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S O U T H   A U S T R A L I A

Report

of the

Auditor-General

for the

Year ended 30 June 2003

Tabled in the House of Assembly and ordered to be published, 13 October 2003

Third Session, Fiftieth Parliament

PART A

Audit Overview

By Authority: J. D. Ferguson, Government Printer, South Australia

2003

Government
of South Australia

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30 September 2003

The Hon R R Roberts, MLC
President
Legislative Council
Parliament House
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The Hon I P Lewis, MP
Speaker
House of Assembly
Parliament House
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Gentlemen,

AUDITOR-GENERAL'S REPORT 2002-03

Pursuant to the provisions of the *Public Finance and Audit Act 1987*, I herewith provide to each of you a copy of my 2003 Annual Report. This Report includes the Honourable the Treasurer's Statements for the financial year ended 30 June 2003.

Content of the Report

This Report is in two parts – Part A and Part B.

Part A –The Audit Overview is a general review of, and report on, the public finances of the State. It also contains some commentary of Audit findings and comment concerning specific issues of importance and interest in the public sector that are brought to the attention of the Government and the Parliament pursuant to the provisions of subsections 36(1)(a)(iii) and 36(1)(b) of the *Public Finance and Audit Act 1987*.

Part B – Volumes I, II, III and IV contain comment on the operations of individual public authorities, the financial statements of those public authorities, and the Treasurer's Statements. A number of matters that, in my opinion, are of administrative significance or importance to the Government and the Parliament that are contained in Part B of this Report are listed separately under the heading 'References to Matters of Significance'. This list can be found immediately after the Table of Contents in the front of Volumes I, II, III and IV of Part B.

Auditor-General's Annual Report

In accordance with subsection 36(1)(a) of the *Public Finance and Audit Act 1987*, and subject to comments made within this Report, I state, that in my opinion:

(i) the Treasurer's Statements reflect the financial transactions of the Treasurer as shown in the accounts and records of the Treasurer for the financial year ended 30 June 2003;

(ii) the financial statements of each public authority reflect the financial transactions of the authority as shown in the accounts and records of the authority;

(iii) the controls exercised by the Treasurer and public authorities in relation to the receipt, expenditure and investment of money; the acquisition and disposal of property; and the incurring of liabilities, are sufficient to provide reasonable assurance that the financial transactions of the Treasurer and public authorities have been conducted properly and in accordance with law.

Whilst I have not seen fit to express a qualified opinion with respect to matters referred to in subsection 36(1)(a)(iii) above, there have been cases where in some agencies, systems of internal controls have not, in my opinion, been of an acceptable standard. Where this has occurred, I have, in accordance with the provisions of subsection 36(1) of the *Public Finance and Audit Act 1987*, drawn attention to this fact and included comment on my reason(s) in the report on the agency concerned in Part B of this Report.

In addition, attention is also drawn to the comments made under section 3.5.5 of this Report in relation to a matter identified during the audit of Statement K of the Treasurer's Statements.

Report and Opinion on Controls

As required by subsection 36(1)(a)(iii) of the *Public Finance and Audit Act 1987*, the audit included an assessment of the controls exercised by the Treasurer and public authorities in relation to the receipt, expenditure and investment of money, the acquisition and disposal of property and the incurring of liabilities and also, where applicable, whether the controls in operation were consistent with the prescribed principles of the Financial Management Framework as required by Treasurer's Instruction 2 'Financial Management Framework'. The overall aim of that assessment was to establish whether those controls were sufficient to provide reasonable assurance that the financial transactions have been conducted properly and in accordance with the law.

It is not practical in any such assessment to review each and every control in respect of each and every transaction. Whilst every effort is made to test the sufficiency of controls across a representative range of transactions, it must be remembered that no system of control is 'fail-safe'.

The Parliament has recognised this in stating that the controls need only be sufficient to provide, at the time of audit, 'reasonable assurance' of the matters set out in subsection 36(1)(a)(iii).

The Audit assessment has been made by reviewing the adequacy of procedures and testing a number of control components against a range of financial transactions conducted at various levels of the organisation.

In assessing the sufficiency of these controls, particular regard has been had to the organisation's structure and the inter-relation of procedures, policies, people, management's philosophy and operating style, demonstrated competence, and overall organisational ethics and culture. All of these matters serve as inter-related elements of control.

The standard by which Audit has judged the sufficiency of controls is whether and how well those controls provide reasonable assurance that financial transactions of the Treasurer and public authorities have been 'conducted properly and in accordance with law'. This concept requires the organisation to meet the standards of financial probity and propriety expected of a public authority and, at all times, discharge its responsibilities within the letter and spirit of the law, both in terms of its own charter and as an instrumentality of government discharging public functions.

Except for the matters detailed for each agency in Part B of my Report under the section 'Audit Findings and Comments', Audit formed the opinion that the controls exercised in relation to the receipt, expenditure and investment of money; the acquisition and disposal of property; and the incurring of liabilities were sufficient to provide reasonable assurance that the financial transactions were conducted properly and in accordance with the law. In respect of those matters where the controls exercised were not sufficient to provide that level of assurance, Audit has made recommendations as to where improvements are required.

Qualified Audit Opinions

It was found necessary to issue a qualified audit opinion in the Independent Audit Report in eight instances. The agencies concerned are:

- Administrative and Information Services — Department for
- Education and Children's Services — Department of
- Environment and Heritage — Department for
- National Wine Centre

- South Australian Forestry Corporation
- South Australian Motor Sport Board
- University of South Australia
- Water, Land and Biodiversity Conservation — Department of

The reason for, and the extent of, the qualification in the Independent Audit Report is described in the commentary on each of those agencies to be found in Volumes I, II, III and IV of Part B of this Report.

Acknowledgments

I would like to place on record my gratitude for the dedicated efforts of my staff throughout the financial year. Their professionalism and dedication have been of the highest order. Their efforts are reflected in the contents of this Report.

I extend my thanks to the Under Treasurer, Government Publishing SA, and their staff, and the report printing coordinator, Mr D O'Keefe, for their efforts which have assisted materially in the production of this Report. The cooperation of all public authorities with my staff during the financial year is also acknowledged.

Yours sincerely,

K I MacPherson
AUDITOR-GENERAL

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MEMORANDUM TO PARLIAMENT

INTRODUCTION

Over the past several years, in this State, and, indeed, in the Commonwealth and the other Australian States, the public sector has undergone changes that have had far reaching implications regarding its capacity to continue to perform its responsibilities according to its traditional standards and values. This situation has occurred in an environment where the role of the State in the provision of services and infrastructure has been, and is continuing to be, re-examined. Significant governmental services, formerly provided by government agencies, are now being provided through private sector providers.

The past decade has been a period of major contraction of public sector employment with a consequent loss of skill and experience within that sector. During this same period there has been the requirement by government for increased productivity and greater efficiencies from those continuing in public sector employment. Whilst there is clearly a need to examine the efficiency and economy with which public sector services are delivered, and it is necessary that entrenched rigidities in public sector bureaucracies should be addressed, any action taken must be consistent with existing legal requirements with respect to public administration and should not undermine the principles associated with Executive Government accountability to the Parliament under a Westminster system of government.

In the course of the 2002-03 financial year, several matters have been drawn to Audit's attention that, in my opinion, warrant mention as being of importance to the Government and the Parliament. Whilst the detailed audit comment on each agency is to be found in Part B of this Report, there are some matters that, in my opinion, require specific emphasis. These are matters of general importance regarding public administrative arrangements in this State.

For the purpose of providing a quick reference to the scope of matters discussed in this Memorandum the following is a summary of the subject headings:

- Changes in the Presentation of the Audit Report.
- The provision of Public Services in Association with the Private Sector by way of Public Private Partnerships/Private Finance Initiatives.
- Tabling in Parliament of Full Details of Inter-Sectoral Agreements Regarding Matters of Critical Continuing Public Interest Concern.
- Public Sector Procurement.
- Statutory Requirements, Operational Policies and Administrative Practices.
- Motor Accident Commission: Matter of Emphasis in the Report of the Auditor.

- The Auditor-General and Access to Internal Audit Working Papers where Internal Audit is Outsourced.

- Probity Issues Associated with the Renewal/Re-Tender of Major Public Sector Contractual Arrangements.

- Standards of Conduct Regarding Public Office Holders.

CHANGES IN THE PRESENTATION OF THE AUDIT REPORT

This year a number of changes have been made in the Audit Report with respect to the content and the presentation of information concerning public sector agencies. A primary purpose in making these changes is to assist the Parliament in its constitutional responsibilities of maintaining the accountability of the Executive Government.

Statutory Reporting Requirements

The operations of government cover a broad spectrum. The information that is presented in the annual Audit Report covers this entire spectrum as required by the *Public Finance and Audit Act 1987*. Where public authorities submit financial statements for audit after the end of the financial year within the period stipulated in the *Public Finance and Audit Act 1987,* the audit must be undertaken and reported to the Parliament by 30 September in that year.[1] No other jurisdiction in Australia has a similar requirement and, it is my understanding, no other Auditor-General reports on the audit of financial statements within this timeframe.

In essence, in the annual Audit Report to Parliament, there is a reporting at the one time, in the one report, in accordance with applicable legislative and other professional requirements, the financial performance and position of each public authority and the Treasurer's accounts together with Audit commentary on matters that, in my opinion, are of importance and should be brought to the attention of the Government and the Parliament.

The Objective of the Changes Made

There have been several objectives that have been sought to be achieved in making the changes in this year's Report. These have included the need to improve the readability of the report from a users point of view by changing the size of the font in both the general text and the notes to the financial statements. This change will enable a reader to more readily 'read across the page' than was the case in the past.

In addition, the presentation of certain matters, eg basic financial information regarding changes in financial statement items has been highlighted in tables and charts to allow for trends to be noted and for changes over recent years to be readily identified. Also the matter of the interpretation and analysis of the financial statements has, where appropriate, been expanded with the intention of providing the Parliament with information that will assist in understanding that agency's financial performance and position.

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[1] The financial statements as submitted must be of a sufficient standard that allows for the audit to be undertaken. Where further work is required to be taken by the Department to present the financial statements to the standard required, the audit report on that department/agency may be included in a Supplementary Report.

Furthermore, a reader of the report will have the opportunity to review the highlights associated with each of the financial statements for each agency without having the need to examine the detail of those financial statements separately. In short, a summary of the data in each of the financial statements with respect to each agency is now to be found in a separate table in the report.

It is, however, important to emphasise that whilst each agency's financial statements are prepared on an accrual basis, and in some cases may suggest the holding of high cash balances, in respect of Departments of Government, as distinct from statutory authorities, these cash balances are held and managed by the Treasurer. These funds are only available to the Departments concerned in accordance with established legal authority and the principles of Appropriation as determined pursuant to the Estimates and Budgetary processes approved by Parliament.

Presentation of Financial Statements for Each Agency

Over the years I have raised with the Parliament through the Annual Report, and directly with the Economic and Finance Committee, the matter of whether there was a continuing need for the presentation of full financial statements for each of the agencies dealt with in the annual Audit Report. This is not done in any other Australian jurisdiction. It is my understanding that it is the requirement of the Parliament that the current reporting arrangements concerning the publication of the full financial statements for each agency should continue.

Some public sector agencies are not included in the annual Audit Report.[2] For the information of the Government and Parliament, in making a determination regarding the agencies that will not be included, the following factors are taken into account by this Department:

(i) materiality of financial operations;
(ii) materiality of any impact on the public finances;
(iii) consolidation of the financial operations in the parent entity's financial statements included in this Report;
(iv) timeliness of information;
(v) materiality of issues arising from the audit;
(vi) public interest.

A number of the agencies that are not included in the annual Audit Report are required to prepare an annual report to be tabled in the Parliament in accordance with the requirements of the *Public Sector Management Act 1995*. In addition, Treasurer's Instruction 19 requires that each Chief Executive Officer must ensure that the annual report that is required to be submitted to the responsible Minister in accordance with the *Public Sector Management Act 1995* or other legislation includes the general purpose financial statements in the form in which they were presented to the Auditor-General together with a copy of the Report of the Auditor-General on those statements.

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2 Where, for whatever reason the financial statements of a major agency are not included in the annual Audit Report at 30 September each year, the accounts of that agency will be included in a Supplementary Report. For example, this year the accounts of the Courts Administration Authority and the Department of Transport and Urban Affairs will be reported in a Supplementary Report.

Further, notwithstanding the immateriality of the financial position of a particular agency in the context of the public accounts, where, in the opinion of the Auditor-General, the affairs of that agency give rise to a matter of importance for the Government and the Parliament, that matter will be included in the annual Audit Report for the information of the Government and the Parliament.

Reporting Significant Audit Issues Raised with Agencies

There has been a particular audit focus in the annual Audit Report on communicating important audit findings. Also, the summary audit opinion for each agency is now included in the text relating to that agency.

THE PROVISION OF PUBLIC SERVICES IN ASSOCIATION WITH THE PRIVATE SECTOR BY WAY OF PUBLIC PRIVATE PARTNERSHIPS/PRIVATE FINANCE INITIATIVES

Public Policy Objective

It is a stated public policy objective of the Government to engage with the private sector in 'public private partnerships/private finance initiatives' for the provision of governmental services and the provision of infrastructure in this State.[3] This is an important policy initiative and necessitates that the contractual arrangements entered into by the Government protect the public interest and that the probity and legal risks associated with the contract process are adequately managed.

The public policy objective of providing for the delivery of governmental services and the provision of infrastructure in association with the private sector does allow government to provide public facilities that may not otherwise be made available because of fiscal limitations.

There are, in my opinion, several matters associated with the implementation of this policy objective that should, from an audit point of view, be placed on the public record. These matters are as set out hereunder in this section of this Memorandum.

The Concept of Partnership

The concept of 'partnership' is, in my opinion, a misnomer where the subject of the contractual relationship with the private sector (i) relates to the delivery of a service that is a government responsibility or (ii) relates to the operation of infrastructure that remains the property of government.

No matter what nomenclature is used by the parties to described the nature of the contractual relationship, no matter how the risks may be allocated contractually, where the circumstances referred to in the immediately preceding paragraph apply, there is a certain type of risk that will always remain a responsibility of government. This risk in generic terms can be described as 'political risk'. This simply means that where public interest issues arise in the course of the discharge of the contractual relationship and these issues are not addressed by the private sector contractor in a timely and adequate manner, governments, short of abrogating their responsibility to govern in the public

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[3] Other procurement related matters are dealt with separately in this Memorandum.

interest, have an obligation to take such steps as may be necessary to protect that public interest.[4] An example of this type of situation is illustrated by the circumstances surrounding the flooding of residential areas as a result of the failure of the Patawalonga dam gates to open.

'Co-accountability' for a matter that is the responsibility of government is difficult to achieve in a Westminster system of government. Short of outright privatisation of the service and/or the infrastructure that is being provided, the 'Government' responsibility remains.

The provisions for the delivery of public services by the private sector under existing contracts and the policy announcement by the Government referred to above, require that emphasis be accorded by relevant public sector employees to the tendering processes that are to be undertaken and the terms, conditions and management of the contractual arrangements that are agreed by the parties. Each of these matters will continue to be important for Executive Government, departmental management and government audit.

The Reality of 'Political Risk'

Certain experiences in the matter of the outsourcing of government services in this State has highlighted the fact that 'political risk' can become a matter of major importance requiring Executive Government intervention, often at considerable cost to the public revenue.

Regardless of how the matter of risk analysis has been undertaken and risk allocation has been negotiated by the Executive Government prior to entering the contractual relationship, the claimed savings for the public purse under outsourcing contracts are illusory if when a difficulty arises for the private sector provider, the public sector is required to come to the rescue with public monies and/or amends the contract to the benefit of the private sector provider.

In my opinion, it is a negation of the basis upon which the arrangement for the outsourcing was undertaken, if the private sector contractor is provided with further public monies without appropriate benefits being provided to government in return for what is in effect a public bail out of private propriety interests.

In developing these relationships there is, in my opinion, a need for a much sharper focus on exactly what is to be achieved. If the contracted for outcome/service/etc is not delivered, there must be a realistic sanction to compensate the Government (as the communities' representative) for the breach of the contract.

TABLING IN PARLIAMENT OF FULL DETAILS OF INTER-SECTORAL AGREEMENTS REGARDING MATTERS OF CRITICAL CONTINUING PUBLIC INTEREST CONCERN

Inter-sectoral agreements for the provision of public services/public infrastructure in matters where there is a critical continuing public interest, eg public health, public safety, etc should, in my opinion, be public documents notwithstanding claims for commercial confidentiality.

4 There will always be a default back to the terms of the contract if a problem/dispute arises that the parties are unable and/or unwilling to resolve.

These agreements, whilst matters of private law, can have far reaching public consequences. In my opinion, the extensive use of contracts in discharging governmental responsibilities can result in the by-passing of Parliament and undermining of the principles that underpin representative government and hence democracy in this State. The fact that similar conduct may have occurred in other jurisdictions is not to the point.

The Parliamentary political process in maintaining the accountability of the Executive Government can only operate to the extent that it is adequately informed of relevant matters.

Without detailed understanding by the Parliament of what is required in accountability terms of both the Executive Government and private sector providers, there can be no knowledge of the fact of time and cost overruns, risks to public health and safety, inadequate outcomes, potential and actual conflicts of interest, and indeed, political manipulation.

PUBLIC SECTOR PROCUREMENT

Renewal of Major Government Contractual Arrangements

Commencing in the course of the next 12 months, decisions will need to be made regarding the matter of the renewal of major government contractual arrangements with the private sector.[5] In my opinion, for reasons already discussed in Audit Reports to the Parliament, contractual arrangements must be based on objective due diligence.

A number of matters associated with public sector procurement were examined in a recent Audit Report to Parliament associated with the acquisition of an MRI machine for the North Western Adelaide Health Service.[6] The matter of procurement services within government is closely related to other activities based on a contractual relationship with a private sector provider. In this context, the renewal of major contracts for the provision of public services and/or public infrastructure and the entering into arrangements associated with public/private partnerships are all related concepts.

Contracts for both the provision of services and the provision of public infrastructure should, in my opinion, include clearly stated key performance indicators (KPIs)[7] that are capable of 'measurement'. It is generally the case that a service level that cannot be 'measured' cannot be enforced.

Requirements for the provision of 'economic benefits' for the State are in many instances difficult to measure, are subject to different interpretations, and accordingly, in my opinion, are not capable of 'enforcement' as a 'contractual condition'. This is not to suggest that because such benefits are difficult to measure that they are not to be regarded as both real and valuable.

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5 In Part A of the 1998 Report of the Auditor-General, a separate report was made to the Parliament regarding a range of matters associated with government contracts. In my opinion, the matters raised at that time continued to be operative as important considerations for government in contractual arrangements.

6 Supplementary Report by the Auditor-General on the matter of the acquisition of a MRI machine for the North Western Adelaide Health Service, July 2003.

7 KPIs must always be clear and unambiguous and where there has been a failure to meet the stipulated service level required the payment to the contractor should be at risk.

Contractual Management

Contractual management necessitates close monitoring of performance of contractual obligations by all parties including the Government. Liquidated damages, the provision for the abatement of payments for non-performance, and other clearly calculable penalties for non-performance by any contracting party should be readily ascertainable from the terms of the contract.

Not unreasonably, the private sector will have a tendency, where possible, to seek a 'lock in' arrangement when engaging with the Government. Notwithstanding the claims that have been made with respect to existing contracts, the possibility of 'lock in' or 'unfair competitive advantage' will inevitably arise where an incumbent provider seeks to continue in providing the service, etc.

Over recent years, the skill, knowledge and institutional memory within the public sector has been depleted and a real question arises as to whether presently available public sector resources have the necessary management skills for contract management so as to be able to protect the public interest when engaging with private sector providers. Having regard to the imminent renewal of several major contractual relationships it is important that the resources available to government be reviewed to ensure their adequacy to deal with the matters that will arise in this context.

Free Trade Agreements

It is well known that the Commonwealth Government is in the course of negotiations with the United States Government for the purpose of achieving a 'Free Trade Agreement' between the two countries.

Under certain circumstances there is the potential for a Free Trade Agreement with the United States to impact on the processes adopted by State Governments in procurement matters. At this stage it is not known, indeed it can only be a matter of speculation as to what the final arrangements will be. A Free Trade Agreement may significantly impact on tendering and contract management arrangements for State Governments and may, inter alia, have implications with respect to State Government policies regarding support for local industry. It is important that if 'Government Procurement' is to be included in this agreement that State interests are not ignored.

Definition of 'Procurement Operations'

The *State Supply Act 1985* includes a definition of 'supply operations' that establishes the nature of procurement activities (covering goods and services) that fall within the legislative ambit of responsibility of the State Supply Board.

It is considered important that the Government and its agencies, and the State Supply Board, have a clear understanding of the various types of procurement arrangements that fall within the jurisdiction of the Board. It is also important that the associated accountability arrangements with respect to procurement matters are clearly understood by all relevant parties. This applies to significant procurement activities such as capital works, outsourcing operations, public private partnerships, and information and communication technology contracts.

Potential can exist for contention regarding those matters that fall within the jurisdiction of the State Supply Board. By way of example, the matter of the renewal of information and communication technology contracts should clearly fall as a matter of legislative authority to a particular entity, the State Supply Board, or as otherwise provided by legislation. It is my recommendation that this matter be reviewed to ensure clarity.

STATUTORY REQUIREMENTS, OPERATIONAL POLICIES AND ADMINISTRATIVE PRACTICES

The Parliament and Statutes

Whatever Parliament mandates by statute is the policy of the State and any administrative practice and/or policy that is not in accordance with the statutory requirements is unlawful. This is recognised as one of the fundamental principles of the common law.[8] For this reason, it is essential that Chief Executive Officers of public sector agencies maintain a continuous review of operational policies and administrative practices to ensure that such policies and practices are not inconsistent with any applicable statutory requirements and further, that the tendency of the operation of such policies and practices do not directly or indirectly defeat a statutory requirement.[9]

To determine the adequacy of the control procedures regarding both the lawfulness and propriety of the several matters dealt with in section 36 (i) (a) (iii) of the *Public Finance and Audit Act 1987*, during the course of the audit of the Police Department, issues were raised with departmental management regarding procedures adopted in both operational and administrative matters. It is to be emphasised that the Commissioner of Police was already aware of the need to address certain matters associated with Audit concerns and was in fact doing so.

The Matter of 'Administrative Convenience'

Nonetheless, the issues identified by Audit do highlight the need to be aware of the fact that 'administrative convenience' is not a lawful basis to modify or fail to fully comply with applicable statutory requirements. This is particularly the case where the matter of the collection of the revenue of the Crown is involved.

Unless the statutory provision that imposes the obligation to collect the revenue incorporates a power vested in a nominated person to have the authority to modify the application of the law in particular situations, the law must be applied as enacted by the Parliament consistent with the normal principles of statutory construction.[10]

The importance of this matter arises from the fact that a citizen who has failed to satisfy in full the statutory requirement under a statutory provision to pay a stipulated amount, continues to be in default of his/her obligations under the law for the period within which proceedings may be instituted. Strict compliance is necessary in the case of expiation matters.

Where a statute has dealt with a matter that may prior to the enactment of the statute, have been a matter within the prerogative powers of the Crown, any prerogative of the

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8 *Wilkinson v Osborne* (1915) 98 CLR 89.

9 ibid p. 98.

10 Section 27 of the *Taxation Administration Act 1996* and section 11 of the *Land Tax Act 1936* include provisions that provide authority not to pursue amounts of a stated amount. Although these provisions are not analogous in the context of the discussion in this part of this Memorandum, they do provide an example of legislative authority for the non-collection of monies that would otherwise be payable.

Crown that may have existed regarding that matter is displaced and is no longer operative.

The legality and regularity of all administrative practices/policies of government must be based on a lawful authority. This is simply one aspect of the rule of law in its application to Executive Government.[11] The foregoing of revenue that should be received and/or the retention of monies that are in excess of the right of the Crown to receive under statutory authority are matters that must be dealt with consistently with the legislative arrangements that apply in the particular matter.

