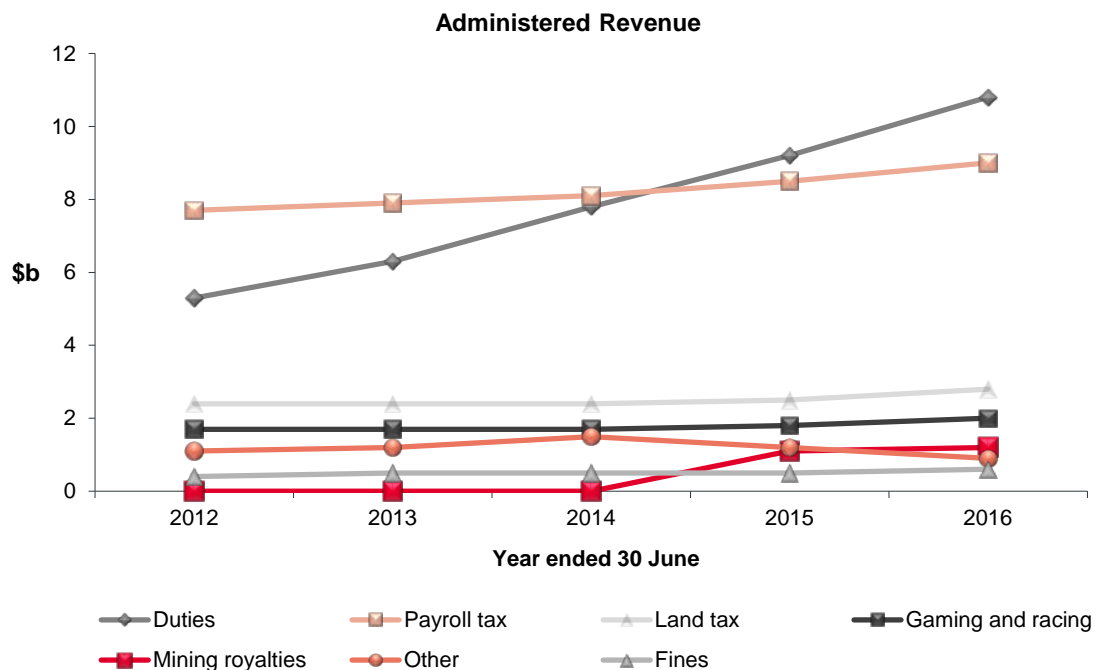
Finance and services

Office of State Revenue (OSR)

Record administered revenue collected in 2016

OSR (Division of DFSI) administers State taxation and revenue, manages fines and administers grants and subsidies and recovers State debt.

DFSI collected \$27.3 billion (\$25.0 billion in 2015) in taxes, fines and fees.



Source: Audited financial statements.

Duties have increased by 17.3 per cent since last year and have doubled since 2012. The continued strength in the property market has seen strong sustained growth in transfer duties confirmed by increases in land and property title information transfers.

Payroll Tax increased by 5.8 per cent since last year mainly as a result of wage and employment growth. The tax rate remained constant this year at 5.45 per cent but has increased to 5.75 per cent from 1 July 2016.

2015–16 was the second full year that DFSI was responsible for mining tax royalties.

Performance measures

Performance measures					
Year ended 30 June	2016	2015	2014	2013	2012
Percentage of electronic transactions	93	91	90	--	--
Cost to collect \$100 taxation (\$)	0.45	0.47	0.48	0.50	0.50
Cost to administer \$100 fines (\$)	8.62	10.97	9.42	10.10	12.20

Source: DFSI unaudited.

The percentage of electronic transactions (mainly taxes) remains high and supports the State Priority of 70 per cent of government transactions conducted electronically by 2019.

The cost to collect \$100 of taxation has been reducing slightly over the past five years. The cost to administer fines has more volatility due to its nature and complexity.

Land and Property Information

Strong property activity drives higher revenues

Land and Property Information provides for land titling and conveyancing, surveying, valuation, spatial information and related matters. LPI supports the statutory functions of the Registrar General, Surveyor General and the Valuer-General, protects land titles and cadastral integrity in NSW.