A Proposed Remedy to Deal with Small Over/Under Payments

Clearly, where the amount of money involved is 'small' administrative convenience would suggest that where there was an overpayment that the cost of arranging a refund would outweigh the fact of a refund being made. This, however, in my opinion, is not to the point. Difficult, and indeed, inconvenient, may such a need appear to be, without the lawful authority to do so, public administrative practices in such matters are 'arbitrary' and in my opinion, unsafe.

It would not be difficult to devise an omnibus statutory provision to deal with the practice to be applied to small overpayments and a discretionary authority to waive 'underpayments' in certain circumstances. Without such a provision, existing administrative practices associated with 'unders and overs' in matters where statutory provisions mandate the payment of a stipulated amount is, in my opinion, simply unlawful.

It is noted that on 28 May 2003, a Bill for an Act to amend the *Expiation of Offences Act 1996*, the *Road Traffic Act 1961* and the *Summary Procedure Act 1921* was laid on the table of the House of Assembly and read a first time. The citation of this Bill was the 'Statutes Amendment (Expiation of Offences) Bill 2003'. If considered appropriate by the Government and the Parliament, authority to deal with 'unders and overs' and indeed, the protection of persons presently exposed to risk for having failed to fully satisfy an Expiation Notice as presently required by law, could be dealt with in this Bill.

MOTOR ACCIDENT COMMISSION: MATTER OF EMPHASIS IN THE REPORT OF THE AUDITOR

The following is an extract from the Audit commentary relating to the above named agency to be found in Part B of this Report. This matter has been included in this Memorandum, because, in my opinion, it is matter of importance that should be drawn to the attention of the Government and the Parliament.

Solvency Level

One of the amendments to the *Motor Accident Commission Act 1992* proclaimed during the year requires the Commission to seek to achieve and maintain a sufficient level of solvency for the CTP fund in accordance with a formula determined by the Treasurer.

The primary aim of establishing a benchmark level of solvency is to ensure that the fund can reasonably meet all of its liabilities as they fall due and essentially reflects the target

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[11] Chief Justice Murray Gleeson, Hight Court of Australia; Boyer Lectures 'The Rule of Law and the Constitution' p. 5.

level of reserves deemed by the Treasurer to be appropriate for the CTP fund to provide comfort that the scheme will endure future market turbulence with minimal risk of falling into a negative net assets position. The level of solvency determined by the Treasurer requires that the Commission's assets exceed its liabilities by an amount equal to 10 percent of the provision for outstanding claims plus 10 percent of investments in equities and real properties.

As at 30 June 2003 the target level of reserves, as determined by application of the formula, was $163.9 million. The net assets of the CTP fund as at that date was $4.2 million or 2.6 percent of the target level of reserves, a shortfall of $159.7 million.

To achieve the target level of reserves required by the Government, the Commission has implemented a five year plan which takes into account expected claims and investment activity and is dependent on the Treasurer allowing premium increases as determined by the independent Third Party Premium Committee (TPPC).

The recent history regarding the implementation of premium increases recommended by the TPPC is outlined below:

	2003	2002	2001	2000
TPPC:	**Percent**	Percent	Percent	Percent
Recommended rise (effective for the financial year)	**21.7**	13.6	7.8	10.8
Actual rise	**15.5**	4.7	2.6	2.6
Difference	**6.2**	8.9	5.2	8.2

	2003	2002	2001	2000
	$'million	$'million	$'million	$'million
Estimated value of additional premiums had full TPPC rise been applied*	**17**	22	13	19

* Based on previous year's premium income, no allowance for growth or other variations.

As can be seen from the foregoing table over the four years to 2003 there has been considerable difference between the premium recommended by the TPPC and the amount approved by the Treasurer. The actual rise in 2003, while below the TPPC recommendation, was greater by many times than the previous three years. Clearly, had a premium increase of the order of the previous three years been adopted, the Commission would have had a negative net assets position at 30 June 2003. Had the full increase recommended by the TPPC been implemented over that four year period there would have been estimated additional premium revenue of $71 million available to the Commission which would have resulted in an improved solvency level.

The amendments to the Act include a provision that, subject to any direction of the Treasurer to the contrary, the Commission must not, while there is less than sufficient level of solvency in the Fund, fix its third party insurance premiums at amounts less than those determined by the TPPC. For premium increases effective from 1 July 2003 the TPPC recommended an increase of 16.4 percent. The Treasurer approved this increase for certain classes of vehicles while the approved increase for other classes was 9 percent.

Other statutory amendments made in 2002 that may benefit the Commission's solvency level are the Commission's removal from the tax equivalent regime and clarification of powers to offer structured settlements.

While the position of the fund as at 30 June 2003 is not strong, in a practical sense it does not mean that the Commission will not be able to meet its claim obligations. The nature of the insurance industry is such that claims can take many years to settle and generally cash flows from premiums received in any one year are sufficient to meet the claim payments in that year. The liabilities of the Commission are also supported by a government guarantee pursuant to section 21 of the *Motor Accident Commission Act 1992*.

THE AUDITOR-GENERAL AND ACCESS TO INTERNAL AUDIT WORKING PAPERS WHERE INTERNAL AUDIT IS OUTSOURCED

In some agencies, the internal audit function has been contracted out to private sector providers. During the course of the year access by my Office to the working papers of the private sector providers was initially resisted until such time as a confidentiality undertaking was given by Audit. This matter has now been satisfactorily resolved. It does, however, raise the need for agency Chief Executives to ensure that in outsourcing functions that the contractual arrangements recognise the need for Audit access to all relevant documentation. Any limitation regarding access to relevant documentation necessarily results in a 'scope limitation' and when this occurs the discharge of the State audit responsibility is compromised.

PROBITY ISSUES ASSOCIATED WITH THE RENEWAL/RE-TENDER OF MAJOR PUBLIC SECTOR CONTRACTUAL ARRANGEMENTS

Further to the abovementioned comment with respect to the renewal/re-tender of major public sector contractual arrangements, there are some additional comments that, in my opinion, should, having regard to their importance, be advised to the Government and the Parliament.

Probity Issues and the Potential for Conflict of Interest and Duty

In the matter of the proposed renewal/re-tender of major public sector contractual arrangements, it has come to the attention of Audit that the management of the probity issues associated with the evaluation of proposals/tenders by private sector proponents faces certain difficulties. One such difficulty noted involves the situation whereby several senior public sector Executives who it would be considered essential to be involved in the evaluation process, hold a limited number of shares in entities that directly or indirectly may have an involvement with the contracts concerned. This matter has the potential to arise in respect of proposed tendering/contracting for future information and communication technology services of government. This arises from the fact of the pervasive nature of telecommunications issues inherent in some of these contracts.

Whilst nothing has finally been settled with respect to this matter, in my opinion, it is my responsibility to state from an audit point of view the criteria that, as a matter of public sector probity, if not the law, should apply in these circumstances. This matter has been raised in this Memorandum as a result of the intimation that the view is held that no difficulty concerning a conflict of interest and/or duty would arise where the holding of securities by a person involved with the evaluation process was 'immaterial'.

With the greatest respect to those who advocate the appropriateness of allowing such persons to be involved in the evaluation process, in my opinion, such involvement should not be permitted. 'Materiality' should not, in my opinion, be a determinate as to whether a particular individual would, or would not, be influenced by his or her interest. It has been recognised by the law that a person in public office should not place himself/herself in a position where there is even the tendency that concerns that can arise regarding the integrity of public administrative processes. The temptation threshold of each individual is different. What may be immaterial in terms of one individual may be different in the case of another individual.

The fact that such a person has an interest places that person in a position whereby it cannot be denied that his/her interest and duty may conflict. In such a situation a question must arise as to whether he/she incapacitates herself/himself from exercising his/her true judgment in the matter.

The ordinary impulse of human nature would suggest that a person would try to avoid a personal loss or seek to optimise a potential gain. Private advantage may pull in one direction whilst public duty may pull in a different direction. The law has long recognised that it is inherently dangerous for a person exercising public duties to be placed in circumstances of such temptation.

In my opinion, the involvement of any person associated with the evaluation of tenders etc with a direct or indirect pecuniary interest may vitiate the exercise of public power with the consequence of serious financial loss for the Government. For this reason, no persons associated with the evaluation of matters associated with tenders and/or proposals should have any pecuniary interest in the matter whatsoever.

STANDARDS OF CONDUCT REGARDING PUBLIC OFFICE HOLDERS

Probity of the Conduct of Persons Holding Public Office

There is at this time a heightened public interest in the matter of the probity of the conduct of persons holding public office and the manner in which those persons exercise the powers of the office that they hold. In certain circumstances the exercise of public power may be improper, unlawful in a non-criminal sense, and may also contravene the provisions of the *Criminal Law Consolidation Act 1935* of this State.

Section 36(1)(a)(iii) and section 36 (1)(b) of the *Public Finance and Audit Act 1987* provides as follows:

> *36. (1) The Auditor-General must prepare an annual report that-*
>
> *(a) states whether, in the Auditor-General's opinion-*
>
> *(i) ...*
>
> *(ii) ...*
>
> *(iii) the controls exercised by the Treasurer and public authorities in relation to the receipt, expenditure and investment of money, the acquisition and disposal of property and the incurring of liabilities is sufficient to provide reasonable assurance that the financial transactions of the Treasurer and public authorities have been conducted properly and in accordance with law; and*
>
> *(b) sets out any matter that should, in the opinion of the Auditor General, be brought to the attention of Parliament and the Government.*

The *Public Finance and Audit Act 1987 (SA)* itself does not prescribe standards of propriety to be applied in testing the conduct of officers of public authorities pursuant to section 36. However, principles derived from decisions of the High Court of Australia and other courts and their subsequent application by Royal Commissions are important in providing guidance as to what are the appropriate standards. Having regard to the importance of this matter at the present time, I have stated hereunder for the information of the Government and the Parliament my understanding of the approach to be taken in determining appropriate standards and the basis upon which these matters will be dealt with in the discharge of the Audit mandate.

Over the years, a wide range of unlawful conduct has been the subject of consideration by my Office. Some, but not all, of the matters that have been examined have been the subject of comment in Audit Reports to the Parliament. These matters have been dealt with in accordance with my judgment on the basis of the evidence before me (and where considered necessary with the advice of Senior Counsel), as to whether there was or was not evidence of criminal conduct as distinct from conduct that was unlawful in a non-criminal sense. Furthermore, these matters were also considered in the context as to whether the factual circumstances gave rise to matters that could be characterised as improper in accordance with objective standards recognised by the law as applicable in matters of public administration in this State.

In some matters, the factual circumstances raise difficult issues and are susceptible to varying interpretations. With respect to matters that may involve certain types of conduct under the *Criminal Law Consolidation Act 1935*, Lord Diplock, in his judgment in the House of Lords in *Director of Public Prosecutions v Stonehouse* 1977 2 All ER 908 at 917 commented as follows:

> *There are some crimes whose definition incorporates as a constituent element a concept which is imprecise in that it involves some matter of degree on which opinions of reasonable men may differ and as to which the legal training and experience of a judge does not make his opinion on the matter more likely to be right than that of a non-lawyer.*

In my opinion, the concept of 'improper' not being a term of art, can, in some instances, fall into the category referred to by Lord Diplock in the Stonehouse case.[12] Of course,

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[12] Section 238 in Part 7 of the *Criminal Law Consolidation Act 1935* provides as follows:

> ***Acting improperly***
> *238. (1) For the purposes of this Part, a public officer acts improperly, or a person acts improperly in relation to a public office, if the officer or person knowingly or recklessly acts contrary to the standards of propriety generally and reasonably expected by ordinary decent members of the community to be observed by public officers of the relevant kind, or by others in relation to public officers or public offices of the relevant kind.*
>
> *(2) A person will not be taken to have acted improperly for the purposes of this Part unless the person's act was such that in the circumstances of the case the imposition of a criminal sanction is warranted.*
>
> *(3) Without limiting the effect of subsection (2), a person will not be taken to have acted improperly for the purposes of this Part if—*
> *(a) the person acted in the honest and reasonable belief that he or she was lawfully entitled to act in the relevant matter; or*
> *(b) there was lawful authority or a reasonable excuse for the act; or*
> *(c) the act was of a trivial character and caused no significant detriment to the public interest.*
>
> *(4) In this section—*
> *"**act**" includes omission or refusal or failure to act;*
> *"**public officer**" includes a former public officer.*

where there is evidence of criminal conduct the matter must be referred to the Police Department.

Propriety and Impropriety

The concept of 'propriety' may be elucidated from the concept of 'impropriety'. The courts have established principles based on the consideration of the term 'improper' in relation to corporate behaviour.

In *Grove v Flavel*,[13] the South Australia Full Court described the term 'improper' in the following terms:

> *The word 'improper' is not a term of art. It is to be understood in its commercial context to refer to conduct which is inconsistent with the 'proper' discharge of the duties, obligations of the officer concerned.*[14]

The High Court in *R v Byrnes & Hopwood*[15] embraced this description of 'improper' and held that what is 'improper' is determined by an objective assessment of impropriety. Brennan, Deane, Toohey and Gaudron JJ said:

> *Impropriety does not depend on an alleged officer's consciousness of impropriety. Impropriety consists in a breach of the standards of conduct that would be expected of a person in the position of the alleged offender by reasonable persons with knowledge of the duties, powers and authority of the position and the circumstances of the case. When impropriety is said to consist in an abuse of power, the state of mind of the alleged offender is important and the alleged offender's knowledge or means of knowledge of the circumstances in which the power is exercised and his purpose or intention in exercising the power are important factors in determining the question whether the power has been abused. But impropriety is not restricted to abuse of power. It may consist in the doing of an act which a director or officer knows or ought to know that he has no authority to do.*[16]

Although these principles have been derived from consideration of 'impropriety' in the context of commercial applications and prosecutions, they may, in my opinion, be adapted and applied in the context of the discharge of the duties, obligations and responsibilities of a public nature. Indeed, they have consistently so been adapted and applied by Royal Commissions.[17]

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13 (1986) 4 ACLC 654.

14 Grove at 662.

15 (1995) 130 ALR 529 (following *Chew v R* (1992) 107 ALR 171; *Whitehouse v Carlton Hotel Pty Ltd* (1987) 70 ALR 251).

16 Byrnes at 538. See also the judgment of McHugh J at 544.

17 Royal Commission into Commercial Activities of Government, Western Australia (1992) and Royal Commission into the City of Wanneroo, Western Australia (1996).

Thus, for the purposes of matters arising in the discharge of the audit mandate under the *Public Finance and Audit Act 1987*, the concept of 'impropriety' is based upon judicial authority, principles of which are, in my opinion, succinctly stated in the Report of the Royal Commissioner, Mr K Marks, QC (formerly Mr Justice Marks of the Victorian Supreme Court) as follows:[18]

> 1. *The test of 'impropriety' is objective, that is, it does not depend on consciousness of impropriety on the part of the person under consideration.*
>
> 2. *Impropriety in a particular case is to be determined by reference to the particular circumstances in which it is said to have occurred.*
>
> 3. *The issue is whether the conduct impugned is inconsistent with the proper discharge of the duties of the office in question.*
>
> 4. *Impropriety consists in a breach of the standards of conduct that would be expected of a person in the position of the person under consideration by reasonable persons with knowledge of the duties powers and authorities of the position in the particular circumstances.*

The Atkinson / Ashbourne / Clarke Matter

This matter has involved myself, as Auditor-General. There have been issues raised in the Parliament regarding the nature of my involvement, and suggestions to the effect that my Office has been involved in some communications with the Executive Government that may in some unspecified way not be appropriate in the circumstances.

Being mindful of the bounds of propriety to be observed pending the outcome of matters before the court, there are, nonetheless, some matters that should be communicated to the Parliament regarding the involvement of this Office in this matter.

Notwithstanding the fact that the Acting Premier responded to questions regarding my involvement in this matter, further communication by another Member of the Parliament has been made with me requesting my comments on whether the statements made were in fact correct.

With respect to those who have every right to pursue their interest in this matter both within and outside of the Parliament consistent with the need to not be in contempt of any court proceedings, in my opinion, it is not appropriate to request me, as Auditor-General, to become involved in a matter that is now of party political contention otherwise than through proper processes, ie the Parliament and/or as a witness in a court of law.

As a matter of record, I can state for the information of the Parliament that, following a request in writing from the Premier to review the then relevant material with respect to this matter, I agreed to do so.[19] My approach to dealing with this matter has been no

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18 Royal Commission into Commercial Activities of Government, Western Australia (1992).

19 The issues inherent in this matter fall within the audit mandate under the *Public Finance and Audit Act 1987*.

different to that of similar matters that I have dealt with over past years. Any suggestion otherwise is utterly rejected by me.

As Auditor-General, I am available to attend as a witness before relevant Parliamentary Committees. I have not to-date been requested to do so in regard to this matter. I am of course available should such a request be made to me.

K I MacPherson
Auditor-General

30 September 2003

STATE FINANCES

AND

RELATED MATTERS:

SOME AUDIT OBSERVATIONS

1 SUMMARY OF MAIN POINTS

This section of my Report provides a summary of the more significant audit observations and conclusions resulting from the discussion and analysis of the State's finances, including the management of those finances. References are made to the detailed commentary contained within this Report.

REPORTING FRAMEWORK

The Budget prepared each year focuses on targets based on the reporting standards of the Australian Bureau of Statistics' Government Financial Statistics (GFS) accrual-based framework. (Section 3.1)

Although GFS accrual reporting has many similarities to that under the Australian Accounting Standards (AAS) framework, the GFS framework excludes revaluations from the GFS operating statement. (Section 3.2.1)

FISCAL MEASURES AND TARGETS

The Government's stated fiscal principles are to contain the public sector's level of liabilities by ensuring no growth in debt from ongoing operations of the General Government Sector, by eliminating unfunded superannuation liabilities, and by requiring all Public Non-financial Corporation (PNFC) borrowing to be fully funded from resultant cash flows. (Section 4.1)

The fiscal target is to achieve, on average, balanced budgets in the General Government Sector so that general government operating expenses and investing expenditure are met entirely by revenues. (Section 4.1)

The budget balance is measured by the net lending position from operations. (Section 5.2)

FINANCIAL PERFORMANCE

The 2003-04 Budget sees a marked change in anticipated results compared to the 2002-03 Budget. While budgeting for a small deficit for 2003-04, the Government has budgeted to achieve the targeted net lending position over the remaining years of the forward estimates to 2006-07. This is the first time such outcomes have been projected over an extended period. (Section 5.2)

I am of the view, however, that the budget picture for this State continues to demand focused attention and improvement to its processes. Although this budget forecasts surpluses, they are certainly not of an order that places the State in a position to relax its focus on financial management improvement. Pressure also derives from the Government's stated aim to improve the State's financial standing and seeking a AAA credit rating for the State. This outcome will not be obtained without a track record of achievement. (Section 5.3)

2002-03

The estimated outcome for 2002-03 was a GFS net lending result of $312 million, which was an improvement of $387 million from the budget for the year and was due mainly to higher stamp duties ($107 million above budget) from the strong property market, better than expected receipts of Commonwealth grants and increases in operating expenses, which were offset by a decrease in capital expenditure. (Section 5.4.1)

The capital underspend has been a persistent issue for budgets over a number of years and it is notable that the 2003-04 Budget includes disclosure of a slippage allowance for capital payments of $40 million in anticipation that this will continue. The persistency of underspending outcomes suggests the need for further attention to capital budgeting and management. (Section 5.4.1.1)

The estimated result for 2002-03 is reflected in the change in net debt, which at 30 June 2003 is estimated to be $2.8 billion (for the non-financial public sector), down $493 million from the previous year. (Section 5.4.1.2)

For a number of years I have reported that the budget result has been managed by some very large transactions at year end. Typically these have been the deferral of distributions from financial institutions or large prepayments of superannuation past service payments. If, as is apparent in the 2002-03 estimated results, this practice has ceased for the future, I believe this to be an important improvement in financial reporting and management control. (Section 5.4.1.3)

2003-04 and the Forward Estimates

The budgeted net borrowing result for the 2003-04 year of $20 million is a $68 million improvement over the earlier estimate for that period. This is partly due to a real increase of $186 million in total operating revenues for 2003-04 being slightly higher than real increases of $170 million in operating expenses. The main improvement in 2003-04, however, largely coincides with the higher budgeted distributions from Public Non-Financial Corporations and Public Financial Corporations. (Section 5.5.2)

Net lending results (surpluses) are expected in the following three years to 2006-07. The average surplus over the four years to 2006-07 of $75 million per annum is a significant improvement over the prior year estimates, which anticipated an average deficit of $81 million per annum over the forecast period. (Section 5.6.1)

The improvement reflects a combination of anticipated real increases in operating revenues (including taxation and Commonwealth grants) and an overall real decrease in operating expenditure. (Section 5.6.2)

It is notable that outlay increases experienced in recent years have been covered by better than budgeted performance by taxation receipts and Commonwealth general-purpose grants. It is of course possible that this will not occur in any particular year given that revenue performance is subject to the influence of economic conditions. This prospect heightens the importance of controlling outlays within targets. (Section 5.8.1)

Importantly, the Budget has been prepared recognising the risk of a weakening in the property market and it continues to incorporate provisions for unplanned outlays and emerging priorities that will assist in this management task. The projected net lending outcomes add a further buffer to the achievement of the fiscal target of, on average, balanced budgets. (Section 5.8.1)

A key feature of the estimated results to 2005-06 is the level of distributions from public financial institutions. I have previously indicated I am of the view that large distributions from SAAMC and SAFA are unsustainable, as these entities have no capacity to replace amounts of this magnitude going forward. It is notable that the forward estimates for 2006-07 anticipate the lowest distributions from these entities while also estimating the highest net lending result over the forward estimates. (Section 5.8.2)

If the budgeted results are achieved over the forward estimate years, the Government will have met a key fiscal target, which is to achieve, on average, balanced budgets in the General Government Sector. (Section 5.8.3)

Revenue

Revenue from the Commonwealth is the most significant source of revenue to the State representing 56 percent of total operating revenues in 2002-03. (Section 6.2)

Total Commonwealth funding paid to the State during 2002-03 amounted to $4.7 billion, an increase of $108 million (2.3 percent) over the previous year. Estimated funding for 2003-04 is $4.8 billion. Funding in 2006-07 is expected to grow to $5.3 billion, a real increase of $0.2 billion over 2002-03. (Section 6.2)

In the long-term, Commonwealth GST revenues are expected to be a growth tax that will provide additional revenue benefits to the State. Whether outcomes will influence the level or conditions of other Commonwealth funding such as specific purpose payments or national competition payments is as yet unknown. (Section 6.2)

Taxation receipts for 2003-04 are estimated to be $2.5 billion, an increase of $90 million over 2002-03. Of this, only $9.5 million is due to new taxation measures, after reductions in some taxation arrangements. (Section 6.3)

Taxation revenue in 2006-07 is expected to grow to $2.7 billion a real increase of $127 million over 2002-03. (Section 6.3)

Strong projected growth of $71 million (real) in gaming machines tax receipts from $241 million in 2002-03 to $312 million (real) in 2006-07 reflects the full year impact in 2003-04 of the increase in the net tax take from the more profitable gaming machine venues effective from 1 January 2003, estimated growth in gaming machine expenditure and a change in the tax structure. (Section 6.3.3)

With respect to taxation revenues, estimates have prudently taken account of possible changes in economic conditions. Even so, the total amounts of taxation revenues is increasing over the forward estimates. (Section 6.7)

Expenses

GFS Expenses for 2003-04 are budgeted to increase by $147 million in real terms. Going forward, expenses are projected to decrease in real terms in 2004-05, remain steady in 2005-06, and increase again in 2006-07 to $8.8 billion due to higher capital payments. (Section 7.1)

Salaries and related costs ($3.9 billion in 2002-03) represent a very high proportion (45 percent) of the total current expenses. The 2003-04 Budget provides sums for anticipated public sector wage increases over the forward estimates period, both in individual agency budgets, and as a contingency item in the Department of Treasury and Finance (DTF) administered lines to cover future enterprise agreement outcomes. The inclusion of these allowances is a consistent approach to previous Budgets. (Section 7.2.1.1)