Revenue					
Year ended 30 June	2016	2015	2014	2013	2012
	\$'000	\$'000	\$'000	\$'000	\$'000
Titling revenue	193,059	183,216	168,829	146,765	140,619
Valuation revenue	21,871	21,224	18,034	16,493	17,885

Source: Audited DFSI financial report.

The continued increases in titling revenue are underpinned by the strong activity in the property market. Titling revenue has increased 5.4 per cent over 2015 and 37 per cent since 2012. This correlates to a 3.8 per cent increase in document registrations since 2015 and 29.5 per cent increase since 2012.

Performance measures					
Year ended 30 June	2016	2015	2014	2013	2012
	000's	000's	000's	000's	000's
Documents registered	935	901	844	739	722
Plans registered	11	11	10	9	9

Source: LPI unaudited.

Expressions of interest will be called to operate LPI businesses

From 1 July 2016, LPI separated into five discrete business units integrated into DFSI. The government has announced its intention to invite the private sector to tender for LPI's titling and registry services under a long-term concession.

StateFleet

StateFleet has ceased leasing motor vehicles

In August 2015, the government announced that StateFleet, the agency responsible for providing fleet management and leasing services, would be replaced by a new model to manage the State's fleet of 22,000 passenger and light commercial vehicles.

The new fleet model, consisting of a competitive leasing panel and two separate fleet management suppliers was implemented from July 2016.

StateFleet					
Year ended 30 June	2016	2015	2014	2013	2012
	\$'000	\$'000	\$'000	\$'000	\$'000
Motor vehicle leasing	182,133	184,225	180,629	185,355	192,690
Proceeds from sales of MV	115,982	126,688	110,184	125,582	146,715
Written down value of MV sold	(99,630)	(115,337)	(100,722)	(107,148)	(118,775)
Net proceeds	16,352	11,351	9,462	18,434	27,940

Source: Audited DFSI Financial Report.

Services

Service NSW

Service NSW is expected to be self-funding by 2018

Service NSW delivers transactional services to customers across New South Wales through digital, phone and a network of one-stop shops and other points of presence.

Contributing to government transactions being conducted electronically, Service NSW continues its growth towards fully sustainable operations by 2017–2018.

Performance measures			
Year ended 30 June	2016	2015	2014
Digital transactions (% of all transactions)	43	37	25
Transactions offered	992	800	800
Sustainability gap (contributions)	\$395,799	\$310,750	\$118,759

Source: SNSW unaudited.

The sustainability gap represents capital and recurrent contributions that need to be achieved through user charges from 2017–18 onwards. Grants and contributions budgeted for 2016–17 are estimated at \$338 million.

NSW Public Works

NSW Public Works provides expert advice and professional services in the commissioning, design, and delivery of community infrastructure and environmental projects.

Revenue					
Year ended 30 June	2016	2015	2014	2013	2012
	\$'000's	\$'000's	\$'000's	\$'000's	\$'000's
Project and asset management services revenue	134,299	131,998	134,738	167,146	174,706

Source: Audited DFSI Financial Report.

NSW Public Works transformation

Public Works no longer focuses on providing infrastructure delivery services

In June 2015, the NSW Government announced a series of reforms to NSW Public Works in order to optimise the delivery of the State's public infrastructure and more effectively leverage private sector services and experience.

During 2015–16, the NSW Public Works transformation moved the division's core focus away from project management, design and delivery of infrastructure services into providing expert strategic advice and commissioning services.

From 1 July 2016, NSW Public Works Advisory commenced operating as a specialist advisor to support local councils and government agencies in Water Solutions, Heritage Asset Advisory, Regional and Rural and Emergency Engineering Management services. Additionally

the Construction Services Group business was sold to TJS Services Pty Ltd with 51 staff accepting offers of employment with the new owner.

GPNSW

GPNSW greatly contributed towards the Government's Assets Recycling initiative

Government Property NSW (GPNSW) had received \$89.7 million from property divestments and paid \$200 million into the Restart NSW fund during 2015–16.