Notwithstanding amounts provided in the Budget, the Government estimates that if wages and salaries for public sector employees increased by 0.5 percent more than is currently factored into the Budget, then wage and salary expenditure would increase by over $50 million in 2006-07. (Section 7.2.1.1)

GFS other operating expenses, which include general purchases of goods and services, are estimated to fall in real terms from 2004-05 to the end of the forward estimates. There is a potential risk to the Budget and forward estimates if savings targets that have been built into the Budget are not achieved. Audit has been advised that the Government is well aware of this risk and has put in place a framework to monitor closely the progress of the savings strategies factored into the Budget and forward estimates. (Sections 7.2.2 and 7.2.3)

Capital underspending against budget was significant in 2001-02 and 2002-03. Variances between the 2002-03 Budget Papers and the 2003-04 Budget Papers have been a contributor to the presentation of projected improvements to net lending (borrowing) outcomes in the general government operating statement, reducing gross capital formation expenses by $90 million over the two years to 2005-06. (Section 7.2.4.1)

Due to revisions of the estimated unfunded superannuation liability, including the effect of negative investment earnings in 2002-03, the projected nominal superannuation interest expenses over the forward years are almost $50 million per annum higher than was estimated in the 2002-03 Budget. As larger amounts of assets are accumulated to offset the unfunded liability, this also increases the exposure of those assets to market movements, both positive and negative. (Section 7.2.6)

Savings

The Budget includes savings amounting to $430 million that have been identified by agencies. (Section 7.4.2)

The nature of savings initiatives range through reductions of staff, IT expenditure, administrative costs (including through the use of shared services), grants and maintenance. Some are in the nature of an exchange and deferral of capital for operating expenditure through private financing initiatives (Section 7.4.3)

Many of the services or activities conducted by public sector agencies are by force of legislation and it is necessary for agencies to fully understand and fulfil their legislative responsibilities. There may be limited opportunities for cost savings in these areas. (Section 7.4.3.1)

In relation to the increasing use of shared services arrangements I would observe that in order for such arrangements to be successful in both efficiency of costs and effectiveness for controlling and managing operations, their implementation needs careful planning and risk analysis. (Section 7.4.3.2)

The DTF has in progress a range of matters that will improve the budget monitoring and control processes. It will be important, however, for DTF to monitor whether the tightening of any significant policy change has the unintended consequence of encouraging agencies to 'spend up', particularly at year end. (Section 7.4.4)

FINANCIAL POSITION

Financial Assets

Total General Government Sector financial assets are expected to reduce by $36 million from 2001-02 to $14 billion in 2002-03 and increase thereafter reaching $15.2 billion in 2006-07. The decrease results mainly from the first time inclusion of estimated net liabilities of $384 million for WorkCover Corporation. (Section 9.2.1.1)

WorkCover has not previously been reported in the Government's financial reports, including the whole-of-government AAS based reports. This has been a matter noted in Audit correspondence over a number of years. (Section 9.2.1.1)

The inclusion of WorkCover in the Government's financial reports, in Audit's opinion, properly acknowledges the Government's responsibilities and exposures. (Section 9.2.1.1)

Investment assets as at 30 June 2003 for the major investing agencies amounted to $9.7 billion. (Section 9.2.3)

Non-Financial Assets

General Government Sector non-financial assets are estimated to increase continuously over the forward estimates period and in total by $0.8 billion from 2000-01 to $11.5 billion in 2006-07. Increases are due primarily to the net acquisition of non-financial assets for the Budget years. (Section 9.3.2)

With respect to the future acquisition of non-financial assets, the Government has indicated its intention to pursue partnership opportunities with the private sector. (Section 9.3.5)

Indications are that project initiation processes being applied to public private partnerships currently under investigation, are at a standard that is likely to surpass that applying to traditional build and operate arrangements. (Section 9.3.5.1)

Liabilities

Total liabilities for the General Government Sector are expected to grow to $11 billion in 2003-04 and to $11.4 billion by 2006-07. (Section 10.2.1)

The estimated unfunded superannuation liability as at 30 June 2003 is $4.5 billion. This is an increase of $508 million from 30 June 2002 actual liability, and is due mainly to negative investment earnings from assets managed by Superannuation Funds Management Corporation of South Australia (Funds SA) during the year. This was due principally to negative returns on international and domestic equities that comprise a large proportion of superannuation assets. (Section 10.3.4)

The assumed rate of return on superannuation assets in the 2001 triennial review was 7.5 percent per annum. It is important to note that a major investment objective of Funds SA is to achieve long-term returns of 4.5 percent in excess of inflation. That being the case, any assessment of the appropriateness of the assumed investment return rate needs to be made over the long-term. (Section 10.3.5)

Over the 10 year period to 2002-03, on average, investment returns have been lower than the budgeted investment-earning rate. (Section 10.3.5)

The commitment to fully fund unfunded liabilities was reaffirmed by the Government in the 2003-04 Budget Papers, with the position as at 30 June 2003 remaining consistent with the plan to eliminate unfunded superannuation liabilities by 2034. Additional funding contributions will be required, however, to compensate for reduced earnings in 2002-03 to remain on target. All other things being equal, investment performance above the long term earning assumption in any year may provide an ongoing benefit to future Budget results. (Section 10.3.7)

It is important to note that any change in the long-term earning rate can greatly impact upon the unfunded superannuation liability. (Section 10.3.6)

On current projections, unfunded liabilities are expected to continue to increase until peaking around the period 2014-15. It is estimated that benefit payments will peak in 2018-19. (Section 10.3.8)

Although they are not recognised in the statement of financial position, guarantees and contingent liabilities are an important issue for the Government. Identification and reporting of contingent liabilities has been a matter raised by Audit over a number of years. The 2003-04 Budget Statement reports on a number of matters that have arisen over the past two years and highlights the importance of reporting and managing contingent liabilities from their time of incurrence. (Section 10.5)

Net Worth and Net Financial Worth

General Government Sector net worth is forecast to decrease $418 million in 2002-03 to $14.3 billion and rise thereafter in the four years to 2006-07 to $15.3 billion with a net increase over the forward estimates period of $1.0 billion. (Section 11.3)

General Government Sector net financial worth is forecast to decrease $469 million to $3.1 billion in 2002-03 and increase annually over the forward estimates period, except for 2003-04, with a total increase of $713 million to $3.8 billion over the four years to 2006-07. (Section 11.3)

NET DEBT

Total net debt for the Non-financial Public Sector is projected to steadily decrease in nominal terms over the period of the 2003-04 Budget from $2.8 billion in 2002-03 to $2.2 billion in 2006-07. (Section 12.3.2)

Over the forward estimates net debt decreases in the General Government Sector by $534 million to $232 million due to projected budget surpluses. Net debt of the Public Non-Financial Corporations remains relatively stable over the same period and is estimated to be $2 billion in 2006-07. (Section 12.3.2)

BUDGET PREPARATION AND PERFORMANCE MONITORING

Although there has been a marked improvement in the budget reporting and monitoring process, there is still a need for continued work in improved timing of monthly budget results and subsequent reporting. Continued coordination and leadership by the Department of Treasury and Finance will be needed to ensure ongoing improvements in the quality and timeliness of whole-of-government reporting. (Section 14.7)

2 INTRODUCTION

This commentary provides some audit observations on a number of aspects of the State's finances. In particular:

- the reporting frameworks that exist for reporting on the State's finances. This is important, as there are a number of statutory and conventional accounting reporting requirements, each providing a different perspective;
- some brief analysis of the financial performance of the State for the year, based on some of the different reporting frameworks. This includes looking at the results for the past year, and the Budget and forward amounts included in the Budget Papers;
- analysis of some of the major revenue and expense components that contribute to the overall financial performance of the State's finances;
- a review of the financial position of the State, including understanding some of the major assets and liabilities, and the impact that they have on the State's finances;
- some observations with respect to several key financial management issues for the control of State finances.

3 REPORTING FRAMEWORK

3.1 INTRODUCTION

There are in place a range of reporting frameworks that have been, and in most cases will continue to be, used for reporting on the State's finances. Although there is a place for each of them, it can make it difficult to draw a consistent and comparable range of data to allow for the analysis of financial performance and the financial position of the State.

In last year's Report I provided details of the major frameworks relevant to the discussions on the State's public finances. The following sections provide a brief overview of frameworks referred to throughout this Report namely:

- Uniform Presentation Framework (UPF)
- Cash-based Non-Commercial Sector
- Australian Accounting Standards (AAS)
- Treasurer's Statements pursuant to the *Public Finance and Audit Act 1987.*

For a number of years I have indicated that such a range of reporting must be regarded as administratively costly and risks being confusing not only for users, but more importantly for preparers and managers who may find conflicting imperatives arising from the different reporting regimes that affect the quality and usefulness of information and decision making.

Given this situation, the Department of Treasury and Finance (DTF) had undertaken a number of reviews that led to a change to the primary basis for Budget presentation and the specific target(s) for 2002-03.

As a consequence, although the AAS framework basis remains the basis for agency (budget and actual) and whole-of-government (actuals only) reporting, the Budget prepared each year focuses on targets associated with the UPF framework (which is based on the reporting standards of the Australian Bureau of Statistics' (ABS's) accrual-based Government Financial Statistics (GFS) framework).

As a result of the focus on the UPF framework by DTF, the major proportion of the discussion and analysis is directed at reviewing information that is reported on that basis, with reference to other reporting framework based information as relevant.

The following sections provide a brief overview of each of the frameworks.

3.2 UNIFORM PRESENTATION FRAMEWORK (UPF)

3.2.1 Background

The UPF is a reporting standard based on the ABS's accrual-based GFS framework[20] which has been adopted by all Australian Government jurisdictions. The information is supplementary information reported in Budget and Budget Result documents prepared by each jurisdiction.

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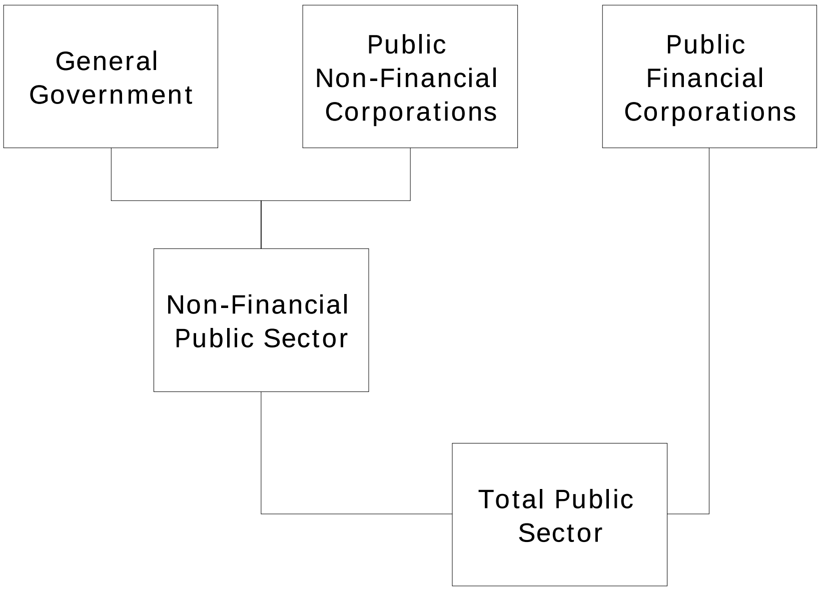
[20] To avoid confusion and ensure consistency, Audit has used the term GFS throughout this Report to refer to the accrual-based Government Financial Statistics (GFS) framework adopted under the Uniform Presentation Framework (UPF).

From the 2002-03 Budget the focus has been on the accrual-based GFS framework.

Although GFS accrual reporting has many similarities to that under the AAS framework, the GFS framework excludes revaluations from the GFS operating statement as they provided scope for varying interpretations and potentially substantial differences in the reporting of financial information across jurisdictions.

Notwithstanding these differences, the main statements emanating from GFS financial reporting are the operating statement, balance sheet and cash flow statement.

Another key aspect of the GFS framework is that of the identification of different sectors, recognising that state government activities cover a wide range of activities. Three sectors (which are then consolidated into two additional sectors) of government activity are identified in the following chart:



A description of the make-up of the three primary sectors is as follows.

General Government — all Budget dependent departments and agencies providing services free of charge or at prices below their cost of production or service cost. These are the services that tend to be financed mainly through taxes and other charges, and for this reason tends to be the focus of fiscal targets.

Public Non-Financial Corporations (PNFCs) — trading enterprises mainly engaged in the production of goods and services for sale in the marketplace at prices that aim to recover most or all of the costs involved. In South Australia the sector includes South Australian Housing Trust, South Australian Water Corporation and TransAdelaide. The consolidation of the General Government and Public Non-Financial Corporations represents the Non-Financial Public Sector (NFPS).

Public Financial Corporations — bodies primarily engaged in the provision of financial services. This includes financial institutions such as the South Australian Government Financing Authority (SAFA), South Australian Asset Management Corporation (SAAMC), HomeStart Finance and Funds SA.

The Budget Papers tabled in Parliament by the Government include a number of GFS financial statements as follows:

- General Government Sector Operating Statement and Balance Sheet.
- Public Non-Financial Corporation Sector Operating Statement and Balance Sheet.
- Non-Financial Public Sector Operating Statement and Balance Sheet.

Cash flow statements are also published for these sectors.

It is noted that the Public Financial Corporations sector data is not published in the Budget Papers. This data would include transactions from such entities as Superannuation Funds Management Corporation of South Australia (Funds SA), SAFA and SAAMC. Although data is produced and published for these entities by the ABS, it is not for some months after the budget process has concluded. As a result, the Budget Papers do not provide any details of the total public sector.

Ideally, when analysing the State's finances using GFS data, a more complete picture of some aspects would be formed if 'Total Public Sector' data were available. This data is, however, provided only by the ABS in its publications.

The Audit Analysis

As previously mentioned, Audit's discussion on the State's financial performance and position have mainly focused around the use of the General Government Sector consistent with the Budget presentation. The focus on the General Government Sector is because of its dependence upon taxation revenue and Commonwealth government grants to support their expenditure requirements. Non-financial and financial corporations generally earn a large proportion of their revenues through the provision of a good or service and provide support to the General Government Sector.

When analysing GFS financial statements, the key GFS headline amounts are as follows:

- ***GFS Net Operating Balance*** — the excess of GFS revenues over GFS expenses.

- ***GFS Net Lending/Borrowing (or Fiscal Balance)*** — measures a government's investment saving balance. This measure includes net capital expenditure, but not the use of capital (ie depreciation). It indicates whether a government is saving more than enough to finance all of its investment spending and is therefore not contributing directly to the current account deficit.

- ***Net Worth*** — a financial position measure that comprises total assets (financial and non-financial) less total liabilities less any contributed capital. This measure includes non-current physical assets (land and fixed assets) and employee entitlements such as unfunded superannuation and employee leave balances.

- ***Net Financial Worth*** — a similar measure to net debt, which is calculated from the balance sheet as financial assets less total liabilities.

- ***Net Debt*** — comprises gross financial liabilities less the stock of gross financial assets. The items included in this measure are discussed in depth in the Budget Papers.

These measures have been focused on by Audit throughout its discussion of the State's financial performance, financial position and overall financial strength.

3.2.2 Scope of Audit of GFS Financial Statements

GFS accrual data is not directly subject to audit. Notwithstanding this fact, the GFS accrual numbers should be reasonably consistent with Australian Accounting Standard (AAS) numbers for each agency that is audited by the Auditor-General's Department. Work performed on the 2003-04 Budget year's GFS data has included some analytical procedures to ensure that the amounts presented are reasonably supported and where trends in data materially differ, that they can be adequately explained.

Further, much of the information provided relates to budget and other forward estimates. Although Audit seeks to have a broad understanding of the budget preparation process, the data and assumptions are not subject to audit.

No opinion is, therefore, provided on the accuracy of both historic and prospective figures presented.

3.2.3 Convergence of GFS and Australian Accounting Standards

In April 2003 the accounting standard setting bodies commenced a project pursuing harmonisation of GFS and AAS based reporting. The aim of the project is to achieve an Australian Accounting Standard for a single set of Government financial reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements.

The Australian Accounting Standards Board proposes to finalise an Exposure Draft for a new standard in May 2004.

3.3 NON-COMMERCIAL SECTOR

The cash-based non-commercial sector operating result was the focus for the State's financial management strategy (the Budget refers to these as fiscal strategy) up to 2002-03. That presentation has been superseded by the GFS presentation. Some comment is made in this Report on this sector but I do not intend to consider this basis in the future.

3.4 AUSTRALIAN ACCOUNTING STANDARDS (AAS)

3.4.1 Background

The statutory financial reports that are prepared by individual agencies and subject to audit are compiled using Australian Accounting Standards.

In addition, in 1998-99 Accounting Standard AAS 31 'Financial Reporting by Governments' became operative. Whole-of-government financial reports have been prepared in this State since that time.

The basis for consolidation is Australian Accounting Standard AAS 24 'Consolidated Financial Reports', which details the principles for determining what makes up the economic entity. As a result of using the control concept from the standard, the accounts exclude local government bodies, universities, most marketing and professional regulatory authorities, the Legislature, and associations and financial institutions incorporated under State statute but not controlled by the Government.

3.4.2 Scope of Audit of AAS Whole-of-Government Financial Statements

Previously, I have reported that there is presently no requirement under the *Public Finance and Audit Act 1987* or other legislation to provide an independent audit opinion on the preparation of whole-of-government financial statements. Therefore, unless relevant legislative provisions are passed, I will not issue a formal independent audit opinion on the whole-of government financial statements.

Although there is no mandate for the Auditor-General to issue a formal independent audit report in respect of such information, I consider it both valuable and within the ambit of wider public expectation that such financial information should be subject to some form of independent review regarding its credibility and validity. As a result, sufficient work has been undertaken to be able to provide observations in respect to the financial statements for each year since 1999.

The key features of the audit undertaken of the financial statements include a review of:

- the principles adopted in the definition of the economic entity for whole-of-government purposes;
- controls and procedures within the DTF for evaluating the reliability and validity of data forwarded by agencies;
- the adequacy and reliability of the database used for the preparation of the whole-of-government financial statements;
- the preparation of the whole-of-government general purpose financial statements;
- compliance with appropriate legislation and accounting frameworks, in particular Australian Accounting Standards, Urgent Issue Group Consensus Views, Treasurer's Instructions and other professional reporting requirements in Australia.

3.4.3 Audit Findings and Comments

Following the review of the financial statements for 2001-02 by Audit, a management letter was forwarded to the DTF in May 2003 that contained important reporting and operational considerations that would need to be addressed in order to provide an unqualified audit opinion should legislative changes precipitate the need to provide an audit opinion. The Audit management letter was reproduced in full in the whole-of-government financial statements published by the DTF.[21]

The matters raised included:

- timeliness issues with the preparation of whole-of-government financial statements. In particular, it was noted that a number of other States had been able to finalise and publish their whole-of-government financial statements many months before South Australia, which did so in May 2003;

[21] Government of South Australia, Consolidated Financial Statements for the year ended 30 June 2002.

- the whole-of-government financial statements excluded WorkCover Corporation, which Audit considered should have been included. Therefore the financial statements do not correctly include all revenues, expenses, assets and liabilities controlled by the Government;

- some of the individual entities consolidated did not have audited information available;

- the inclusion of a number of material account balances from government entities that received qualifications;

- recommendations for disclosure and presentation improvements when preparing future whole-of-government financial statements.

Departmental Response

The Department responded positively to the issues raised and expected to resolve most issues in time for the financial statements for the year ended 30 June 2003.

Limitations still exist with the current reporting process, however, the usefulness and importance of these reports in providing an understanding of the broad structure of the State's financial position is recognised as a key reporting tool of the Government. This usefulness would be significantly improved by the more timely completion of the financial statements.

3.5 TREASURER'S STATEMENTS - *PUBLIC FINANCE AND AUDIT ACT 1987*

3.5.1 Background

Reporting on the result of the Consolidated Account remains important as it is through this Account that, pursuant to the requirements of the *Public Finance and Audit Act 1987* (the Act), a high proportion of public monies are received and expended. The main receipts to the Consolidated Account are State taxation and Commonwealth general purpose grants to the State. The importance of reporting derives from the fact that funds in this Account can be expended only by Parliamentary appropriation. Reporting therefore establishes the actual sources and application of Consolidated Account funds pursuant to the Act.

The Treasurer's Financial Statements set out the appropriation authority available from various sources for the financial year including the annual *Appropriation Act*, the Governor's Appropriation Fund and specific appropriations authorised under various acts. Also set out are the purpose and amount of payments from the Consolidated Account, that is the use of that appropriation.

The Treasurer's Financial Statements are reported, in full, as an Appendix to Part B, Volume IV of this Report.

3.5.2 Appropriation Flexibility

Appropriation authority under the annual *Appropriation Act* and Governor's Appropriation Fund lapse on 30 June each year pursuant to the relevant legislation notwithstanding the availability of unused appropriation.

While there is specific appropriation authority established under various legislation, there is also flexibility in the existing appropriation arrangements in this State. A significant aspect in this regard is that most appropriation from the Consolidated Account is transferred to Special Deposit Accounts and Deposit Accounts established pursuant to the *Public Finance and Audit Act 1987*. Under related provisions, monies credited to those accounts can be spent without further appropriation from Parliament. This is of significance in that monies appropriated in one year and transferred to a deposit account need not actually be expended in that year, that is, they may be carried over into the next year.

Such unspent balances do come under the scrutiny of Parliament in as much as they are reported in the financial positions of agencies in the Budget Papers and the balances are also reported in the Treasurer's Financial Statements (as referred to before) Appendix F, F(1), F(2) and G.

3.5.3 Governor's Appropriation Fund and Contingency Provisions

Other key aspects of flexibility in appropriation authority arise from the provision of sources of funds for additional/new initiatives or unforeseen cost pressures that can be used without a requirement to return to Parliament for additional appropriation authority. The two such sources generally now used are the:

- Governor's Appropriation Fund (GAF), previously mentioned, which adds to the amount appropriated by Parliament each year and affects the budget result as these are unbudgeted expenses;

- contingency provisions for employee entitlements, supplies and services and plant and equipment in the total of the appropriation purpose 'Administered Items for Department of Treasury and Finance'. These amounts are included within the total appropriation (and budgeted expenses) but are generally not committed to a specific purpose at the time of the Budget.

3.5.4 Scope of Audit of the Treasurer's Statements

Audit reviewed the internal controls surrounding the appropriation and disbursement of monies through the Consolidated Account. This included the:

- testing of appropriations from the Governor's Appropriation Fund, Contingency Funds and Ministerial payments;

- establishment and changes to Treasurer's Special Deposit and Deposit Accounts;

- updating and recording of the Treasurer's Loans.

3.5.5 Audit Findings and Comments

The results of audit work undertaken indicated that while internal controls were in general operating satisfactorily, there were a number of issues raised that Audit believed should be considered. These included:

- that a reconciliation be prepared on a regular basis between the contingency provision spreadsheet and DTF's general ledger;

- the need to ensure that documented policies and procedures are properly maintained.

DTF responded that each of the matters raised had either been resolved, or that steps had been put in place to implement the Audit recommendations.

In addition, during the audit of the Treasurer's Statements, an issue with respect to Statement K (Statement of Appropriation Authorities) was noted.

Statement K sets out the amounts that have been applied and issued by the Treasurer from the Governor's Appropriation Fund pursuant to section 12 of the *Public Finance and Audit Act 1987*. Whilst in most cases formal approval had been received from the Treasurer in relation to the amounts identified as issued and applied, three amounts totalling $1.1 million had not been approved as at 30 June 2003.

Although the amount involved did not affect my ability to issue an unqualified opinion in respect of the Treasurer's Statements, it does raise the need for agencies and the Department of Treasury and Finance to ensure that monies applied from appropriated funds are subject to the appropriate approvals before 30 June after which Parliament's appropriation lapses.

4 SUMMARY OF KEY FISCAL MEASURES AND TARGETS

4.1 SOUTH AUSTRALIAN FISCAL TARGETS

In my last Report I provided comment on the development of new fiscal targets for this State that were adopted in the 2002-03 Budget.

The 2003-04 Budget Papers indicate that the Government remains committed to the following fiscal principles:

Fiscal target	to achieve on average balanced budgets in the General Government Sector.
Taxes	to ensure the State has an effective tax regime having regard to the Government's social and economic objectives.
Services	to provide value for money community services and economic infrastructure within available means.
Superannuation	to fully fund accruing superannuation liabilities as they arise and progressively fund past service superannuation liabilities.
Risk	to ensure risks to State finances are prudently managed, while maintaining at least an AA plus credit rating.
PNFCs borrowing	to ensure Public Non-Financial Corporations (PNFCs) will only be able to borrow where they can demonstrate that investment programs are consistent with commercial returns (including budget funding).

These fiscal principles reflect a commitment by the Government to containing the public sector's level of liabilities by ensuring no growth in debt from ongoing operations of the General Government Sector, by eliminating unfunded superannuation liabilities, and by requiring all PNFC borrowing to be fully funded from resultant cash flows.

This rationale is supported by the risk principle that aims to ensure that public sector liabilities and contingent liabilities are carefully managed.

These principles are consistent with those proposed for a Charter of Budget Honesty. The Charter requires the Government's fiscal objectives to take into account a range of issues including tax policy and burden, risk and service delivery. Further, these principles ensure that both short term and long term objectives are taken into account to ensure equity between present and future generations.

The Government's long-term objective is for general government operating expenses and investing expenditure to be met entirely by revenues. The fiscal targets do not distinguish general government investing expenditure from operating expenditure. General government investing expenditure is not undertaken to generate future revenue streams and therefore must be met from current revenue streams or operating surpluses. This target ensures no growth in general government net debt from operating or investing expenditure.

As a result of the Government's decision to pursue these particular targets, the focus of Audit's commentary is directed to those and associated measures.

4.2 FISCAL MEASURES IN OTHER JURISDICTIONS

In considering the State's fiscal strategy, it is useful to note what is current practice across Australian jurisdictions. The following table summarises the current budget targets for each jurisdiction.

Jurisdiction	Budget Fiscal Objective / Strategy (a) (b)
Commonwealth	Maintain budget balance on average over the economic cycle (Fiscal Balance = 0).
	Maintaining surpluses over the forward estimates period while economic growth prospects remain sound.
NSW	Achieve a sustainable fiscal surplus in the General Government Sector.
Victoria	Short Term: Target Operating Surplus of $100 million for the General Government Sector (measured on AAS 31 basis).
	Long Term: Maintain a substantial budget operating surplus.
Queensland	The Government will ensure that its level of service provision is sustainable by maintaining an overall General Government operating surplus.
WA	Achieve accrual operating surpluses for the General Government Sector.
Tasmania	The annual General Government Sector budget will be maintained in surplus.
	The General Government Sector cash surplus will be sufficient to achieve the Government's established net debt targets.
ACT	Maintenance of a balanced budget over the economic cycle (from 2002-03 to 2005-06) (measured on a AAS 31 basis).
NT	To achieve an underlying cash surplus by 2004-05.
	To achieve a positive GFS operating balance within 10 years in the General Government Sector.

(a) unless otherwise stated, all fiscal measures relate to the ABS defined General Government Sector
(b) other targets may also be used in relation to such areas as debt, taxes, expenses, net worth, superannuation, infrastructure and risk.

While it is evident that there is some variation between the states, the most prevalent position is to target net operating surpluses in the General Government Sector, based on the GFS accrual method as is the position in this State.

4.3 SOME AUDIT OBSERVATIONS ON THE FISCAL MEASURES

Given the availability of common data from all jurisdictions and that it is a framework constructed for the specific issues of the public sector, the GFS financial statements and associated measures/indicators are, in Audit's opinion, appropriate for the development of the primary fiscal strategy.

However, notwithstanding that the focus on the General Government Sector within that framework is common among almost all jurisdictions, to focus on a smaller sector such as the General Government Sector introduces some issues. One of particular importance, in my opinion, is the following.

General government is only part of the overall public sector as it does not include Public Non-Financial or Public Financial Corporations. While transactions with the other sectors will be included in the General Government Sector results, I believe it important that relevant information also be available for the PNFC sector in particular. Currently the General Government Sector picks up four year forward estimates for that sector. By comparison, the PNFC published data is only for the immediate budget year with some financial position data (eg. net worth) through the forward estimated period. I believe it important that comparative period information be available for users so as not to lose sight of the broader public sector activity.

5 STATEMENT OF FINANCIAL PERFORMANCE

5.1 OVERVIEW

The following sections discuss the financial performance of the State's finances in relation to:

- the estimated actual result for 2002-03, and how it compares both to the prior year numbers and the budgeted amounts;
- the Budget for 2003-04 having regard to the estimated actual result for 2002-03;
- a longer term view of the forecast results going forward to 2006-07.

The discussion will provide an overall snapshot and form the basis of discussion of some of the individual influences on the actual and predicted results and related matter of managing the State's finances.

Limitations on Analysis

Even though, as I have indicated, there are a number of advantages in adopting the GFS framework for primary targets, there are still some limitations on the data when analysing results, which must be considered to put things in context. These limitations include the following.

- When considering the estimated result for 2002-03 it must be emphasised that these results are only estimates. Past experience has been that actual results have varied substantially from the estimated result. While such variations have been small relative to the level of activity of the State (eg expenses in excess of $8 billion), when the budget result target is small, variations are significant. This is a matter relevant to monitoring budget performance discussed later. This is of less concern for 2002-03 given the magnitude of the result for that year.

- While Audit regards the current accrual based budgeting and reporting framework as superior to the previous cash based methodology, the method does not eliminate the means for the results to be manipulated to manage outcomes. This can occur through such means as the timing of certain discretionary amounts and transfers between GFS sectors.

  The Audit commentary in this Report is based on a review of the budget material and related information. It is not an audit in the same sense as work conducted to provide an audit opinion on financial statements. Notwithstanding this observation, it is also important to acknowledge that the Budget Papers presented for the 2003-04 Budget are regarded as being of a high standard in their presentation and disclosures and are consistent with a history of continuous improvement in financial information.

- Although the use of the GFS framework allows for comparisons between different states, the way individual states structure their public finances may place some limitations on such analysis. An example of this is the arrangements for public sector superannuation liabilities and their funding in Queensland.

- Classification changes occur from year to year in revenue and expense definitions that can affect the comparability across the time series. Such changes do not generally affect the net lending (borrowing) result.

Notwithstanding these limitations, the primary reporting framework does, in Audit's view, provide an important basis for considering the financial performance of the State's finances, both in terms of results over time, and against other states. These limitations are not so great as to invalidate the overall trend analysis from the Budget data, ie it is generally within reasonable limits.

5.2 INFLUENCE OF THE FISCAL STRATEGY FOR 2003-04

As previously discussed the importance of the budget process is that it should provide structure and discipline to the financial management process.

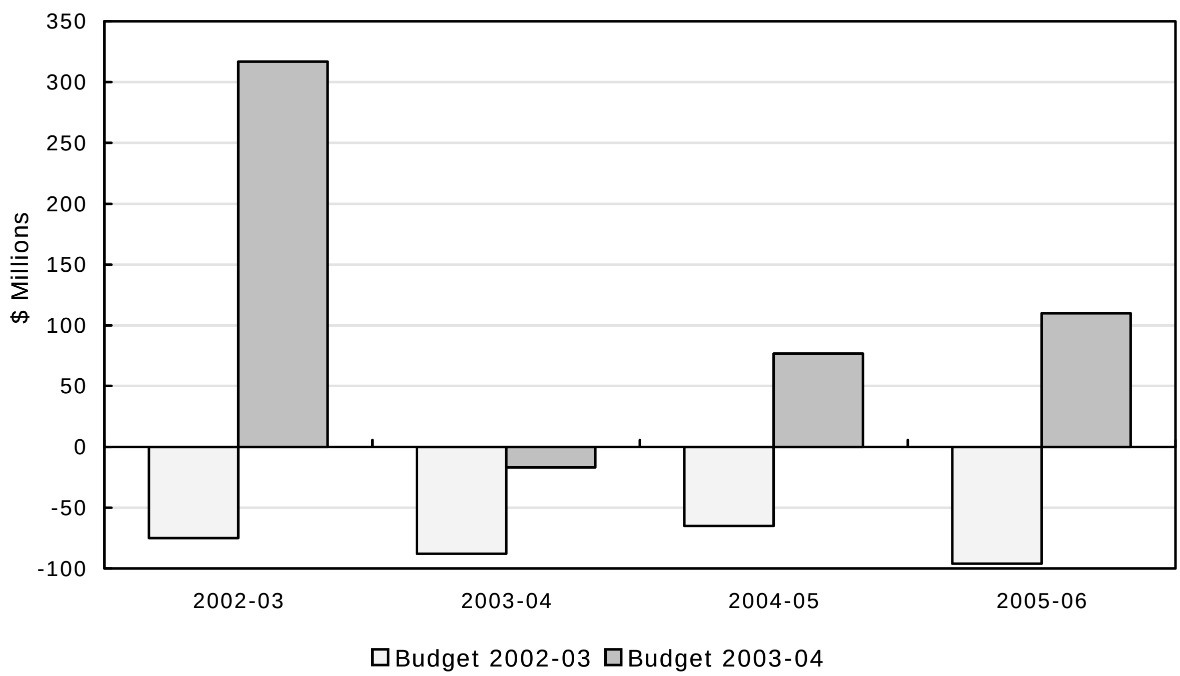
The Government's primary fiscal target is to achieve accrual budget balance, on average, in the general government sector. The budget balance is measured by the net lending position of the Government. A surplus means that net financial liabilities are being reduced (before any revaluation effects).

This target was adopted in the 2002-03 Budget and continues in the 2003-04 Budget.

The 2003-04 Budget sees a marked change in anticipated results compared to the 2002-03 Budget. While budgeting for a small deficit for 2003-04, the Government has budgeted to achieve the targeted net lending position over the remaining years of the forward estimates to 2006-07. This is the first time such outcomes have been budgeted. Net borrowing outcomes were budgeted for all of the forward years in the 2002-03 Budget.

The following chart shows how budgeted outcomes for the forward years have changed between the 2002-03 Budget Papers and the 2003-04 Budget Papers.

Net Lending (Borrowing) Budget 2002-03 to Budget 2003-04



The chart clearly demonstrates the anticipated improvement in operating results over the four years of the 2002-03 Budget to 2005-06. This positive turnaround over the four years amounts to an improvement of $802 million of which $387 million occurs in 2002-03.

5.3 RISKS AND MANAGEMENT TASKS FOR THE 2003-04 BUDGET

The risks and management tasks for the 2003-04 Budget are consistent with those I have reported in the past. Risks to the budget from the possibility of higher levels of growth in expenses remain - there must be management controls to monitor and mitigate this risk. To the extent that revenue estimates are conservative, there is perhaps, some flexibility in the management task. This again, is a matter to be monitored and managed.

I have also observed in past Reports that better than budgeted revenue outcomes, offsetting expenditure levels that have periodically grown beyond the rates budgeted, have been fundamental to the results reported in past years. Interestingly, the Budget notes that an element relevant to the improved net lending position compared to the 2002-03 Budget is agency under-expenditure. Even so, data indicates that actual outcomes have exceeded original budgets in recent years in respect of operating expenses, while capital has generally experienced under expenditure. The persistency of capital under expenditure is an issue for budget analysis and management that I have referred to in previous Reports.

It will be noted in the commentary that follows, that a range of matters provide some latitude in expenses across the 2003-04 Budget estimates years, including:

- targeted savings and revenue initiatives totalling $538 million over four years;[22]
- taxation measures designed to bring in an additional $27 million in a full year;[23]
- reliance on distributions from the financial corporations sector of government amounting to $305 million over four years,[24] of which $273 million is from two entities.

Importantly, it is projected that by the end of the Budget forward estimates, 2006-07, achievement of the key fiscal target will be well established. Given the projected net lending outcomes for the three years to 2006-07, there is perhaps some additional room built into the estimates compared to the long term balanced budget aims.

Notwithstanding these observations, I am of the view that the budget picture for this State continues to demand focused attention and improvement to its processes. Although this budget forecasts surpluses, they are certainly not of an order that places the State in a position to relax its focus on financial management improvement. Pressure also derives from the State’s aim to improve its financial standing. This is epitomised in public statements the Government has made on seeking a AAA credit rating for the State. This outcome will not be obtained without a track record of achievement.

The commentary that follows in sections 5 to 7 provides further analysis of the 2003-04 Budget and related control issues that the Government has identified in response to the Budget position and its fiscal targets.

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22 Budget Statement 2003-04, Budget Paper 3, Table 2.2.

23 Budget Statement 2003-04, Budget Paper 3, Table 3.1.

24 Budget Statement 2003-04, Budget Paper 3, Table 3.12.

5.4 ESTIMATED RESULT FOR 2002-03

5.4.1 GFS Accruals

The estimated result for the year was a GFS net lending result of $312 million, which is an improvement of $387 million from the budget for the year.

The result was also an improvement of $436 million from the previous year's result, but this comparison is heavily influenced by the fact that revenue distributions amounting to $276 million had been deferred in 2001-02.

The following table shows the estimated result for 2002-03 in comparison to the original budget estimate, and the actual result for the 2001-02 financial year, and identifies the differences to the 2002-03 Budget.

Table 5.1 — Budget Comparisons 2001-02 to 2002-03

	2001-02 Actual $'million	**2002-03 Budget $'million**	**2002-03 Estimated Result $'million**	Difference to Budget $'million	Difference to Budget Percent
Operating Revenue:					
Taxation revenue	2 193	2 183	2 373	190	9
Sale of goods and services	902	832	930	98	12
Other State source revenue	358	292	299	7	2
Commonwealth grants (current)	4 424	4 528	4 545	17	-
Commonwealth grants (capital)	186	153	173	20	13
Other grants	61	40	57	17	43
Total Operating Revenue	8 124	8 027	8 376	349	4
Less: **Operating Expenses:**					
Gross operating expenses (excluding depreciation) [(a)]	6 099	6 241	6 304	63	1
Current transfers	1 663	1 500	1 479	(21)	(1)
Capital transfers	44	43	61	18	42
Total Operating Expenses	7 806	7 785	7 845	60	1
Current Operating Surplus before Interest Depreciation and Distributions	318	243	531	288	-
Less: Net interest expense	141	164	146	(18)	(11)
Less: Nominal superannuation interest expense	244	284	299	15	5
Add: Distributions received from PNFCs and PFCs	283	635	649	14	2
Less: Depreciation	390	388	406	18	5
GFS Net Operating Balance	(174)	42	329	287	-
Gross fixed capital formation [(a)]	337	503	420	(83)	(17)
Less: Depreciation	390	388	406	18	5
Add: Change in inventories	3	2	2	-	-
Total Net Acquisition of Non-Financial Assets	(50)	117	17	(100)	-
GFS Net Lending (Borrowing)	(124)	(75)	312	387	-

Note: Totals may not add due to rounding.

(a) The 2002-03 Budget gross operating expenses includes approximately $62 million reclassified from gross fixed capital formation.

As shown above, events have occurred during the 2002-03 financial year resulting in significant changes to the original budget estimates. In total, the variances have resulted in a better than budgeted estimated GFS net lending (borrowing) result for the State by reversing the result to an estimated net lending position.

The primary reasons for the change in the original budget result are as follows:

- ***Taxation Revenue*** — stamp duties on conveyances exceeded expectations by $107 million due mainly to a stronger than budgeted for property market. In addition, most other taxes also were above the original Budget amounts.

- ***Sales of Goods and Services*** — most of this change is due to a reclassification of monies from Commonwealth Grants. The stronger property market also resulted in higher than budgeted fees.

- ***Commonwealth Grants*** — the increase relates to better than expected receipts of financial assistance grants and specific purpose payments.

- ***Expenditure*** — Increases in operating expenses, which were offset by a decrease in capital expenditure.

More detailed discussions on some of the reasons are included in the sections on 'revenue' and 'expenditure' later in this Report.

The nature of the movement is generally consistent with previous years, although limiting the extent of over-run of operating expenses has resulted in revenue gains flowing through to the 'bottom line'.

5.4.1.1 Capital Underspending

As in past years, the capital underspend in 2002-03 is substantial. This has been a persistent issue for budgets over a number of years and it is notable that the 2003-04 Budget includes disclosure of a slippage allowance[25] for capital payments of $40 million in anticipation that this will continue. The practicality of capital works is that there are long lead times into commencement of projects and construction can be subject to delays. Nonetheless, the persistency of underspending outcomes suggests the need for further attention to capital budgeting and management.

5.4.1.2 Application of the Result

The result for 2002-03 is essentially reflected in the change in net debt, which at 30 June 2003 is estimated to be $2.8 billion for the Non-Financial Public Sector, down $493 million from the previous year.

5.4.1.3 Change in Reporting Practice

The very large estimated net lending result for 2002-03 highlights an apparent change in practice from past budgets. For a number of years I have reported that the budget result has been managed by some very large transactions at year end. Typically these have been the deferral of distributions from financial institutions or large prepayments of superannuation past service payments. These transactions have allowed smoothing of

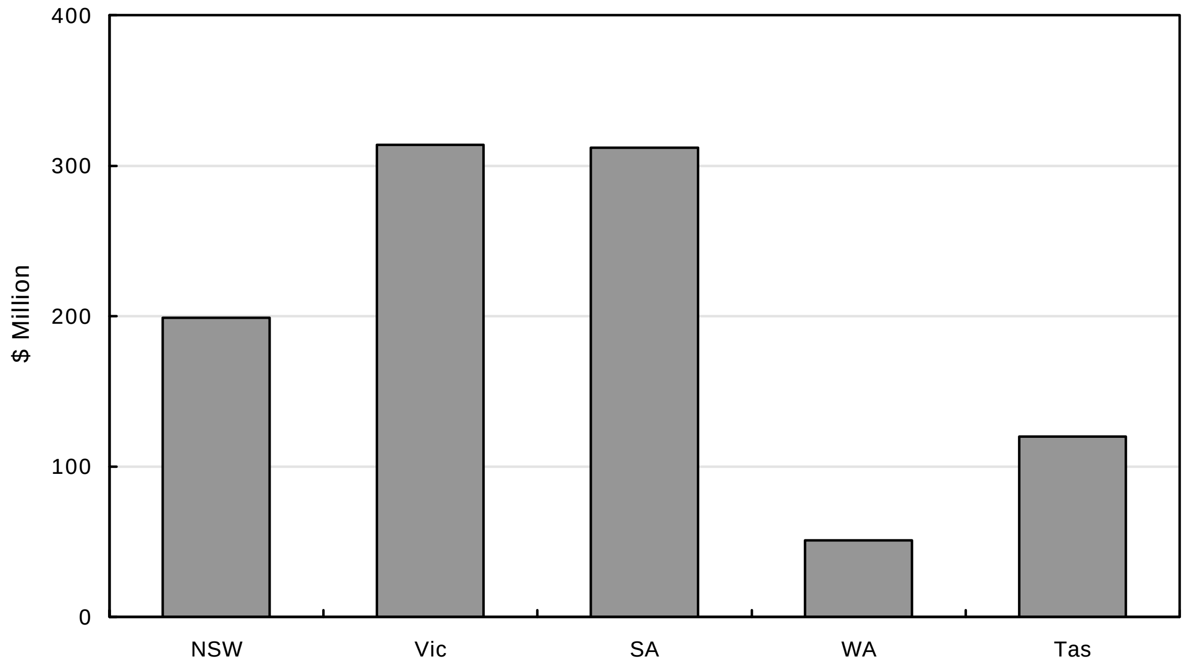
[25] Budget Statement 2003-04, Budget Paper 3, p2.34.

results, offsetting unbudgeted revenue gains or underspending, particularly on capital. If, as is apparent in the 2002-03 estimated results, this practice has indeed ceased for the future, I believe this to be an important improvement in financial reporting and management control. It will allow focus on actual performance against the original budget and appropriate responses to the budget results.

5.4.1.4 Comparisons to Other States

The following chart shows the estimated GFS General Government Sector net lending (borrowing) result for each of the mainland states for the year ended 30 June 2003.

GFS - General Government Sector Estimated Net Lending (Borrowing) Result for 2002-03



The preceding chart shows that the result for South Australia was equal to the best performing state (Victoria). However, this needs to be considered in the context of previous statements about the impact of very large distributions from State-owned financial institutions on the result for 2002-03. Notwithstanding this, the result represents a significant improvement on the budgeted position.

5.4.2 Non-Commercial Sector

The non-commercial sector budget was a principal focus of the State finances fiscal strategy up to the 2001-02 Budget, with the Government’s 2001-02 Budget objective under the plan to achieve an underlying balanced cash budget (including current and capital spending) for the non-commercial sector.

As a result, it is considered relevant to include some final commentary on the estimated result for 2002-03 under that framework.

The 2002-03 estimated budget outcome is presented below in summary form.

Table 5.2 — Cash-Based Non-Commercial Sector 2002-03

	2001-02 Actual $'million	**2002-03 Budget $'million**	**2002-03 Estimated Result $'million**	Difference $'million
Current outlays	(7 387)	(7 199)	(7 209)	(10)
Capital outlays	(582)	(689)	(531)	158
Own source revenues	3 071	3 172	3 380	208
Grants received	4 604	4 681	4 775	94
Financing transactions	71	84	89	5
	(222)	50	504	455
TVSP, asset sale and other sundry costs	244	42	10	(32)
Underlying Surplus (Deficit)	22	92	514	422

The estimated result is a surplus of $514 million. This represents a $422 million improvement on the original Budget.

The key differences between the original budgeted amounts and the estimated result are similar to those as explained for the General Government Sector, namely increases in both taxation and Commonwealth Grants, and an underspend in capital payments.

5.4.3 The Consolidated Account Outcome

As discussed, reporting on the result of the Consolidated Account remains important as it is through this Account that, pursuant to the requirements of the *Public Finance and Audit Act 1987* (the Act), a high proportion of public monies are received and expended.

The Treasurer's Financial Statements set out the appropriation authority available from various sources for the financial year including the annual *Appropriation Act*, the Governor's Appropriation Fund and specific appropriation authorised under various acts.

Total appropriation authority for 2002-03 was $6.1 billion (excluding the Governor's Appropriation Fund and specific appropriations authorised in various acts). Actual payments were $5.9 billion, well within appropriation authority.

The result on the Consolidated Account for 2002-03 was a surplus of $444 million ($120 million in 2001-02). This surplus was determined after total receipts of $6.6 billion and payments of $6.1 billion.

The cash surplus of $444 million exceeded the budgeted amount by $395 million.

This surplus was used to repay borrowings from SAFA. This is reflected in the reduction in net debt as at 30 June 2003 as previously discussed.

The key differences between actual and budgeted amounts are explained as follows:

- Large increases in stamp duties receipts of $189 million due partly to higher than expected housing activity brought on from lower interest rates and the First Home Owners Grant (FHOG) Scheme.

- Commonwealth General Purpose Grants exceeding budget by $83 million, mainly through GST revenue grants increasing by $110 million.

- Savings experienced through lower payments of interest on borrowings ($34 million), targeted voluntary separation package (TVSP) schemes ($32 million) and the purchase of property plant and equipment ($25 million).

- Contributions from state undertakings increased by $43 million due to increased dividends and tax equivalent payments by non-financial corporations and the Department of Administrative and Information Services.

Further details of this budget and actual data are presented in Statement A 'Comparative Statement of the Estimated and Actual Payments from the Consolidated Account of the Government of South Australia'.[26]

5.4.3.1 Governor's Appropriation Fund and Contingency Provisions

Earlier in this Report reference was made to aspects of the flexibility within the appropriation process, in particular the availability of the Governor's Appropriation Fund (GAF) and the provision for contingencies within the DTF Administered Items.

The 2002-03 Budget included contingency funds totalling $98 million ($113 million), which when added to the $184 million ($175 million) available from the GAF provided uncommitted flexibility within the Budget of $282 million ($288 million) or 4.7 percent (4.7 percent) of the total of the *Appropriation Act 2002* less the total of budgeted contingency funds.