The Sydney Harbour Foreshore Authority (SHFA) also earmarked a number of surplus properties for divestment under the Government's Assets Recycling initiative.

Information Technology (IT) Governance and Security

Whole of government ICT strategy update

Digital+ 2016 was launched and the NSW Government ICT Strategy updated. The update set out seven priority areas for ICT reform including the expansion of digital services through Service NSW, open government, data sharing and analytics, cyber security, ICT procurement, ICT investment, and ICT skills and capabilities.

GovDC

The Government Data Centre (GovDC) reform included the migration of NSW mandated agencies to two purpose-built data centres by August 2017. At June 2016, 81 per cent of the data centre space was being taken up by NSW Government departments and marketplace providers.

Digital Information Security Policy

In 2012, the NSW Government issued the Digital Information Security Policy. The policy establishes digital information security requirements for the NSW public sector and the Department of Finance, Services and Innovation (DFSI) monitors it. It requires agencies:

- to maintain an Information Security Management System that takes into account a minimum set of controls
- if they are a shared service provider, to obtain independent certification that these controls meet the requirements of the ISO 27001 information security standard
- to attest to the adequacy of information security in their annual report.

Some agencies are putting the government's policy objectives at risk

Recommendation

All agencies should submit their attestation to DFSI annually and this should be monitored by DFSI.

Thirteen of 108 agencies required to attest to having a minimum set of information security controls did not do so in their 2015 annual reports. This increases the risk of the government's policy objectives not being achieved.

Year ended 30 June	Attestation status			
	2015		2014	
Agency category	# expected	# not received	# expected	# not received
Principal departments	9	0	9	0
Other agencies	108	13	95	13

Source: Department of Finance, Services and Innovation (unaudited).

DFSI advises that it will continue to work with agencies to enable higher levels of compliance with the policy, support good information security practice and reduce the incidence of security vulnerabilities in agency IT systems.

A 2010 performance audit on Electronic Information Security reported:

- 'The government cannot say with any certainty whether agencies have implemented its policy. As a result, the government does not know how well agencies are securing sensitive personal information'
- 'Progress toward compliance and certification has not been effectively monitored.'

The Digital Information Security Policy objectives are:

- 'confidentiality – to uphold authorised restrictions on access to and disclosure of information including personal or proprietary information
- integrity – to protect information against unauthorised alteration or destruction and prevent successful challenges to its authenticity
- availability – to provide authorised users with timely and reliable access to information and services
- compliance – to comply with relevant legislation, regulations, Cabinet Conventions, policies and contractual obligations requiring information to be available, safeguarded or lawfully used
- assurance – to provide assurance to NSW Parliament and the people of NSW that information held by the government is appropriately protected and handled.'

Some agencies' IT strategic plans do not sufficiently address IT risks

Recommendation

Agencies' IT strategic plans should address IT risks.

IT strategic plans and IT risk registers are key elements of effective governance frameworks. The NSW Government has established an overarching IT strategy to improve service delivery and derive better value from its investments. We assessed IT strategies and risk registers in a selection of agencies, which are financially significant to the State's accounts.

Each agency we reviewed had based its IT strategy on its overall strategy. Most IT strategic plans were current. However, some do not adequately address the IT risks of the agency. Without this linkage, the agency's key IT risks may not be mitigated and result in resources being directed at areas that do not provide the most benefit.

Agencies should define their IT direction and priorities based on their overall strategy and consider technology risks as part of their broad risk management activities. Consideration of the risks documented in IT risk registers should not be confined to the IT function.

Formulation and mitigation of IT risks is inconsistent amongst agencies

Recommendations

All agencies should have an IT risk register which aligns with the agency-wide risk register and assign risks to individual owners.

Agencies should collaborate when formulating and reviewing IT risks.

Most of the agencies' registers we reviewed had been updated in the preceding 12 months. However, it was unclear how some agencies aligned their IT risks to the agency-wide risk register. Some agencies did not have an owner for each risk or had not assigned them to an individual for accountability.

Failing to adequately manage IT risks, rated as extreme or high, exposes agencies to serious disruption, unauthorised manipulation of information, breaches of confidentiality and significant costs.

The IT risks identified by the agencies were many and varied. Some agencies' risk registers rated at least one risk as extreme or high where mitigation strategies were not considered sufficiently effective to reduce the threat to acceptable levels. In some cases, however, agencies identified similar extreme/high risks where they believed the controls in place sufficiently mitigated the risk to a moderate or lower rating.

Agencies with similar IT risk profiles should consider collaborating with each other to leverage their understanding of the risks they face, their probability and impact, and the controls that most effectively mitigate the risks.

The table below shows the top 10 common risks in the agencies we reviewed that were rated as extreme or high before mitigation.

Top 10 common extreme/high IT risks

Ineffective or inappropriate levels of IT security controls resulting in unauthorised access to information, virus/malware infections, and/or successful website intrusion

Unauthorised or inappropriate access is granted to the systems and data

External vendors do not meet contracted service level agreements

IT fails to support business needs

Failure to provide business critical services and security due to the outdated data centres or critical hardware devices have also reached end-of life

Insufficient IT resources to meet demand and deliver IT services

Failure to properly provide business application support resulting in failure to provide services, or resolve issues in a timely manner

Inadequate or unsecure design of the front end environment causes risk of information being compromised

The end-to-end deployment may not be achievable within the planned timeline

Lack of disaster recovery solution/planning

Source: Summary based on information provided by agencies (unaudited).

Shared service provider agreements do not adequately address IT security

Recommendations

Agencies that use shared service providers should ensure their Service Level Agreements sufficiently cover IT security risks and controls.

When agencies rely on a shared IT service provider, the Service Level Agreements (SLAs) should ensure their IT security requirements are being met by the provider.

We reviewed SLAs for five shared IT service providers to determine whether IT security requirements were specified and whether the SLA was current. The SLAs were inconsistent in how they addressed IT security and only one was current. If SLAs do not adequately cover IT Security arrangements, agencies do not have a clear mechanism to hold shared service providers accountable and demonstrate security is being adequately managed.

The table below summarises how each SLA considered IT security and related areas:

SLA IT security considerations	Shared service provider				
	1	2	3	4	5
SLA is current	x	x	x	x	✓
Acceptable use of IT (forbidden sites, code of conduct, etc.)	x	x	x	x	✓
Access controls (methods, lockout, etc.)	x	x	x	x	x
Password policies	x	✓	✓	x	x
Breaches and incidents	✓	✓	x	x	x
Management responsible for confidentiality, integrity and compliance	✓	x	x	x	✓
Mobile devices	x	x	x	x	x
Administering new, modified and terminated users	✓	✓	✓	x	x
Physical security	x	x	x	x	x
Audit provisions	x	✓	✓	x	✓
No IT security issues raised in our 2016 audit	x	x	✓	✓	x
Total (✓)	3	4	4	1	4

Source: Summary based on information provided by agencies (unaudited).

Procurement

\$436 million in procurement benefits

Major activities undertaken in 2015–16 included the implementation of ten procurement reforms designed to deliver \$436 million in benefits to agencies and suppliers over the next four years.

Regulation

Better Regulation

The Better Regulation Division administers NSW's work health and safety laws, and the regulation of workers and home building compensation and motor accidents compulsory third party insurance.

NSW Fair Trading

NSW Fair Trading is a consumer protection agency that administers laws to enable a fair and effective NSW marketplace. It jointly administers the Australian Consumer Law with other Commonwealth, State and Territory agencies.

The regulation of specific industries and occupations is also part of Fair Trading's role, with its licensing services helping maintain and improve industry integrity. NSW Fair Trading also administers the residential bonds held on behalf of NSW property renters.

Rental Bond Board bonds

\$1.3 billion rental bonds are held in trust

Recommendation

The Rental Bond Board should seek the necessary legislative or other mechanism to confirm its accounting treatment of rental bonds.

The Rental Bond Board prepared its financial statements on the basis it holds rental bonds of \$1.3 billion in trust. As a result, it does not record the bonds as assets or a corresponding liability on its balance sheet. In 2012–13, the Crown Solicitor recommended the legislation governing the Rental Bond Board be reviewed and amended to clarify whether or not the Rental Bond Board holds the bonds in trust. This will remove uncertainty over who controls these funds and will enable the appropriate accounting treatment to be determined.