Use of both the contingency provisions and the GAF requires the Treasurer to approve the expenditure of the funds. As mentioned, use of contingency provisions does not effect the budget result as they are already figured into that result. Use of the GAF, on the other hand, is an additional expense for the Budget result.

The following table sets out the availability and use of these funds in 2002-03.

Table 5.3 — Appropriation Flexibility

	Authority / Budget $'million	Actual Payments $'million
Governor's Appropriation Fund	184	62
Total contingency provisions	98	100
Total Flexibility	282	162

[26] Report of the Auditor-General for the year ended 30 June 2003, Part B, Volume IV, Appendix.

Details of the purpose of the actual payments from the GAF are provided in Statement K of the Treasurer's Statements.[27]

Details of payments from the contingency funds are not disclosed in the Treasurer's Financial Statements. Payments are transfers of additional funding to agencies. These payments are included within the total payments from the line 'Administered Items for Department of Treasury and Finance' in Statement A of the Treasurer's Statements.

As can be seen from the above table the flexibility arrangements within the 2002-03 Budget were sufficient to meet additional costs.

5.4.4 AAS 31 Results

The following briefly discusses the financial result of the AAS 31 statements as at 30 June 2002.

As previously discussed, there are some limitations in analysing AAS 31 data particularly due to the timing of its preparation each year, however they do provide the opportunity to observe the financial result of the Government using a full accrual accounting basis, and the consolidation of all sectors.

The following table summarises the financial result for the year ending 30 June 2002, with comparative amounts for the preceding three years.

Table 5.4 — AAS 31 Financial performance (1999-2002)

	1999 $'million	2000 $'million	2001 $'million	2002 $'million
Revenues				
Taxation	1 729	2 081	2 024	2 037
Grants	3 697	3 925	4 361	4 807
Sale of goods and services	3 964	3 788	3 122	2 556
Investment revenues	1 048	1 552	871	811
Net revenues from asset disposals [(a)]	64	1 137	268	63
Other	526	575	717	1 025
	11 028	13 058	11 370	11 299
Expenses				
Employee expenses	3 660	3 298	3 526	4 942
Supplies and services	2 814	3 149	3 008	2 884
Grants and subsidies	1 387	1 497	1 356	1 380
Borrowing cost expenses	1 554	2 119	921	757
Other	1 953	1 908	1 734	2 362
	11 368	11 971	10 545	12 325
Net Surplus (Deficit)	(340)	1 087	825	(1 026)
Increase in asset revaluation reserve	215	353	1 184	666
Increase (Decrease) in adoption of new standard	(178)	6	348	2
Total Changes in Equity	(303)	1 446	2 357	(358)

(a) These amounts include gains made on the disposal on electricity infrastructure and businesses.

27 Report of the Auditor-General for the year ended 30 June 2003, Part B, Volume IV, Appendix.

The following briefly explains the large movements in 2002 revenue and expense amounts.

Revenue

Total operating revenue for the 2001-2002 financial year was $11.3 billion; a decrease of $71 million on the revenues earned in the 2000-2001 financial year. The decrease was due mainly to the following:

- ***Net Revenues from Asset Disposals*** — decreased by $205 million due to fewer proceeds being received from the disposal of the government businesses in comparison to the previous year.
- ***Sales of Goods and Services*** — decreased by $566 million, following the sale of SA Ports Corporation and SA TAB Pty Ltd.
- ***Grants*** — Commonwealth Government grants increased by $446 million, including an increase in general purpose grants of $314 million.

Expenses

Total expenses increased by $1.8 billion during the financial year. These increases were mainly derived from:

- Employee Expenses — a large increase in employee expenses of $1.4 billion, due to increases in the unfunded superannuation liability because of negative returns on superannuation assets.
- Net Investment Expenses (classified among 'Other') — increased by $677 million due to the devaluation of investments. This movement is primarily a reflection of the weaker investment returns received this financial year on international and domestic equities.
- It is expected that lower or similar investment expenses will be recognised in 2002-03 due to estimated negative returns on domestic and international equities.
- Further details on investment returns on equities are provided in the section on 'Assets'.
- Depreciation expenses (classified among 'Other') — additional depreciation expenses of $98 million arose mainly as a result of prior asset revaluations on infrastructure assets.

5.5 2003-04 BUDGETED RESULTS

The following focuses on the trends arising from the 2003-04 Budget tabled in Parliament in May 2003. It provides an overview of the expected result and provides the context for discussions on individual lines of the Budget later. Given that the fiscal targets are now focused on the accrual-based GFS framework, the analysis deals only with that framework.

5.5.1 GFS - General Government Sector - Operating Statement

The Budget presented to Parliament in May 2003 details a budget GFS net borrowing result for 2003-04 of $20 million, a deterioration of $332 million on the estimated 2002-03 result.

The differences between the two years are set out in the following table.

Table 5.5 — Budget Comparison 2002-03 and 2003-04

	2002-03 Estimated Result $'million	2003-04 Budget $'million	Difference $'million	Difference Percent
Operating Revenue				
Taxation Revenue	2 373	2 463	90	3.8
Sales of goods and services	930	952	22	2.4
Other State source revenue	299	294	(5)	(1.7)
Commonwealth grants (current)	4 545	4 671	126	2.8
Commonwealth grants (capital)	173	166	(7)	(4.0)
Other grants	57	58	1	1.8
Total Operating Revenue	8 376	8 603	227	2.7
Less: **Operating Expenses**				
Gross operating expenses (excluding depreciation)	6 304	6 568	264	4.2
Current transfers	1 479	1 516	37	2.5
Capital transfers	61	23	(38)	(62.3)
Total Operating Expenses	7 845	8 106	261	3.3
Current Operating Surplus before Interest Depreciation and Distributions	531	497	(34)	(6.4)
Less: Net interest expense	146	126	(20)	(13.7)
Less: Nominal superannuation interest expense	299	337	38	12.7
Add: Distributions received from PNFCs and PFCs	649	435	(214)	(33)
Less: Depreciation	406	410	4	1.0
GFS Net Operating Balance	329	58	(271)	(82.4)
Less: **Net Acquisition of Non-Financial Assets**				
Gross fixed capital formation	420	486	66	15.7
Less: Depreciation	406	410	4	1.0
Add: Change in inventories	2	2	0	0
Total net acquisition of non-financial assets	17	78	61	-
GFS Net Lending (Borrowing)	312	(20)	(332)	-

Note: Totals may not add due to rounding.

It can be seen from the above table that the deterioration for the 2003-04 year is due mainly to:

- no real increase in total operating revenues above the level of CPI (2.75 percent for 2003-04);
- increases in operating and capital expenses (approximately $100 million above the level of CPI);
- a large decrease ($214 million) in the distributions received from Public Non-Financial Corporations and Public Financial Corporations. This decrease reflects a discretionary timing difference, rather than a fundamental change in the ability of the entities in those sectors to be able to provide improved distributions on an ongoing basis. In particular there were estimated dividends received from SAAMC and SAFA of $314 million in the 2002-03 financial year (2003-04 Budget estimate is $77 million from those two entities). Further, in 2003-04, the Land Management Corporation is budgeted to make a one-off special dividend payment of $50 million.

Although the budgeted result reflects a substantial deterioration in financial performance from the previous year, a large part of this was due to one-off distributions from other sectors. There remains, in Audit's view, risks inherent in the budgeted result, particularly with respect to continued achievement in taxation revenues should there be a downturn in economic and property indicators, and the long-term sustainability of distributions from government entities in the other sectors.

It is also important to note that given that budget operating results are relatively minor for 2003-04 compared to the level of activity, i.e. operating revenue of $8.6 billion, the discretionary distributions from other government sectors are quite influential.

Each of these factors is considered further in the context of the longer-term trends discussed later in this Report.

5.5.2 Changes in 2003-04 Budgeted Results

Another view of the 2003-04 budget is provided when comparing it to the previous estimate for the 2003-04 year as provided in the 2002-03 Budget Papers. Differences between the estimate and the 2003-04 budget are set out in the following table.

Table 5.6 — Comparison of Estimate and Budget for 2003-04

	2003-04 (2002-03 Budget) Estimated $'million	2003-04 (2003-04 Budget) Budget $'million	Difference $'million	Difference Percent
Operating Revenue				
Taxation Revenue	2 310	2 463	153	6.6
Sales of goods and services	824	952	128	15.5
Other State source revenue	302	294	(8)	(2.6)
Commonwealth grants (current)	4 604	4 671	67	1.5
Commonwealth grants (capital)	150	166	16	10.7
Other grants	38	58	20	52.6
Total Operating Revenue	8 229	8 603	374	4.5
Less: **Operating Expenses**				
Gross operating expenses (excl. depreciation) [(a)]	6 265	6 568	303	4.8
Current transfers	1 510	1 516	6	0.4
Capital transfers	39	23	(16)	(41.0)
Total Operating Expenses	7 814	8 106	292	3.7
Current Operating Surplus before Interest Depreciation and Distributions	415	497	82	19.8
Less: Net interest expense	161	126	(35)	(21.7)
Less: Nominal superannuation interest expense	290	337	47	16.2
Add: Distributions received from PNFCs and PFCs	360	435	75	20.8
Less: Depreciation	394	410	16	4.1
GFS Net Operating Balance	(70)	58	128	-
Less: **Net Acquisition of Non-Financial Assets**				
Gross fixed capital formation [(a)]	410	486	76	18.5
Less: Depreciation	394	410	16	4.1
Add: Change in inventories	2	2	-	-
Total net acquisition of non-financial assets	19	78	59	-
GFS Net Lending (Borrowing)	(88)	(20)	68	-

Note: Totals may not add due to rounding.

(a) 2002-03 Budget adjusted for reclassification of $55 million capital to operating expenses.

It can be seen from this table that the budgeted net borrowing for the 2003-04 year is a $68 million improvement over the earlier estimate due mainly to:

- a real increase in total operating revenues above the level of CPI which is higher than real increases in operating expenses (CPI is estimated to be 2.75 percent for 2003-04) such that there is an improvement in the GFS Current Operating Surplus of $82 million over the earlier estimate;

- an increase of $75 million in the distributions received from Public Non-Financial Corporations and Public Financial Corporations, due mainly to the Land Management Corporation one-off special dividend payment of $50 million;

- an increase in the net acquisition of non-financial assets of $59 million.

While this presentation shows that the budgeted result reflects an improvement in estimated financial performance from the previous year, the improvement largely coincides with the higher distributions now budgeted from Public Non-Financial Corporations and Public Financial Corporations.

5.5.3 GFS Other Sectors

The GFS net borrowing result for the Public Non-Financial Corporation Sector is budgeted to be a deficit of $106 million, a result similar to the estimated result for 2002-03 ($105 million).

At the time of preparing this Report no data was available with respect to the GFS Public Financial Institutions Sector, and as a result the 'all sectors' budget.

5.6 A LONGER TERM PERSPECTIVE OF FINANCIAL PERFORMANCE

The Budget presented by the Government also includes forward projections extending to the 2006-07 year in addition to the detailed information relating to the 2003-04 year. In addition, historical information under the GFS framework is available since the 1998-99 year.

The following sections will discuss in further detail individual elements of the GFS operating statement in the context of their historical perspective, and provide some Audit observations of the forward data.

5.6.1 General Government Sector Operating Statement Time Series

The table on the following page provides some perspective of the overall result to which those individual elements contribute.

The table highlights that although a small net borrowing result (deficit) of $20 million is budgeted in 2003-04, a net lending result (surplus) is expected in the following three years. If the budgeted result is achieved, the Government will have met a key fiscal target, which is to achieve, on average, balanced budgets in the General Government Sector.

Table 5.7 - GFS - General Government Sector Operating Statement Time Series [(a)]

Operating Revenue	1998-99 Actual[(b)] $'million	1999-2000 Actual $'million	2000-01 Actual $'million	2001-02 Actual $'million	2002-03 Estimated Result $'million	2003-04 Budget $'million	2004-05 Estimate $'million	2005-06 Estimate $'million	2006-07 Estimate $'million
Taxation revenue	2 435	2 748	2 197	2 193	2 373	2 463	2 559	2 609	2 713
Sales of goods and services	945	696	982	902	930	952	981	1 008	1 019
Other State source revenue [(c)]	279	195	295	358	299	294	300	306	298
Commonwealth grants (current)	2 867	3 091	3 986	4 424	4 545	4 671	4 744	4 956	5 142
Commonwealth grants (capital)	188	209	164	186	173	166	158	142	134
Other grants	0	7	5	61	57	58	58	59	59
Total Operating Revenue	6 714	6 946	7 630	8 124	8 376	8 603	8 800	9 080	9 364
Operating Expenses									
Gross operating expenses excluding depreciation	5 178	5 357	5 894	6 099	6 304	6 568	6 629	6 760	6 866
Current transfers	1 206	1 345	1 545	1 663	1 479	1 516	1 581	1 651	1 629
Capital transfers	61	59	43	44	61	23	17	10	10
Total Operating Expenses	6 445	6 761	7 482	7 806	7 845	8 106	8 227	8 421	8 504
Current Operating Surplus Before Interest, Depreciation and Distributions	269	185	147	318	531	497	573	659	860
Less: Net interest expense	496	387	184	141	146	126	125	122	109
Less: Nominal superannuation interest expense	277	274	248	244	299	337	345	352	360
Add: Distributions received from PNFCs	502	450	266	233	308	339	294	296	300
Add: Distributions received from PFCs	52	33	44	50	341	96	124	63	22
Less: Depreciation	331	337	322	390	406	410	413	424	425
GFS Net Operating Balance	(282)	(330)	(297)	(174)	329	58	108	120	288
Less: **Net Acquisition of Non-Financial Assets**									
Gross fixed capital formation	347	478	427	337	420	486	444	434	580
Less: Depreciation	331	337	322	390	406	410	413	424	425
Add: Change in inventories	(2)	(0)	(3)	3	2	2	-	-	-
Total net acquisition of non-financial assets	15	140	102	(50)	17	78	31	11	155
GFS Net Lending / (Borrowing)	(297)	(471)	(399)	(124)	312	(20)	77	109	133

(a) The GFS net operating balance and GFS net lending/(borrowing) are consistent with those aggregates produced pursuant to the Uniform Presentation Agreement. Items in the table have been reordered to present the current operating surplus which is comparable to the concept of EBIDD (earning before interest, dividends and depreciation).
(b) 1998-99 data has been derived from the ABS 2000-01 GFE publication
(c) Excluding capital grants and distributions received from PTEs and PFIs

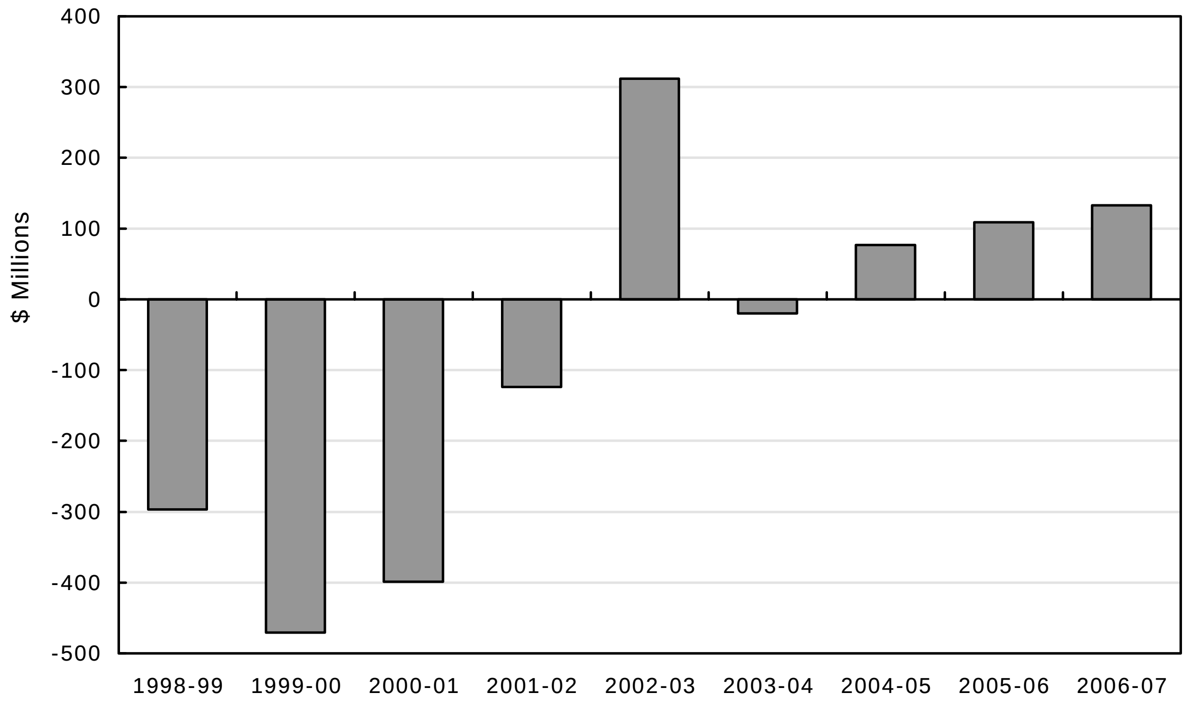
Note - Totals may not add due to rounding.

The following discussion explores some of the key indicators arising from the historic and forecast data.

As discussed earlier, the GFS net lending (borrowing) result provides an indicator of whether a government is saving more than enough to finance all of its investment spending and is therefore not contributing directly to the current account deficit.

The following chart shows the GFS net lending (borrowing) result for the General Government Sector for the period presented in the GFS - General Government Sector Operating Statement Time Series table.

GFS - General Government Sector Net Lending (Borrowing) Result



The results show that the movement in the State's net lending (borrowing) result is forecast to improve each year following a significant reduction from 2002-03.

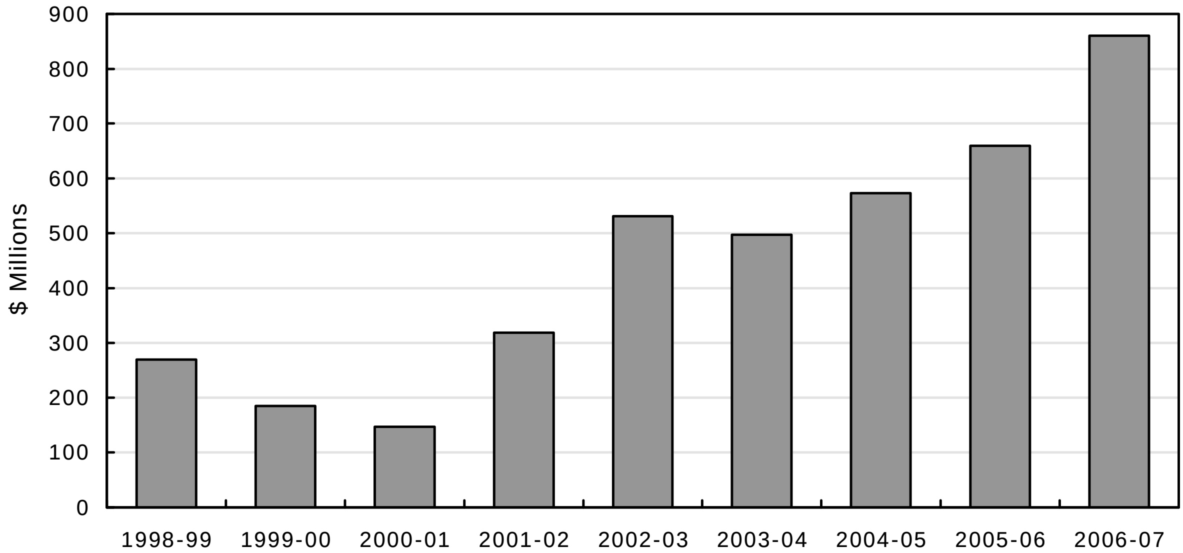
Further, the average surplus over the next four years of $75 million per annum is a significant improvement over the prior year estimates, which anticipated an average deficit of $81 million per annum over the forecast period.

5.6.2 Current Operating Surplus before Interest, Depreciation and Distributions

Last year I indicated that to understand what is behind the improvements going forward, it is useful to look at the performance from a couple of other perspectives. This is particularly important given the comments that have continually been made concerning the use of distributions from entities in other sectors to 'manage' the bottom line.

Current operating surplus before interest, depreciation, and distributions removes the effects of such distributions and items such as interest and nominal superannuation interest, which although extremely important, are as much a result of past decisions as something that is more directly controllable in the short term. The following chart shows the current operating surplus before interest, depreciation, and distributions for the period as shown in the GFS - General Government Sector Operating Statement Time Series table.

Current Operating Surplus before Interest, Depreciation and Distributions



The chart shows that this indicator declined in the three years to 2000-01, and is budgeted to do so again slightly in 2003-04, but shows continued improvement over all other years including the forward years in the 2003-04 Budget. The reasons for the improvements relate mainly to budgeted revenue measures and budgeted savings in expenditure lines.

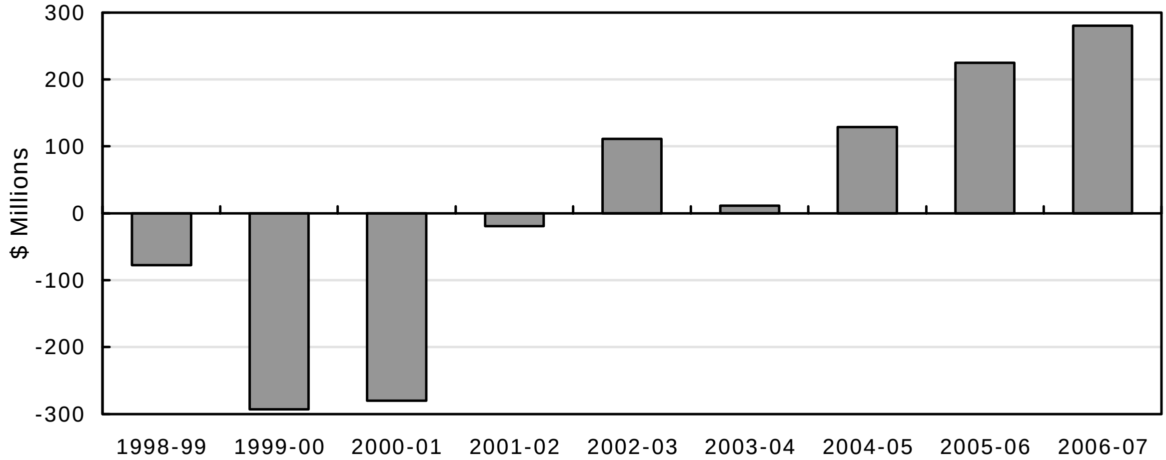
As previously discussed, the decrease in 2003-04 relates to a real increase in operating expenses, partially offset by real increases in taxation revenue.

The improvement in current operating surplus before interest, depreciation and distributions in the final three years of the forward estimates, from $497 million in 2003-04 to $860 million in 2006-07, reflects a combination of anticipated real increases in operating revenues (including taxation and Commonwealth grants) and an overall real decrease in operating expenditure. Achievement of these targets would provide significant improvement to the financial position of the state.

5.6.3 Current Operating Surplus before Interest, Depreciation and Distributions less Capital Expenditure

One weakness in the above indicator is that it does not reflect another item of the overall GFS operating statement that is directly manageable. Expenditure on gross fixed capital formation (or capital expenditure) is an item that can be actively managed in the short term and which has had a significant impact on the GFS net lending (borrowing) result each year. Adjusting the current operating surplus before interest, depreciation, and distributions for gross fixed capital formation provides another indicator of the elements of the operating statement that are more controllable or manageable. The following chart shows that indicator for the period as shown in the GFS - General Government Sector Operating Statement Time Series table.

Current Operating Surplus before Interest, Depreciation and Distributions less Capital Expenditure



This chart shows that the 2002-03 year continues a significant improvement in this indicator since the 2000-01 year. It reduces significantly in 2003-04 due to budgeted increases in both current and capital expenditure. As before, the improvement over the final three years is based on increasing real revenues and decreasing real operating expenses, which will also fund a large forecast increase in capital expenditure in 2006-07.