Insurance

Return to work

Recommendation

icare should design appropriate measures to assess whether programs implemented after the 2012 Workers' Compensation legislation improve workers' return to work.

Performance reporting for 'return to work' programs is unclear

One of the key features of the reforms introduced by the *Workers' Compensation Legislation Amendment Act 2012* focused on assisting and encouraging workers to return to work after an injury.

The existing performance information does not provide trends and benchmarks to assess the success of the return to work program or whether the initiatives are improving outcomes for employees.

The average return to work rate increased from 85.5 per cent to 88.3 per cent after the workers' compensation reforms were introduced. This indicates a 2.8 per cent improvement. There was no benchmark to assess whether this result meets the desired objectives of the reforms.

Insurance and care transformation

Recommendation

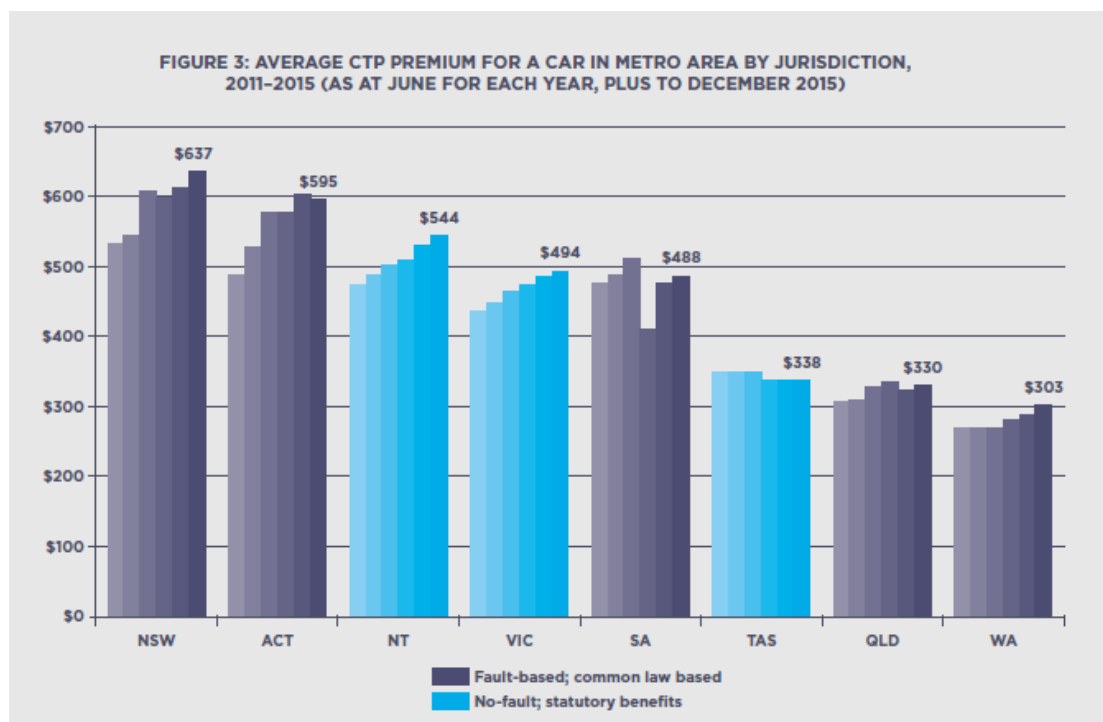
icare should design detailed measurable performance objectives for specific outcomes from its strategic plan and report on performance against these measures in its annual report.

icare's vision is to change the way people think about insurance and care by providing world class services to people, businesses and communities. icare's key strategies are based on a service-driven approach focusing on customers and scheme participants. This will help icare 'deliver an enhanced customer experience' by placing the customer at the centre of its activities.

Green Slip scheme efficiency and affordability

New South Wales Green Slips are the most expensive in Australia

New South Wales motorists pay the highest premiums in the country with the average Green Slip costing \$637 at 31 December 2015. The chart below compares premium prices and affordability between all states and territories. The Northern Territory, Victoria and Tasmania have no-fault based CTP schemes.