5.7 COMPARISON WITH OTHER STATES

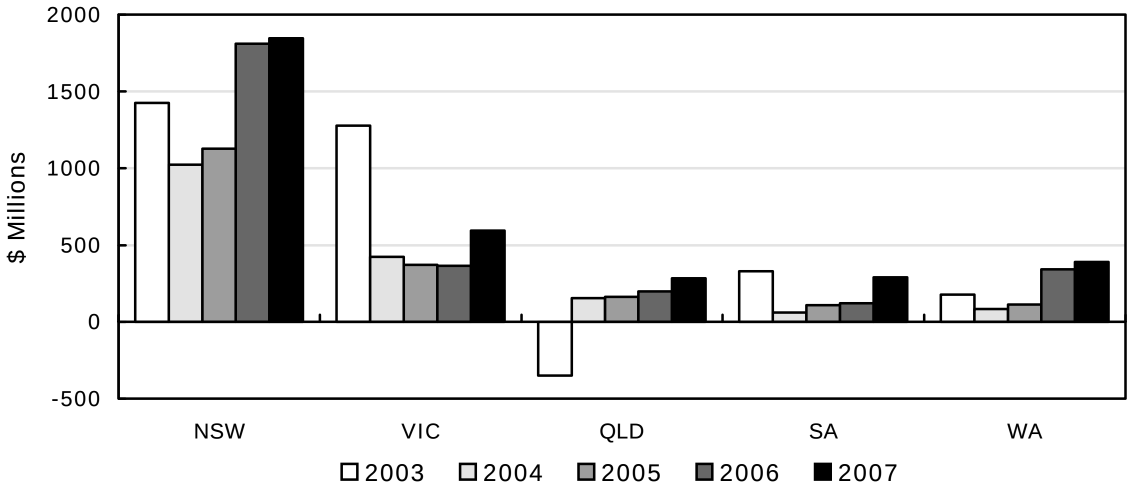
The GFS accrual information is available for all states (subject to timing) as a result of uniform reporting. With this form of reporting it is useful to consider the results and projections across state governments.

Importantly before drawing conclusions, any assessment needs a sound understanding of the specific circumstances prevailing in different states. I have not sought to provide all of the relevant information in this Report. Rather I take the opportunity to give a flavour of what might be expected to occur in the future.

5.7.1 Net Operating Balance Comparison

The following chart compares some trends in the GFS accrual information with the other States.

GFS - General Government Sector Net Operating Balance

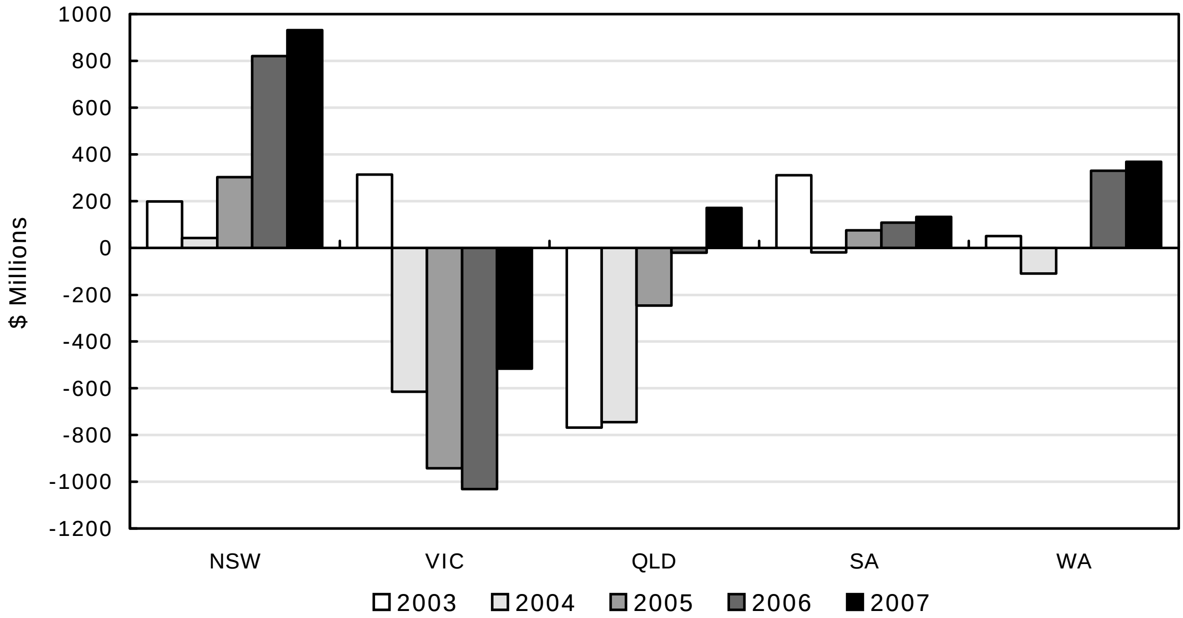


The chart shows that, similar to most other states, South Australia will have a reduced net operating balance in 2003-04 with projected increases over the budget period. Given the relative size of the different states, South Australia's result seems to be in line with those of the other states.

5.7.2 Net GFS Net Lending (Borrowing) State Comparison

The GFS net lending (borrowing) result represents whether a government has funded capital expenditure, net of depreciation expense, from a surplus net operating balance. The following chart compares some trends with the mainland states.

GFS - General Government Sector Net Lending (Borrowing) Result



As detailed in the chart, most states (including South Australia) are projecting consistent improvements in this indicator following initial declines in 2003-04. By the end of the forecast period only Victoria will be in a net borrowing result.

5.8 CONCLUDING OBSERVATIONS

5.8.1 Budget Forecasts

The 2003-04 Budget reports significantly improved estimated results from that set out in last year's Budget, with further improvement forecast in the financial results for the State finances over the longer term period of the Budget.

These matters have been determined principally through improvements in estimated revenues, budgeting for operating expenditure savings and changes to capital outlays.

The outlay trends are matched by revenue trends. Within total revenues, of the two key revenue items, taxation receipts are projected to rise in real terms while Commonwealth general-purpose grants are projected to be steady in real terms over the forward estimates. It is notable that outlay increases experienced in recent years have been covered by better than budgeted performance by taxation receipts and Commonwealth general-purpose grants. It is of course possible that this will or will not occur in any particular year given that revenue performance is subject to the influence of economic conditions. This prospect heightens the importance of controlling outlays within targets. Reductions in gross fixed capital formation estimates from the earlier estimates in the 2002-03 Budget seem appropriate, if only from the aspect of the persistent underspending in this area over a number of years.

Importantly, the Budget has been prepared recognising the risk of a weakening in the property market and it continues to incorporate provisions for unplanned outlays and emerging priorities that will assist in this management task. The projected net lending outcomes add a further buffer to the achievement of the fiscal target of, on average, balanced budgets.

5.8.2 Distributions from Reserves

The use of large distributions from the reserves of Government businesses and particularly SAAMC and SAFA have been projected in most Budgets but have been deferred in most years. In 2002-03 the Government took up the budgeted distributions and reported its result against its original budget. I consider this an improvement in financial management practice as it assists in maintaining the clarity and understanding of the budget targets and outcomes.

From another point of view, these distributions are discretionary and simply transfers between sectors of government. They ultimately allow governments considerable flexibility in budget setting, being limited only by access to funds. In this regard I have previously indicated I am of the view that such distributions from SAAMC and SAFA are unsustainable, as these entities have no capacity to replace amounts of this magnitude going forward. To the extent these distributions support the provision of services, alternatives will ultimately need to be identified. It is notable that the forward estimates for 2006-07 anticipate the lowest distributions from these entities while also estimating the highest net lending result over the forward estimates. If budgets are achieved, the need for these distributions may diminish.

5.8.3 Managing Performance

The characteristics of the 2003-04 Budget are in line with the previous year, particularly in respect to the projection of restraint in relation to expenses over the forward period, and when compared to the recent history for outlays, emphasises the need for managing the actual performance against budget and for control of spending. This is particularly an issue for agencies that have identified and submitted savings targets.

If the budgeted results are achieved over the forward estimate years, the Government will have met a key fiscal target, which is to achieve, on average, balanced budgets in the General Government Sector.

6 REVENUE

This section provides comment on the State's revenue projections as detailed in the 2003-04 Budget.

6.1 OVERVIEW

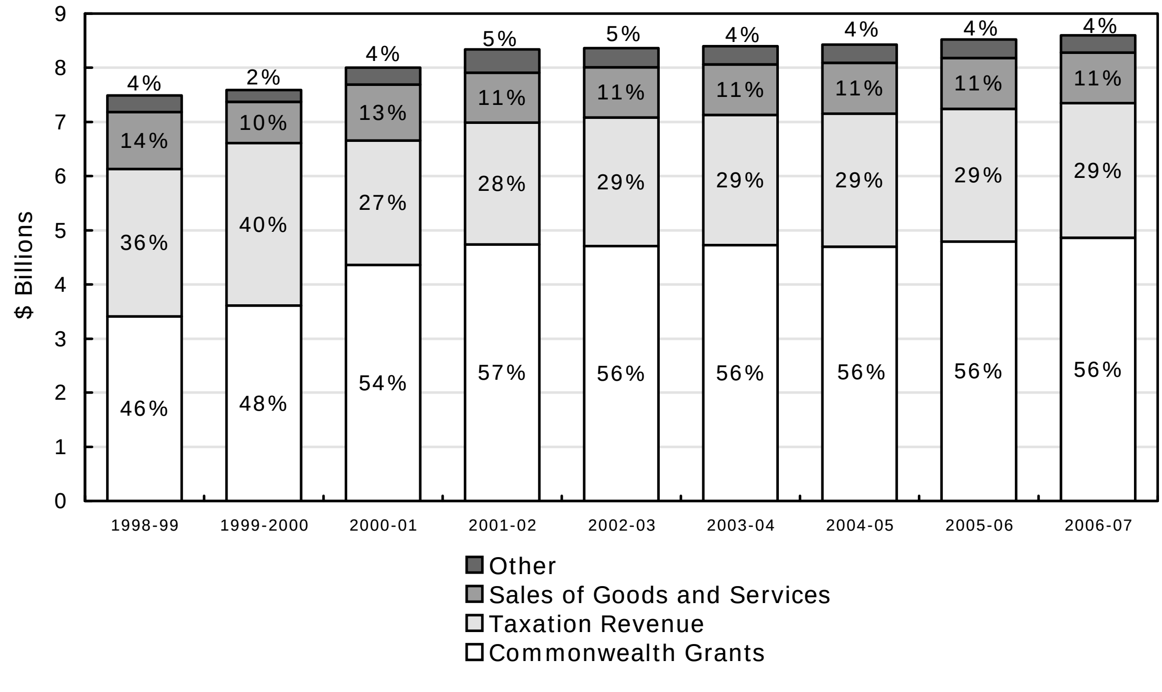
Under the National Tax Reforms, as from 1 July 2000, there have been very significant changes to the composition of the revenue side of the Budget. Foremost in the changes are the effects of the national tax reform and revised Commonwealth-State funding arrangements. Under these arrangements some State taxes have been abolished or reduced. These losses to the State resulting from the introduction of the National Tax Reforms are compensated by Commonwealth funding in the form of GST revenue grants and transitional grants.

While the State is reliant on Commonwealth grants, it continues to derive nearly half its revenue from its own sources, mainly state taxation revenue. Most of the components show steady growth over the forward estimates notwithstanding ups and downs in individual elements. As with recent past budgets, the main item that fluctuates widely is distributions from public financial institutions SAAMC and SAFA.

Total operating revenues are estimated to be $8.4 billion in 2002-03, an increase of $252 million (3.1 percent) over the previous year. Budgeted operating revenues for 2002-03 were $8.0 billion, an increase of $349 million (4.3 percent).

The makeup of Operating revenue and trend in real terms are illustrated in the following chart. Distributions from public financial institutions and public non-financial corporations are excluded from the following chart, but are discussed in the section 'Other Revenue'.

General Government Sector Operating Revenues (Real)[(a)]



(a) Estimated June 2003 value. Excludes distributions from PFNCs and PFCs and interest revenue.

A number of key facts are evident from the chart. They are:

- There have been real increases in total operating revenue in the period up to 2001-02. As from 2001-02 to the end of the forward estimate period in 2006-07 the level of total operating revenue remains fairly stable in real terms.

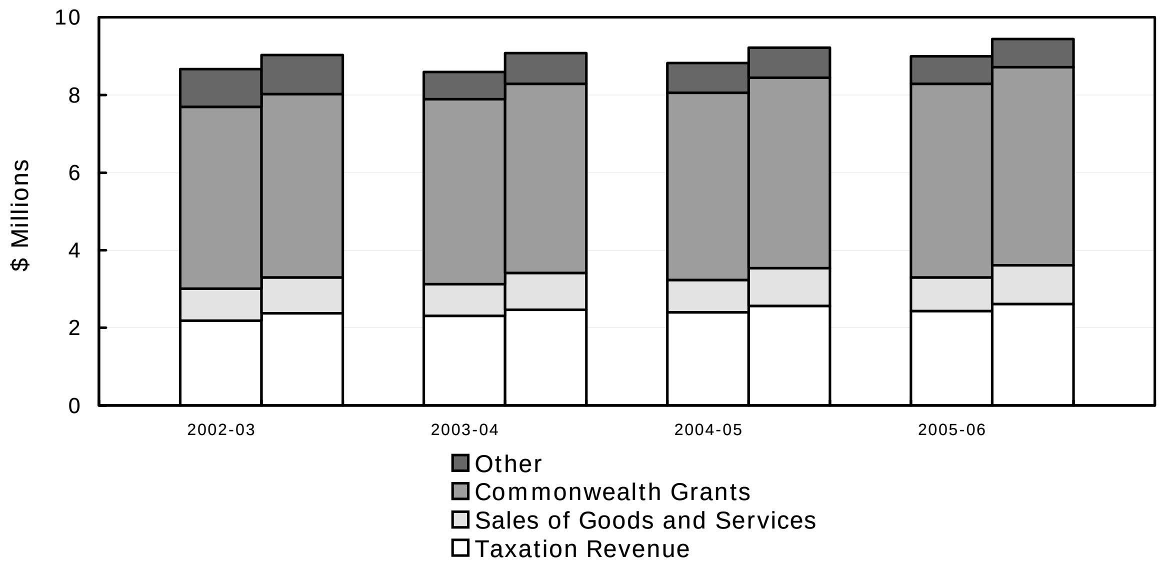
- The effect of the changes from national tax reform. The rapid increase in Commonwealth general-purpose grants and the offsetting reduction in State taxation revenue in 2000-01 and 2001-02 are readily apparent. This is essentially an exchange of State based revenue to Commonwealth based revenue.

- As from 2002-03, the proportion of revenue in the form of Commonwealth funding remains quite stable, representing approximately 56 percent of total operating revenues. This can be explained in large part by the settlement of national tax reform.

The following chart shows the main revenue components as budgeted in the 2002-03 Budget and 2003-04 Budget for the years 2002-03 to 2005-06.

It is evident that significant revisions have taken place in the 2003-04 Budget estimating growth not previously budgeted.

Comparison of 2002-03 Budget and 2003-04 Budget [(a)]



(a) Left column represents data from the 2002-03 Budget Papers and right column represents data from the 2003-04 Budget Papers.

The following commentary provides some additional analysis of the main revenue areas.

6.2 COMMONWEALTH FUNDING

Revenue from the Commonwealth is the most significant source of revenue to the State representing 56 percent of total operating revenues in 2002-03. Commonwealth funding includes general purpose payments, amount received under specific purpose funding agreements such as the Australian Health Care Agreement and amount received for on-passing to other bodies, for example local government and non-government schools.

The significance of Commonwealth funding, particularly as a result of the new tax system from 2000-01, was demonstrated in the earlier chart.

The total estimated Commonwealth funding to the State during 2002-03 is $4.7 billion, an increase of $108 million (2.3 percent) over the previous year. Estimated funding for 2003-04 is $4.8 billion. Funding in 2006-07 is expected to grow to $5.3 billion, a real increase of $0.2 billion over 2002-03.

Under the National Tax Reforms, as from 1 July 2000, the State eliminated some of its own source taxes. Under the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations (IGA) the Commonwealth undertook to underwrite the revenue yield from the Goods and Services Tax (GST) to ensure the states and territories receive, as a minimum, the equivalent of what they could have expected to receive under previous Commonwealth-State funding arrangements. As a result each state receives GST revenue collections plus supplementary transitional funding assistance until the state's share of GST revenues at least matches a guaranteed amount. In South Australia's case, supplementary funding is expected to be required up to and including 2005-06.

In the long term, GST revenues are expected to be a growth tax that will provide additional revenue benefits to the State. Whether outcomes will influence the level or conditions of other Commonwealth funding such as specific purpose payments or national competition payments is as yet unknown. Commonwealth revenues are estimated to be a steady 56 percent of total revenues over the forward estimate period. While Commonwealth funding is the foundation of State finances, it is not controllable by the State.

6.2.1 General Purpose Payments

General purpose payments (GPPs) consist of GST revenue grants, budget balancing assistance and National Competition Policy (NCP) payments. GPPs are distributed according to the principle of horizontal fiscal equalisation (HFE) - except for NCP payments, which are distributed on an equal per capita basis. The principal of HFE is based on Australia's commitment to ensuring that each State has the capacity to provide public services at a similar standard and level of efficiency as the other States for a comparable revenue-raising effort.

Over the forward estimates, GPPs are expected to grow from $3.0 billion in 2002-03 to $3.5 billion in 2006-07, a real increase of $0.2 billion.

6.2.2 Specific Purpose Payments

Specific purpose payments (SPPs) are provided under section 96 of the Constitution for both recurrent and capital expenditure purposes. The allocation of SPPs is based on many approaches, including Commonwealth discretion, historical allocation and formula-based allocation.

Both the Australian Health Care Agreement (AHCA) and the Commonwealth-State Housing Agreement (CSHA) expired on 30 June 2003. New agreements covering the next five years to 2007-08 have now been entered into.

In 2002-03, total specific purpose payments made to the State amounted to $1.7 billion, and are estimated to be $1.7 billion (real) in 2006-07.

6.3 TAXATION REVENUE

Taxation revenue is the second largest source of revenue to the State and represents approximately 29 percent, of operating revenues in 2002-03. Taxation revenue comprises collections from a diverse range of activities, including payroll, property, motor vehicles and gambling activities.

This Government has a fiscal strategy to ensure the State has an effective tax regime having regard to the Government's social and economic objectives. Considerations in relation to the State's capacity to raise taxation revenue include the capacity of taxpayers to pay and the State's relative tax effort compared to other states and territories.[28]

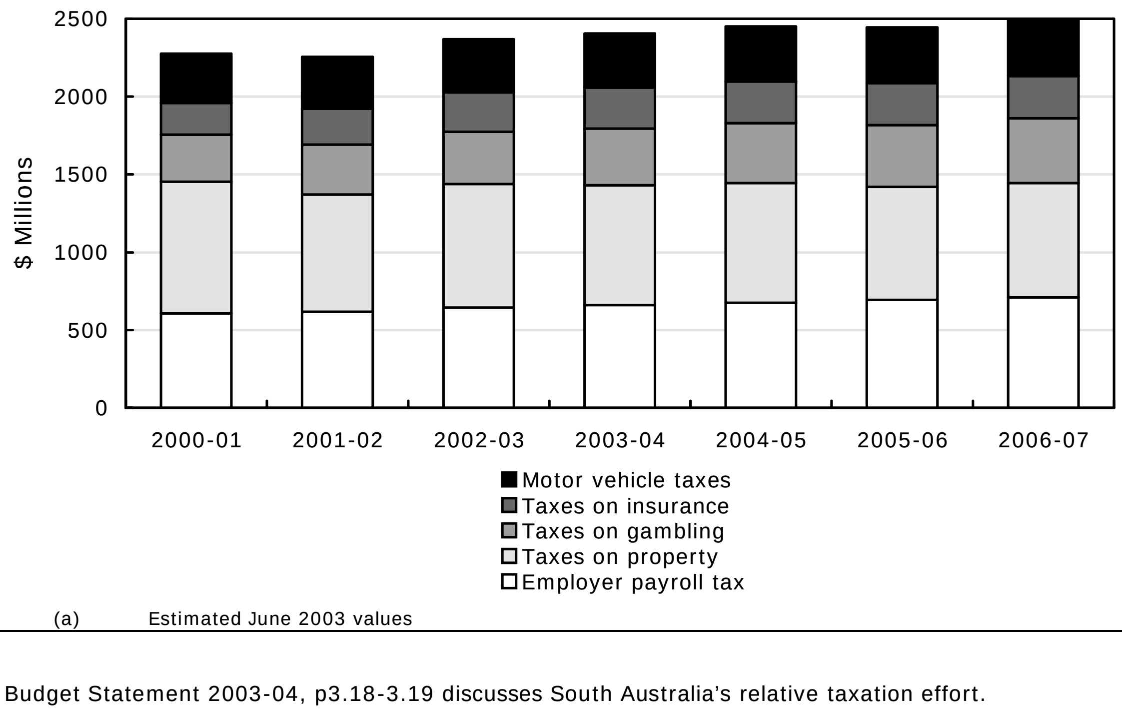
Total taxation receipts for 2002-03 are estimated to be $2.4 billion, an increase of $180 million (8.2 percent) over the previous year, and $190 million (8.7 percent) above budget. This improvement on budget was due mainly to:

- increased stamp duty and land tax due to the stronger than expected growth in the property market and land values;
- recovery of payroll tax identified through tax compliance programs;
- greater than expected receipt of insurance and motor vehicle taxes;

Taxation receipts for 2003-04 are estimated to be $2.5 billion, an increase of $90 million over 2002-03. Of this, only $9.5 million is due to new taxation measures, after reductions in some taxation arrangements. The introduction of the Save the River Murray Levy is the only new tax and is expected to raise $15 million in 2003-04 and $20 million in a full year.

Because of the change in Commonwealth funding arrangements, the following chart commences from the 2000-01 year to examine the trend (in real terms) in the components of taxation receipts and the trend over the period in the forward estimates.

Taxation Revenue (Real) [(a)]



(a) Estimated June 2003 values

[28] Budget Statement 2003-04, p3.18-3.19 discusses South Australia's relative taxation effort.

The chart demonstrates that the overall revenue from taxation is rising from 2001-02.

Taxation revenue in 2006-07 is expected to grow to $2.7 billion, a real increase of $127 million over 2002-03.

The following discussion provides a brief overview of the main components of taxation revenue.

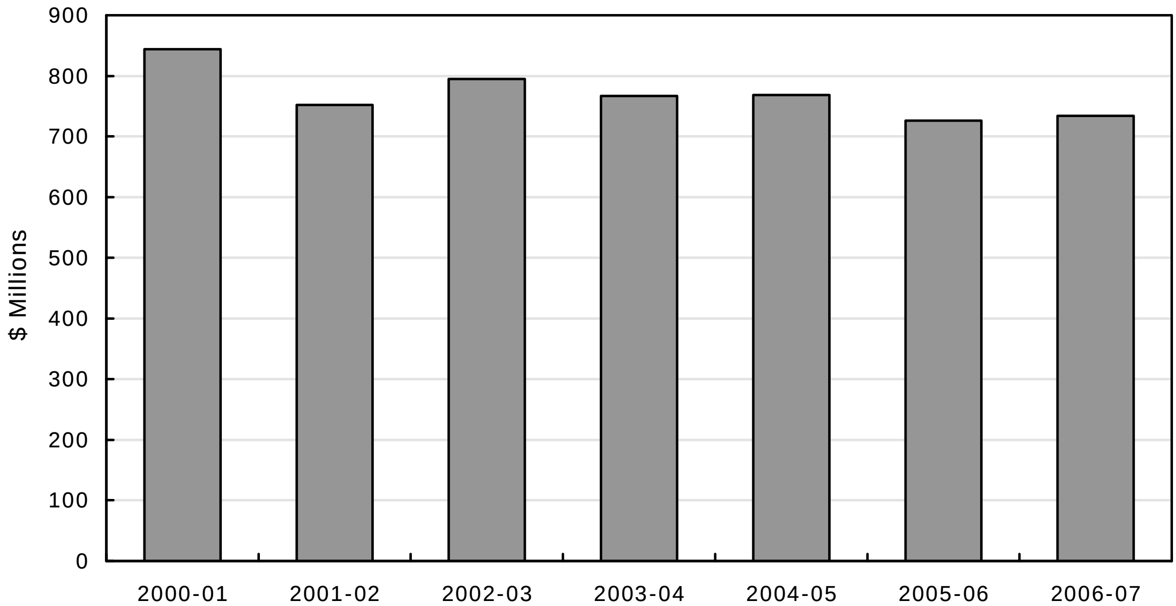
6.3.1 Property Taxes

Property taxes include land tax, stamp duty on conveyances, mortgages, shares, rental, financial transaction taxes, emergency services levy (ESL) and water catchment levies.

In 2002-03, property taxes are estimated to be $795 million representing 34 percent of total taxation revenues, and budgeted to be $784 million in 2003-04.[29]

The following chart shows the trend in property taxes (in real terms) and highlights the budgeted real terms reduction in this item over the forward estimate period.

Taxes on Property (Real) [(a)]



(a) Estimated June 2003 values

Although FID and stamp duty on listed marketable securities were abolished on 1 July 2001, the continued strength in the property market, strong growth in land values and one large share transaction duty receipt have contributed to the net increase in property taxes for 2002-03.

Real decreases in 2003-04 reflect an expectation that the property market will weaken in 2003-04 with a resultant decrease in taxes on property. Acknowledgment of this risk in the estimates in prudent management. This is offset to some degree by increased land tax from higher base property values.

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[29] Budget Statement 2003-04, Budget Paper 3, Table 3.6.

Also, the Save the River Murray levy to be introduced in 2003-04 accounts for some strength in revenue in 2003-04 and 2004-05. Real decreases in 2005-06 reflect possible cessation of the debits tax which will be compensated by Commonwealth funding.

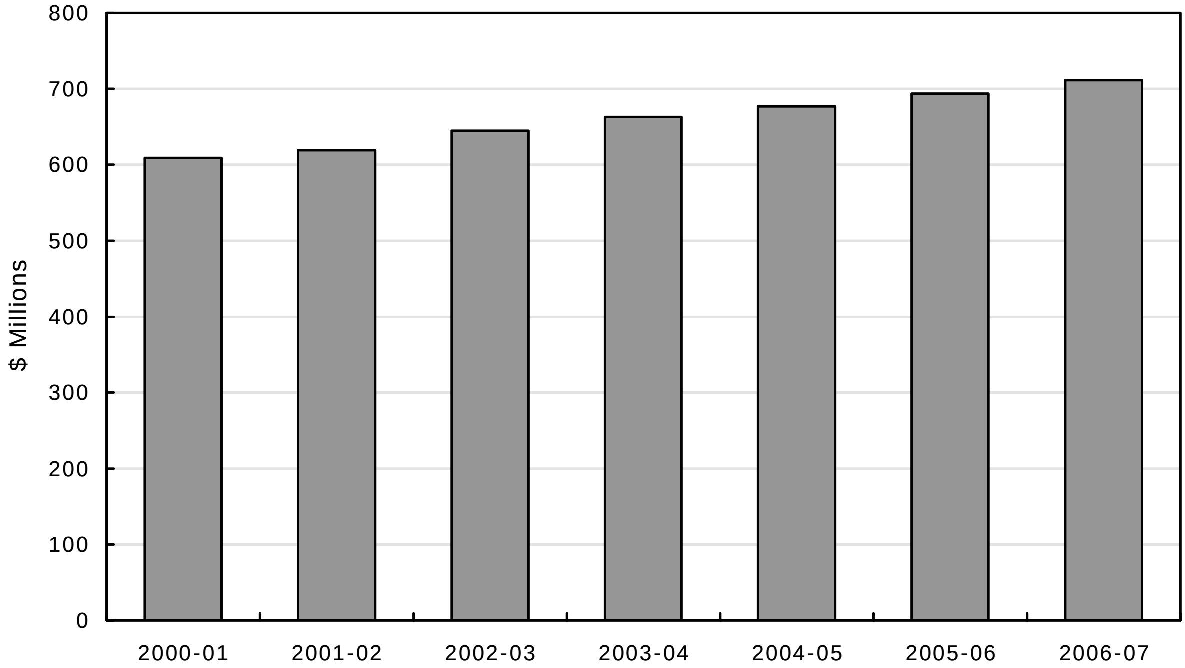
Finally, there is an expectation of a return to normal taxation growth rates in 2006-07.

6.3.2 Payroll Tax

Payroll Tax continues to be a principal source of taxation revenue. In 2002-03, employer payroll taxes are estimated to be $645 million representing 27 percent of total taxation revenues, and budgeted to be $678 million in 2003-04.[30]

As indicated in the following chart, payroll tax revenue is anticipated to continue to increase in real terms over the forward estimates.

Employer Payroll Tax (Real) [(a)]



(a) Estimated June 2003 values

The growth in payroll tax receipts over the Budget period reflects estimated employment and earnings growth.

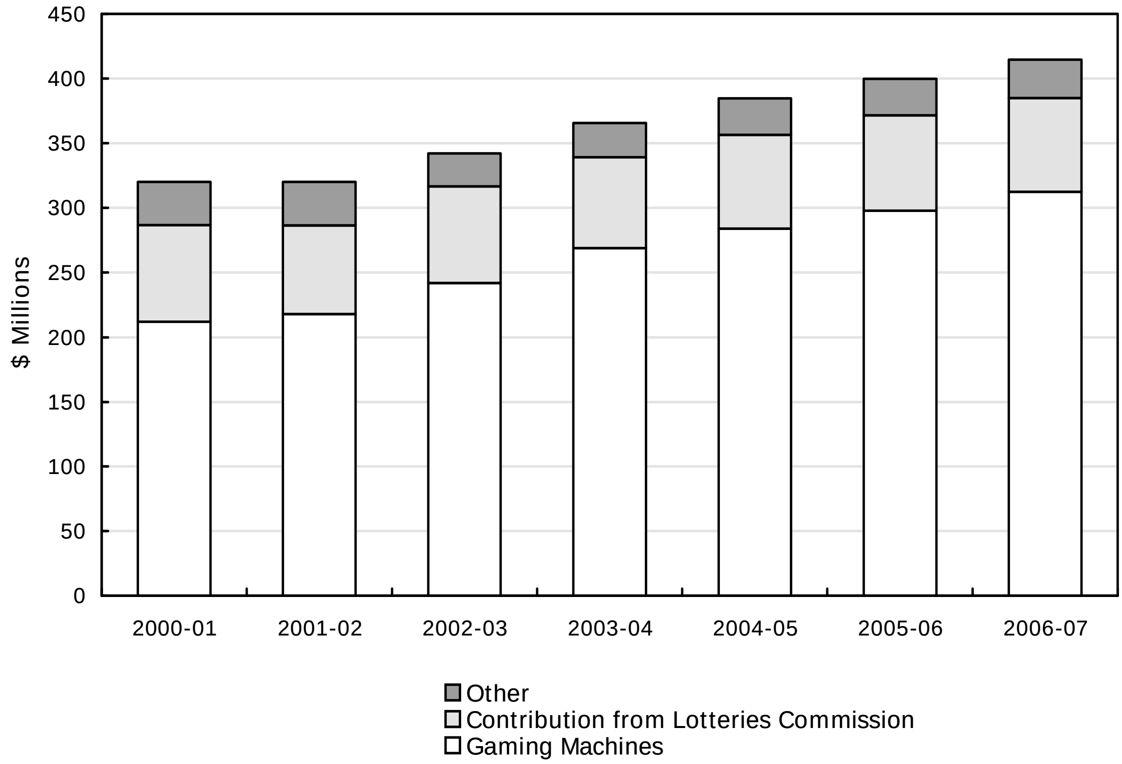
6.3.3 Gambling Taxes

During 2002-03, taxation revenues from gambling activities amounted to $335 million, $23 million (7 percent) over the previous year and were very close to the 2002-03 budget ($336 million).

[30] Budget Statement 2003-04, Budget Paper 3, Table 3.6.

The following chart shows the trend in gambling taxes (in real terms) and highlights the increasing contribution that gaming machines tax makes to the State's Budget.

Gambling Taxes (Real) (a)



(a) Estimated June 2003 values

DTF indicated that the strong projected growth in gaming machines tax receipts of $71 million in real terms over the forward estimates period from 2002-03 to $312 million (real) in 2006-07 reflects the full year impact in 2003-04 of the increase in the net tax take from the more profitable gaming machine venues effective from 1 January 2003, estimated growth in gaming machine expenditure and a change in the tax structure. The estimated growth rates for gaming machine expenditure are greater than the projected growth in household disposable income, reflecting demographic and expenditure trends.

6.4 SALES OF GOODS AND SERVICES

Revenue from sales of goods and services is one of the major sources of revenue to the State representing 11 percent of total operating revenues in 2002-03. Sales of goods and services by the General Government Sector include Government fees and charges which are set on a cost recovery basis and adjusted annually.

Total revenue from sales of goods and services for 2002-03 is estimated to be $930 million, an increase of $28 million (3.1 percent) over the previous year, and $98 million (12 percent) above budget.

Most of the increase against budget reflects classification changes of which $41 million is due to the recognition of regulatory fees charged to bodies external to the General Government Sector and a further $38 million relates to the reclassification of some Commonwealth funds which were previously reported as SPPs rather than as Commonwealth contributions in payment for State services.

The remaining increase against budget in sales of goods and services income for 2002-03 reflects, in part, the unexpected buoyancy in the property market which resulted in higher than budgeted land transfer fees together with upward revisions to a wide range of user charges across portfolio areas.

The level of revenue from sales of goods and services is fairly stable over the forward estimates period. Revenue from sales of goods and services is estimated to grow from $930 million in 2002-03 to $939 million (real) in 2006-07.

6.5 OTHER REVENUE

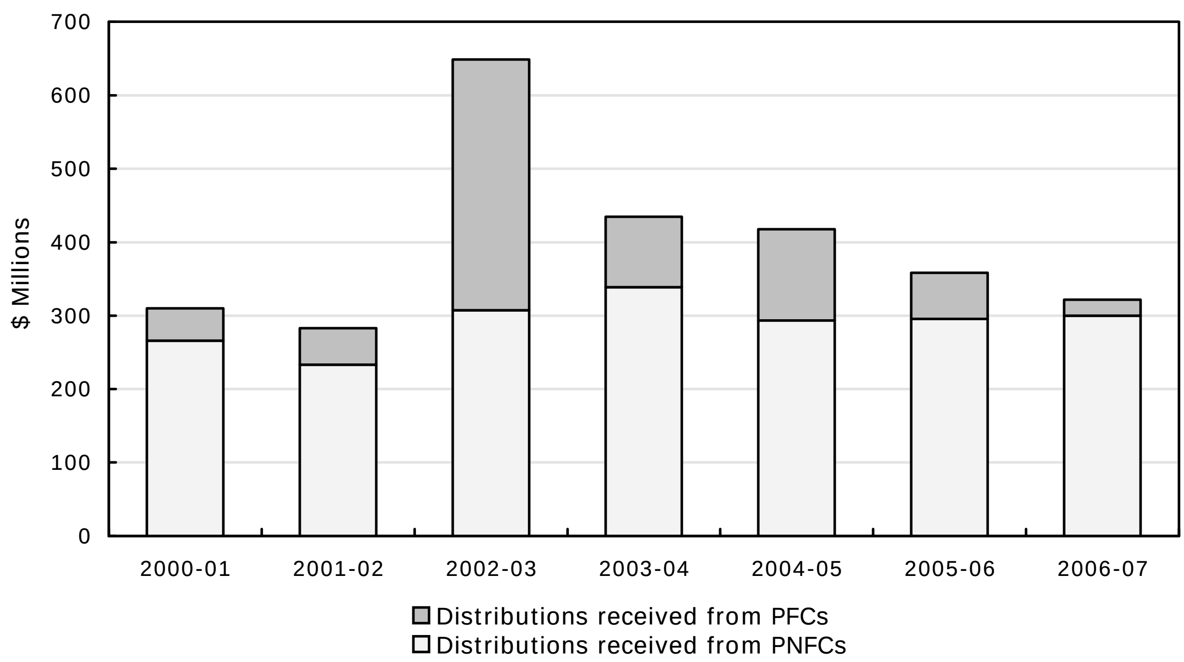
Other revenue is recorded in the GFS General Government Sector operating statement in two places namely, other state source revenue and distributions from Public Non-Financial Corporations (PFNCs) and the Public Financial Corporation (PFCs).

The more significant of these components of revenue in the General Government Sector operating statement is the distributions received from PNFCs and PFCs, which comprise essentially tax equivalent payments and dividends from other government entities. Distributions from PNFCs and PFCs, are significant not only in terms of their size, but because they provide an opportunity for the Government to 'manage' the bottom line given their discretionary nature. Of all revenue amounts incorporated in the General Government operating statement, this source is the most flexible, limited essentially only by amounts available.

The distributions come from two other GFS sectors, namely the Public Non-Financial Corporations (PNFCs) and the Public Financial Corporation (PFCs). On a consolidated financial reporting basis, these distributions are internal transfers and would have no effect on an annual consolidated operating result. On the GFS sector basis, transfers are recorded as revenue in the General Government Sector.

The following chart shows the trend in distributions received from PNFCs and PFCs for the seven years to 2006-07.

Distributions Received by the General Government Sector



The chart highlights that distributions are large but reducing over the forward estimates period. As the net lending result is estimated to improve over that period, budget reliance on this item may diminish in the future.

6.5.1 Public Non-Financial Corporations

In 2002-03, distributions received from PNFCs amounted to $308 million, an increase of $75 million (32 percent) over the previous year. Notwithstanding the increase in 2002-03, these distributions are relatively steady from year to year reflecting the management of ongoing stable businesses.

Increases in distributions from PNFCs in 2002-03 mainly reflect the pattern of income distributions from Forestry SA and SA Water Corporation. Forestry SA is estimated to have an above budget result in 2002-03 arising from continued strong demand for timber products for housing. SA Water Corporation is also estimated to have an above budget profit in 2002-03 arising from continuing above budget water sales, increases in connections/extensions and contributed assets, and savings in interest due to active debt management and lower interest rates.

The increase in 2003-04 reflects a once-off special dividend from the Land Management Corporation of $50 million.

6.5.2 Public Financial Corporations

The main source of revenue projected from the PFCs category is income from the South Australian Assets Management Corporation (SAAMC) and South Australian Government Financing Authority (SAFA) and these fluctuate over the forward estimates period due to the way distributions are managed to achieve the budgeted result.

In recent years, distributions from these entities included in Budgets have virtually entirely been deferred to later periods. In 2002-03, budgeted distributions from SAAMC and SAFA, amounting to $230 million and $94 million were taken up and received. Distributions from PFCs are budgeted to be $96 million in 2003-04.[31]

Projected distributions from SAAMC and SAFA for the period of the 2003-04 Budget are as follows:

Table 6.1 - Projected Distributions from SAFA and SAAMC

	2003-04	2004-05	2005-06	2006-07	Total
	$'million	$'million	$'million	$'million	$'million
SAFA	25.8	44.3	52.3	10.9	133.3
SAAMC	58.5	73.2	4.0	4.2	139.9
	84.3	117.5	56.3	15.1	273.2

As at 30 June 2003 SAFA and SAAMC had accumulated reserves totalling $192 million and $167 million respectively.

The distributions projected to 2006-07 are estimated to reduce the total accumulated reserves of SAFA to around $150 million, and SAAMC to around $50 million. As a result the level of earnings that those entities could be expected to make in future periods (beyond the forward estimates) will not be able to sustain distributions at a level

31 Budget Statement 2003-04, Budget Paper 3, Table 3.12.

anywhere near those that have been reflected in the early part of the current Budget forward estimates. As noted previously and detailed in Table 6.1, the distributions are decreasing over the period of the estimates.

The Motor Accident Commission (MAC) is budgeted to make a distribution of $5 million in 2003-04 relating to the wind up of the non-compulsory third party business of the former SGIC. As at 30 June 2003, MAC had reserves of $10.4 million and failed to meet its Government determined solvency levels. No distributions from MAC are budgeted after 2003-04.

6.6 RISKS TO REVENUE

The Budget Statement 2003-04 provides quite detailed consideration of various risks to the revenue budget. Included in the risk analysis is:

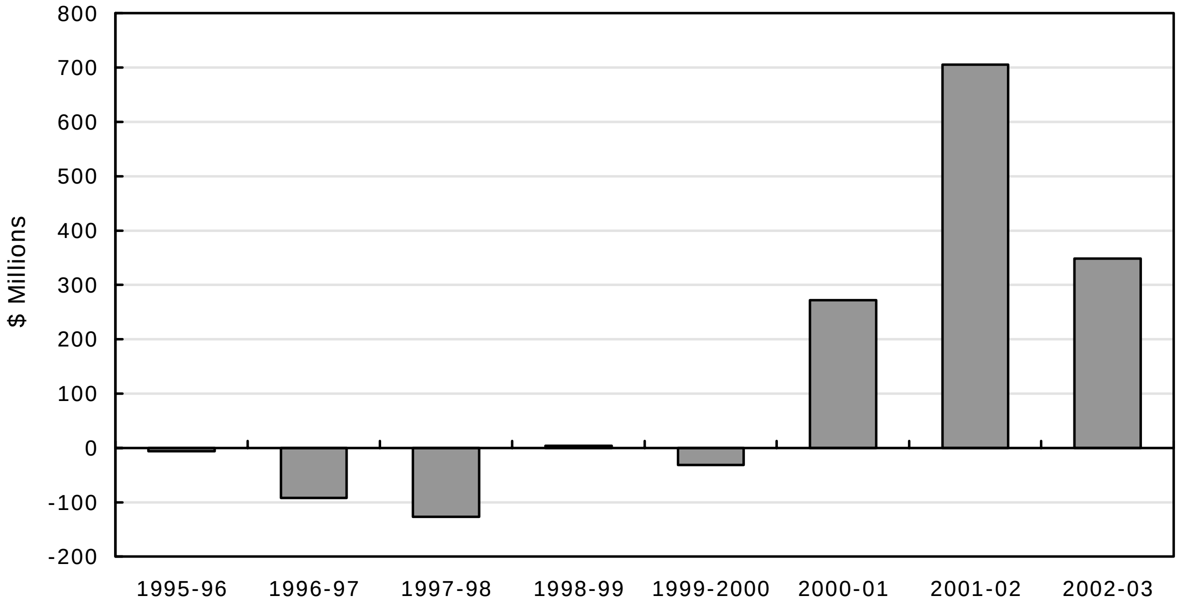
- Taxation and Royalties:
  - A variance of 1 percent in taxation revenue growth equates to about $23 million per annum.
  - The introduction of a ban on smoking in gaming rooms, if adopted, could result in an initial reduction in gaming tax and general purpose grant revenue of between $45-$70 million.
  - Revenue from mining royalties in 2003-04 may come under pressure if the Australian dollar appreciates.
- Sensitivity of State revenues to economic conditions:
  - The fiscal equalisation process distributes revenue collected by States and Territories in accordance with assessed fiscal needs. However, the Commonwealth Grants Commission methodology is such that this sharing is only achieved over a 5 year period. Therefore, the State's revenues (including Commonwealth grants) are affected both by local economic conditions and by economic conditions in other States.
- Commonwealth Grants:
  - General purpose payments (GPPs): Commonwealth GPPs are the vehicle for horizontal fiscal equalisation (HFE). The methodology and data underlying the HFE process is determined by the Commonwealth Grants Commission. States and Territories compete strongly in submitting arguments in support of their position. The risk of methodology changes which may impact on the State, either positively or adversely, is significant.
  - Specific purpose payments (SPPs): Funding levels of SPPs are exposed to the risk of variability in the underlying parameters that determine funding levels for specific expenditures as well as being exposed to variability in Commonwealth policy settings favouring some areas of expenditure over others.

These various risks affect the total revenue that might be collected and also the flexibility with which revenue can be applied. Readers are referred to the Budget Statement, Paper 3, Chapter 7 for the full details.

6.6.1 Past Revenue Outcomes

To provide a recent historic context, the following chart shows the difference between budgeted and actual operating revenue for the past few years.

Difference Between Budget and Actual Operating Revenues (a)



(a) Although the chart is based on a combination of data derived from cash basis and accrual basis, it still demonstrates how successful the Government has been in achieving the Budget target.

The chart highlights that prior to 2000-01, the actual revenues were quite close to budget. As from 2000-01, the actual revenues received have substantially exceeded the budget. This can be explained in part by the national tax reform, changes in the economic conditions such as the property market boom and changes in the relativities determined by the Commonwealth Grants Commission. Classification changes have also impacted.

6.7 CONCLUSION

Over the Budget period, it is expected that the State will achieve a real growth in total operating revenues from $8.4 billion in 2002-03 to $8.6 billion in 2006-07.

Most of the components show steady growth over the forward estimates notwithstanding ups and downs in individual elements. Taxation revenues and Commonwealth funding are the two most significant components, representing 29 percent and 56 percent, of total operating revenue.

With respect to taxation revenues, estimates have prudently taken account of possible changes in economic conditions. Even so, the total amount of taxation revenues is increasing over the forward estimates.

The actual result is subject to risks that arise from changes in economic conditions and Government policies.

7 OPERATING EXPENSES

7.1 OVERVIEW

For 2002-03 estimated GFS operating expenses total $7.8 billion and are estimated to exceed budget by $60 million or 0.8 percent. In addition, net interest expense is estimated to be $146 million (a decrease from budget of $18 million) and capital payments estimated to be $420 million (a decrease of $83 million). A summary of major expenses for the General Government Sector against budget is as follows:

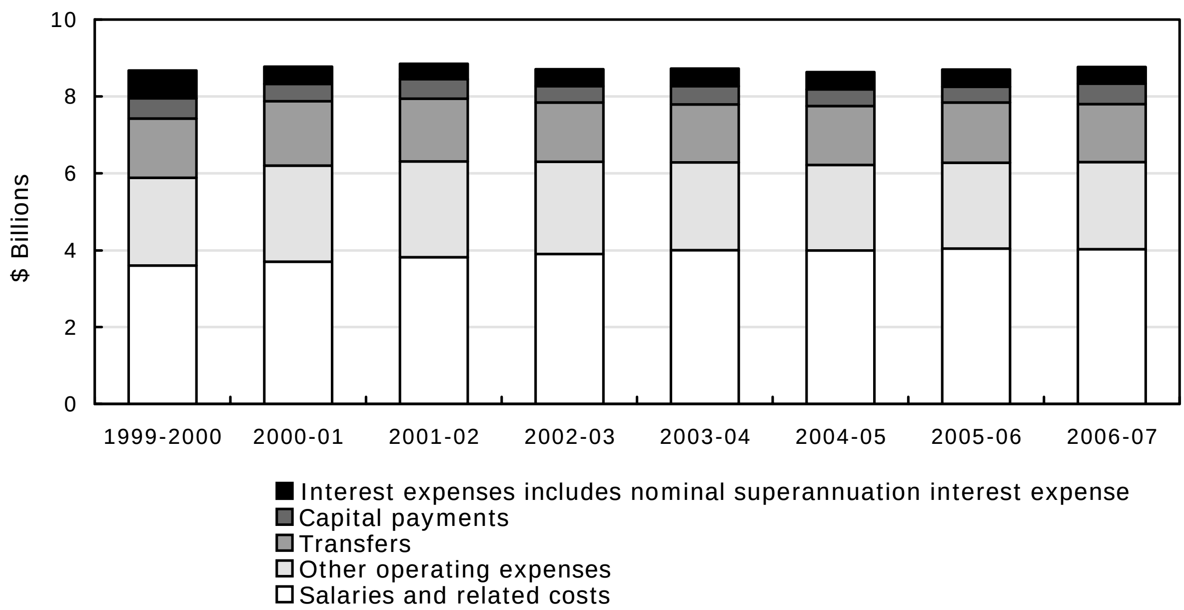
Table 7.1 — GFS - General Government Sector Expenses

	2002-03 Budget $'million	2002-03 Estimated Result $'million	Difference $'million	Difference Percent
Employee expenses	3 813	3 903	90	2.3
Other operating expenses	2 429	2 401	(28)	(1.2)
Transfers	1 543	1 541	(2)	0.0
Total operating expenses	7 785	7 845	60	0.8
Capital payments	503	420	(83)	(16.5)
Net interest	164	146	(18)	(11.0)
Nominal superannuation interest expense	284	299	15	5.3
	8 736	8 710	(26)	(0.3)

Expenses for 2003-04 are budgeted to increase by $147 million in real terms. Going forward, expenses are projected to decrease in real terms in 2004-05, remain steady in 2005-06 and increase again to $8.8 billion (real) in 2006-07 due to higher capital payments.