Source: On the road to a better CTP scheme – Options for reforming Green Slip insurance in NSW (unaudited).

In March 2016, the NSW Government announced a major review for the Compulsory Third Party Motor Accident Insurance Scheme (Green Slip) focusing on four key objectives:

- Increasing the proportion of benefits provided to the most seriously injured road users
- Reducing the time taken to resolve a claim
- Reducing opportunities for claims fraud and exaggeration
- Reducing the cost of green slip premiums.

In June 2016, the NSW Government introduced a bill to extend protection to an extra 7,000 road users not covered under the existing 'at-fault' Green Slip scheme. The proposed 'no-fault' scheme will ensure most injured road users will receive compensation scheduled within legislation rather than a court settlement. However, those injured with greater than 10 per cent impairment, where fault of another party can be proven, continue to be eligible for a court settlement. In October 2016, the NSW Government announced that certain aspects of the proposed bill are under review.

The proposed reform will also give the State Insurance Regulatory Authority (SIRA) more powers to regulate premium setting, market practices and claims management. Key challenges for SIRA will include setting premiums to reduce the financial burden to NSW motorists whilst maintaining the sustainability of the Green Slip scheme.

Home warranty insurance

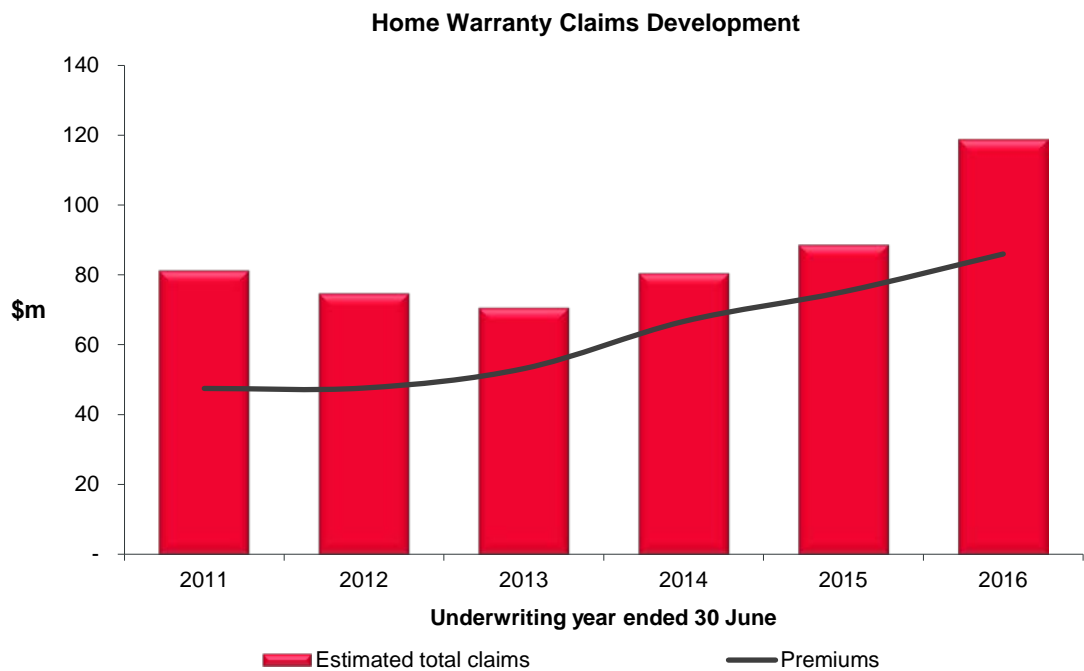
Recommendation

The home warranty scheme requires a strategic review to address the gap between premiums and expected claims.

Sustainability of the home warranty scheme

Home warranty premiums were consistently less than the expected cost of claims since the commencement of the scheme. The scheme requires urgent strategies to address the funding shortfall or strengthen oversight processes to reduce claim costs.

Home warranty claims increased 46 per cent from \$81.4 million in 2011 to \$119 million in 2016 in its first seven year cycle. The graph below shows the nominal value of claims since the scheme commenced in 2011. The graph also compares total premiums collected to expected claims costs.



The icare Home Building Compensation Fund (the scheme) provides a safety net for contracted residential building work for homeowners. Homeowners are covered by the scheme when their builder fails to honour commitments under contract due to insolvency, death or disappearance. Insurance under the scheme is required for all residential construction projects over \$20,000. The scheme is managed by the New South Wales Self Insurance Corporation.

Section Two

Appendices



Appendix One – Recommendations

Financial performance and reporting

Early close

Cluster agencies should ensure all supporting documents for early close and year-end are ready by the due dates. All significant accounting issues should be resolved as part of the early close procedures.

Insurance data quality

Insurance and Care NSW (icare) should address data quality issues impacting claims' valuations.

Work Injury Damages

Trends in Work Injury Damages should be monitored to avoid increases in common law claims.

Budget variances

Cluster agencies should review the 2015–16 budget variances and identify opportunities to improve future year budgets.

Scheme financial sustainability

Premium rates should be reviewed annually for all insurance types to ensure long-term financial sustainability of the schemes.

Financial controls

Ineffective internal controls at service providers

The Department of Finance Services and Innovation (DFSI) resolve any transition issues that remain between ServiceFirst and GovConnect immediately. GovConnect quickly remediate all issues identified in their independent auditor's assurance reports.

Significant transition breakdowns

DFSI should re-examine the significant transition breakdowns and apply learnings to projects currently being transitioned to the private sector.

Deficient security access

Some agencies should strengthen user access to critical financial systems and data.

Governance

Risk management is inconsistently applied

DFSI should review how risk management at an agency level is reported and monitored at the cluster level. A more robust system to collate, manage, identify and escalate risk should be introduced.

Risk culture is fundamental to effective risk management

Agencies should develop key performance indicators to measure and assess risk culture.

Operational functions outsourced by icare

icare should review the outsourcing risks associated with the current transformation program to set up a strong risk governance framework and address key outsourcing risks early in the program.

icare should develop a business continuity management policy that is consistent with the group's risk management strategy and framework.

Service delivery

Rental Bonds held in trust

The Rental Bond Board should seek the necessary legislative or other mechanism to confirm its accounting treatment of rental bonds.

The rate of workers returning to work after injury is unclear

icare should design appropriate measures to assess whether programs implemented after the 2012 reforms improve workers' return to work.

Compliance with Digital Information Security Policy

All agencies should submit their attestation to DFSI annually and this should be monitored by DFSI.

Strategic IT risks

Agencies' IT strategic plans should address IT risks.

IT risk registers

All agencies should have an IT risk register which aligns with the agency-wide risk register and assign risks to individual owners.

Agencies should collaborate when formulating and reviewing IT risks.

Shared service provider SLAs

Agencies that use shared service providers should ensure their SLAs sufficiently cover IT security risks and controls.

icare service delivery transformation

icare should design detailed measurable performance objectives for specific outcomes from its strategic plan and report on performance against these measures in its annual report.

Home warranty scheme funding shortfall

The home warranty scheme requires a strategic review to address the gap between premiums and expected claims.

Appendix Two – Financial Information – Major Cluster Agencies

	Total assets		Total liabilities		Total revenue		Total expenses		Net result	
	At 30 June				For the year ended 30 June					
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Cluster lead entity										
Department of Finance, Services and Innovation	1,573	1,837	1,164	1,971	2,162	1,431	2,231	1,453	(69)	(22)
Executive agency										
Service NSW	276	150	85	53	424	335	330	284	94	51
Independent statutory body										
Insurance and Care NSW	165	--	151	--	576	--	576	--	--	--
Statutory bodies										
Government Property NSW	1,202	1,234	352	346	531	546	717	502	(186)	44
Sydney Harbour Foreshore Authority	1,483	1,406	47	72	202	184	137	151	65	33
State Records Authority of NSW	994	980	7	6	38	53	26	25	12	28
Rental Bond Board	69	71	7	4	57	58	61	55	(4)	3
NSW Government Telecommunications Authority	86	77	14	5	43	44	42	39	1	5

Source: Financial statements (audited).

Appendix Three – Performance Against Budget

	Department of Finance, Services and Innovation		Service NSW		Government Property NSW		State Records Authority of NSW		Rental Bond Board		NSW Government Telecommunications Authority	
	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget	Actual	Budget
	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m	\$m
Abridged statement of comprehensive income - year ended 30 June												
Total expenses	● 2,231	2,018	● 330	313	● 717	531	● 26	20	● 61	56	● 42	43
Total revenue	● 2,162	2,002	● 424	391	● 531	548	● 38	21	● 57	58	● 43	43
Net result	● (69)	(16)	● 94	78	● (186)	17	● 12	1	● (4)	2	● 1	--
Total other comprehensive income/(expense)*	● 4	--	● --	--	● 82	--	● 1	--	● --	--	● --	--
Total comprehensive income/(expense)	● (65)	(16)	● 94	78	● (104)	17	● 13	1	● (4)	2	● 1	--
Abridged statement of financial position - at 30 June												
Total assets	● 1,573	1,624	● 276	215	● 1,202	993	● 994	960	● 69	72	● 86	82
Total liabilities	● 1,164	1,090	● 85	42	● 352	289	● 7	6	● 7	4	● 14	10
Net assets	● 409	534	● 191	173	● 850	704	● 987	954	● 62	68	● 72	72
Abridged statement of cash flows - year ended 30 June												
Purchases of property, plant and equipment	● 181	77	● 98	98	● 9	21	● 4	7	● --	--	● 15	25

* Includes transactions taken directly to equity, such as asset revaluation movements and actuarial movements on defined benefit superannuation plans.

Source: Financial statements (audited).

Actual v Budget indicator			
●	2,450	2,471	Variance below 2 per cent of budget
●	190	200	Variance between 2 and 5 per cent of budget
●	180	220	Variance greater than 5 per cent of budget

Appendix Four – Cluster Information

Agency	Website
Cluster lead entity	
Department of Finance, Services and Innovation	https://www.finance.nsw.gov.au/
Executive agency	
Service NSW	https://www.service.nsw.gov.au/
Independent statutory body	
Insurance and Care NSW	https://www.icare.nsw.gov.au/
Statutory bodies	
Building Professionals Board	http://www.bpb.nsw.gov.au/
Board of Surveying and Spatial Information of NSW	http://www.bossi.nsw.gov.au/
Fair Trading Administration Corporation	http://www.fairtrading.nsw.gov.au/
Financial Counselling Trust Fund	http://www.fairtrading.nsw.gov.au/
Government Property NSW	https://www.property.nsw.gov.au/
Luna Park Reserve Trust	http://www.shfa.nsw.gov.au/
Mine Subsidence Board	http://www.subsidence.nsw.gov.au/
NSW Architects Registration Board	http://www.architects.nsw.gov.au/
NSW Government Telecommunications Authority	http://telco.nsw.gov.au/
Rental Bond Board	http://www.fairtrading.nsw.gov.au/
State Records Authority of NSW	https://www.records.nsw.gov.au/
Sydney Harbour Foreshore Authority	http://www.shfa.nsw.gov.au/
Teacher Housing Authority of NSW	http://www.tha.nsw.gov.au/
Waste Assets Management Corporation	https://www.finance.nsw.gov.au/
Insurance bodies	
Sporting Injuries Compensation Authority	https://www.icare.nsw.gov.au/
Building Insurers' Guarantee Corporation	http://www.fairtrading.nsw.gov.au/
Lifetime Care and Support Authority of NSW	https://www.lifetimecare.nsw.gov.au/
NSW Self Insurance Corporation	https://riskinsite.nsw.gov.au/
State Insurance Regulatory Authority	http://www.sira.nsw.gov.au/
Workers Compensation Nominal Insurer	http://www.workersinsurance.icare.nsw.gov.au/
Workers' Compensation (Dust Diseases) Authority	https://www.ddb.nsw.gov.au/

Our vision

Making a difference through audit excellence.

Our mission

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

Our values

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

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

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

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