The following chart highlights the trends in expenses (in real terms) that have emerged since 1999-2000. Data has been adjusted using deflators provided by DTF.

General Government Sector Expenses (Real) (a)



(a) Estimated June 2003 values

The chart shows total expenses (in real terms) are projected to remain relatively stable over the forward estimate period.

The following discussion focuses on some of the major components that make up the total expenses.

7.2 EXPENSES BY TYPE

7.2.1 Salaries and Related Costs

7.2.1.1 Public Sector Wage Growth

Salaries and related costs ($3.9 billion in 2002-03) represent a very high proportion (45 percent) of the total expenses. The 2003-04 Budget provides sums for anticipated public sector wage increases over the forward estimates period, both in individual agency budgets, and as a contingency item in the DTF administered lines to cover future enterprise agreement outcomes. The inclusion of theses allowances is a consistent approach to previous Budgets.

The major risk to the Budget and, in particular the forward estimates, is the outcomes from enterprise agreements, which are due for renegotiation in the following timeframes:

Wages parity — 1 October 2004
Police — 1 July 2004
Nurses — 1 October 2004
Teachers — 1 October 2005

Notwithstanding amounts provided in the Budget, the Government estimates that if wages and salaries for public sector employees increased by 0.5 percent more than is currently factored into the Budget, then wage and salary expenditure would increase by over $50 million in 2006-07.

7.2.1.2 Separation Packages

Separation payments continue to be a feature of workforce management with a provision of approximately $25 million recognised over the next 12 months for the separation of government employees. The $25 million is included within the employee expenses budget for 2003-04.

The budgeted costs for salaries and related costs include savings commencing in the 2002-03 year relating to previous separation packages given.

7.2.2 Other Operating Expenses

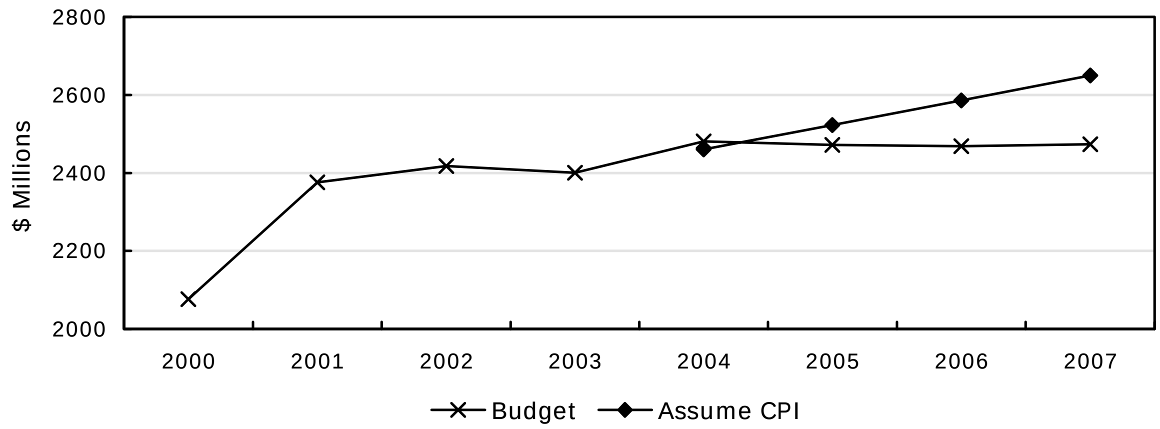
Other operating expenses include general purchases of goods and services.

These expenses are estimated to be $2.4 billion for 2002-03 that is, $28 million or 1.2 percent below budget. These expenses are budgeted to increase by $80 million or 3.1 percent in nominal terms in 2003-04.

Although it is difficult to establish with accuracy the 'natural' cost pressures within this expenditure line, the following chart compares the budgeted expenditure for the GFS General Government Sector other operating expenditure with an increase from the

2002-03 year in line with the long term Consumer Price Index (CPI) assumptions of the 2003-04 Budget.

GFS - General Government Sector Other Operating Expenses



The chart highlights that other operating expenses are estimated to fall in real terms from 2004-05 to the end of the forward estimates.

Based on this analysis the potential shortfall in the Budget in the event of CPI growth in this item would be:

	Based on CPI (2.5%) $'million
2004	(20)
2005	51
2006	117
2007	176

In making that analysis it is recognised that the preparation of the Budget should be based on an approach that takes account of anticipated expenditure rather than simply drawing on past expenditure as a base. However, although the use of the CPI index to predict future expenses may be problematical, it is useful in highlighting a potential risk to the Budget and forward estimates if expenditure targets (which incorporate a significant savings component in the 2003-04 Budget) are not achieved.

Audit has been advised that the Government is well aware of this risk and has put in place a framework to monitor closely the progress of the savings strategies factored into the Budget and forward estimates. This matter is discussed in more detail later under the heading '7.4.2 - Savings'.

Contingency amounts have also been incorporated into the budget to provide some flexibility if additional expenditure is required to be made by the Government. The amount included for 2003-04 is consistent with past year amounts.

7.2.3 Transfer Payments

Transfer payments from the General Government Sector represent payments to other sectors of government and the private sector. These transfers include:

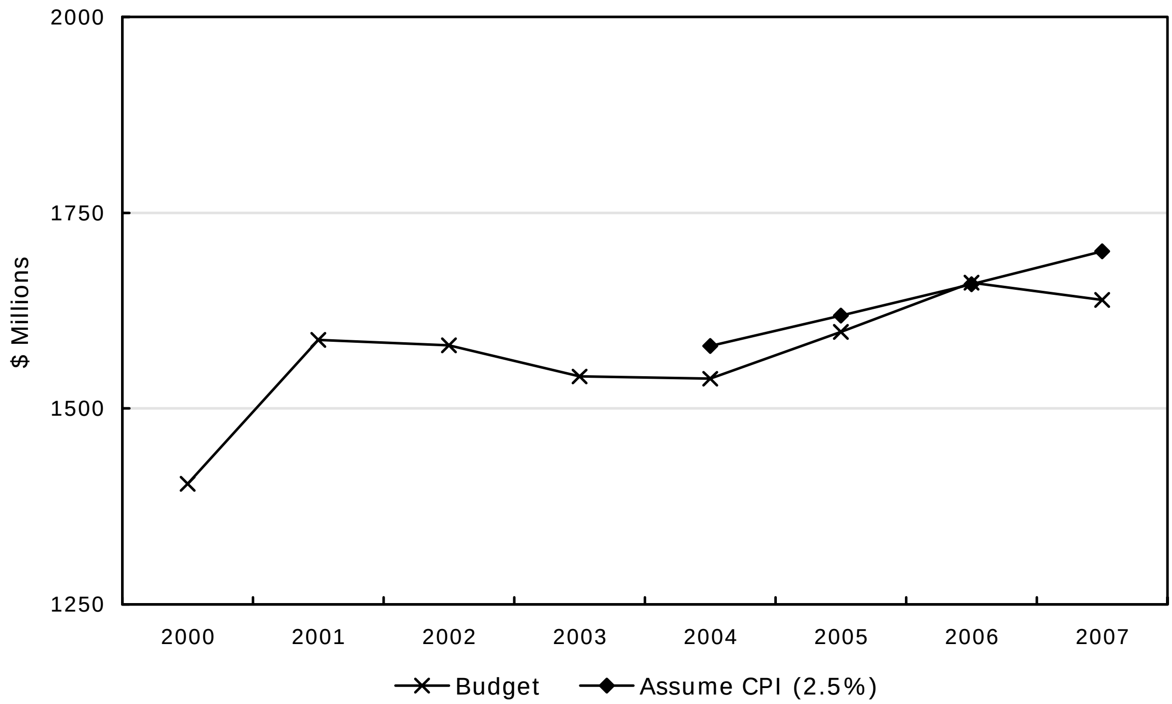
- appropriation for the South Australian Housing Trust and TransAdelaide;

- community service obligation payments to South Australian Water Corporation and Forestry SA;
- grants to non-government schools;
- grants to local government;
- grants to industry.

Transfer payments are estimated to be $1.5 billion for 2002-03 in accordance with the Budget for the year, and are budgeted to fall by $3 million in nominal terms in 2003-04. Increases are expected over the forward estimates.

Again, as was the case for other operating expenses, although it is difficult to determine with accuracy the 'natural' cost pressures within this expenditure line, the following chart compares the budgeted GFS General Government Sector transfer payments with an assumed increase from the 2002-03 year in line with the CPI.

GFS - General Government Sector Transfer Payments



Based on this analysis the potential shortfall for the Budget in the event of CPI growth in this item would be:

	Based on CPI (2.5%) $'million
2004	42
2005	21
2006	(2)
2007	62

In 2005-06 there is estimated to be a substantial increase in transfer payments due to Commonwealth assistance for debt redemption and reclassifications of data.

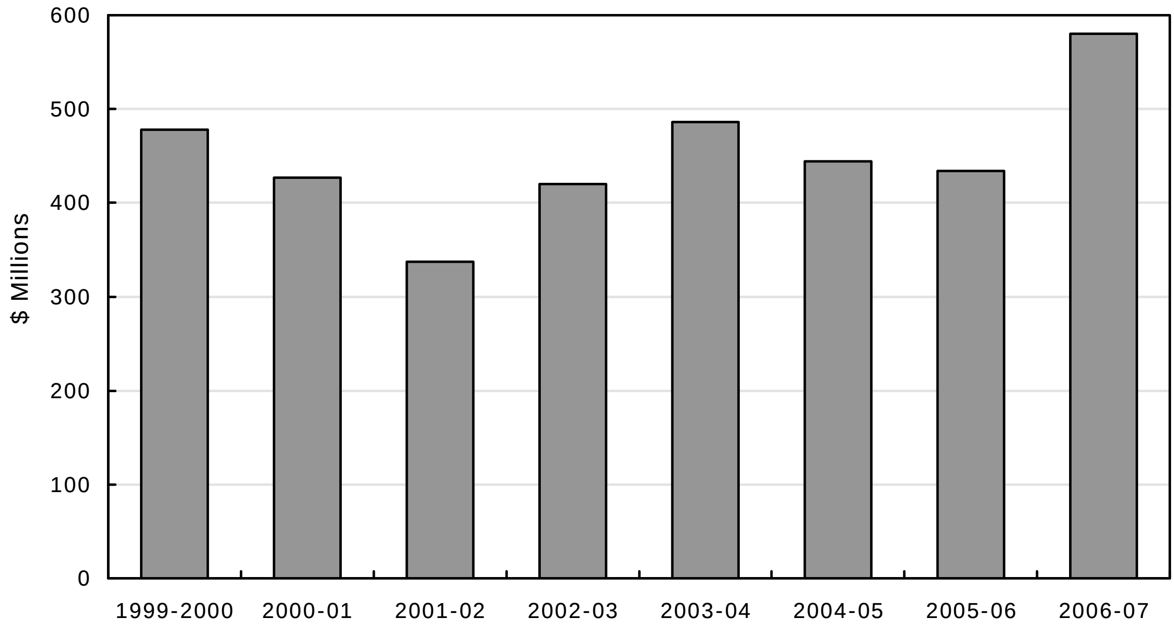
Again, the use of the CPI to inflate past expenditure may not be an accurate reflection of future costs, but highlights the importance of the savings target in the Government achieving its fiscal strategy.

7.2.4 Capital Payments

Gross fixed capital formation in the operating statement represents the value of acquisitions less disposals of new or existing fixed assets.

The following chart shows net capital expenditure over the period presented in the 'GFS - General Government Sector Operating Statement Time Series' table presented earlier in this Report.

GFS - General Government Sector Capital Payments (Nominal)



The nature of this expenditure is that it is highly dependent on the approval of individual projects, and in this respect is in some ways more discretionary in nature than some of the other expenditure types. For example, in the short term it is easier to reduce capital payments than interest expenses to contain outgoings if necessary.

The above chart shows the variability of the expenditure, both historically and in the forward estimates. To a large extent this variability in past payments simply reflects timing effects as capital budgets have typically not been achieved in recent years.

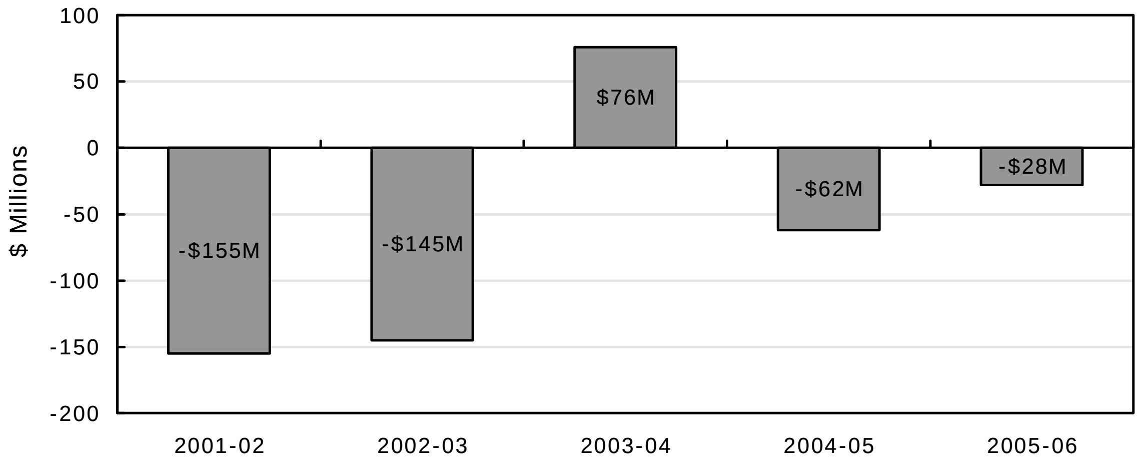
Although there will be components of future expenditure that have effectively been committed, the forward years contain funds contingent on future approvals of between $8.6 million (in 2003-04) and $449.3 million (in 2006-07).

To put this into perspective, although large amounts have been identified as contingent, or yet to be committed, this establishes a base of capital expenditure that can, and most probably should, be earmarked for this purpose. By this commitment there is recognition of the need for ongoing maintenance and improvement of social infrastructure. Not to do so may have a detrimental effect on the long-term health of the State's finances.

7.2.4.1 Change in Estimates Since the 2002-03 Budget

The 2003-04 Budget is different from the 2002-03 Budget in regards to budgeted capital expenditure. The following chart highlights variances between data presented in the 2002-03 Budget Papers and the 2003-04 Budget Papers.

Reduction in Gross Capital Formation



The chart highlights underspending against budget in 2001-02 and 2002-03 and the variances between the 2002-03 Budget Papers and the 2003-04 Budget Papers for the three years to 2005-06. The variances from the 2002-03 Budget have been a contributor to the presentation of projected net lending outcomes in 2004-05 and 2005-06 in the general government operating statement, reducing gross capital formation expenses by $90 million over the two years to 2005-06.

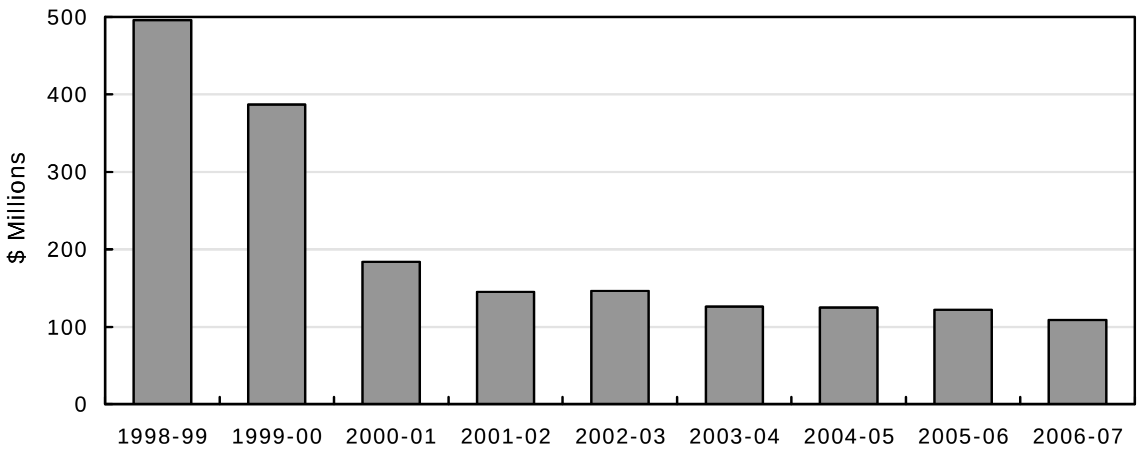
7.2.5 Net Interest

The impact of the net interest expense on the State's finances has diminished greatly over the last few years as the full impact of assets sales has taken place, decreasing from $496 million in 1998-99 to an estimated net expense of $146 million in 2002-03.

To put the reductions since 1998-99 in perspective, it must be remembered that a major portion of the reduction in interest expense has come at the cost of distributions from the assets sold to reduce public sector debt.

The trend in GFS General Government Sector net interest expense is highlighted in the following chart.

GFS - General Government Sector Net Interest Expense (Nominal)



Net interest expense is projected to decrease over the forward estimate period and has reduced in the order of $40 million per year for the forward years compared to the 2002-03 Budget. This improvement is due to lower net interest expenses as a result of cash surpluses, and resultant lower levels of net debt.

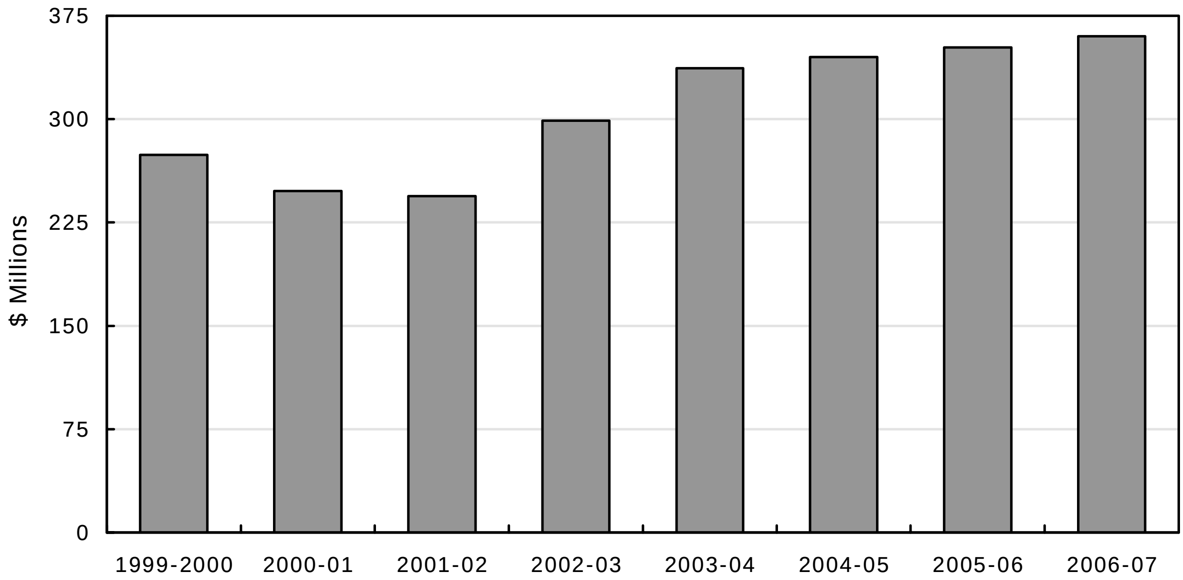
Further discussion in relation to debt movements is provided in the section under the heading '12 - Net Debt'.

7.2.6 Nominal Superannuation Interest Expense

The nominal superannuation interest expense represents the notional borrowing cost of the Government to meet benefits that are not fully funded. This reflects the fact that the unfunded liability for the defined benefits superannuation schemes is equivalent to any other debt. Consequently the Government's nominal interest on the outstanding liability is included as part of expenses in the operating statement.

The following chart shows the GFS General Government Sector nominal superannuation interest expense for the past four years, and the forward estimates in the Budget Papers.

GFS - General Government Sector Nominal Superannuation Expense (Nominal)



The increases over the forward years from 2003-04 recognises the increased liability due to the State experiencing negative investment earnings in the two years up to 2002-03, and the continued expected increases in the unfunded liability over the Budgeted period, notwithstanding the ongoing program to fully fund the liability over the next 30 years.

Due to revisions of the unfunded liability, the budget expenses over the forward years are almost $50 million per annum higher than was estimated in the 2002-03 Budget. To a large extent this reflects the negative effect of investments earnings in 2002-03. As larger amounts are accumulated to reduce the unfunded liability, this also increases the exposure of those assets to market movements, both positive and negative.

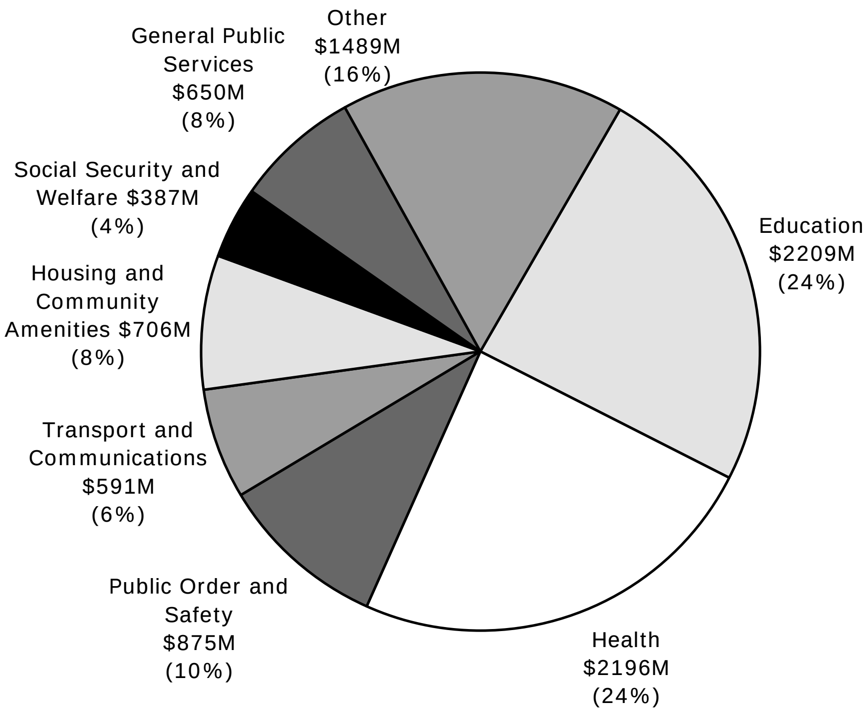
Further details of the unfunded superannuation liability are included later under the heading '10.3 - Unfunded Superannuation'.

7.3 EXPENSES BY FUNCTION

The GFS reporting framework also provides information on expenditure by its function for the General Government Sector. This information demonstrates the extent to which the State's finances are dictated by the needs of the health and education sectors, which make up nearly one half of expenditure.

The following chart relating to the 2003-04 Budget demonstrates the extent to which the health and education sectors dominate the overall expenditure by the State.

GFS - General Government Sector Expenses by Function



7.4 RISKS TO THE BUDGET OUTCOME

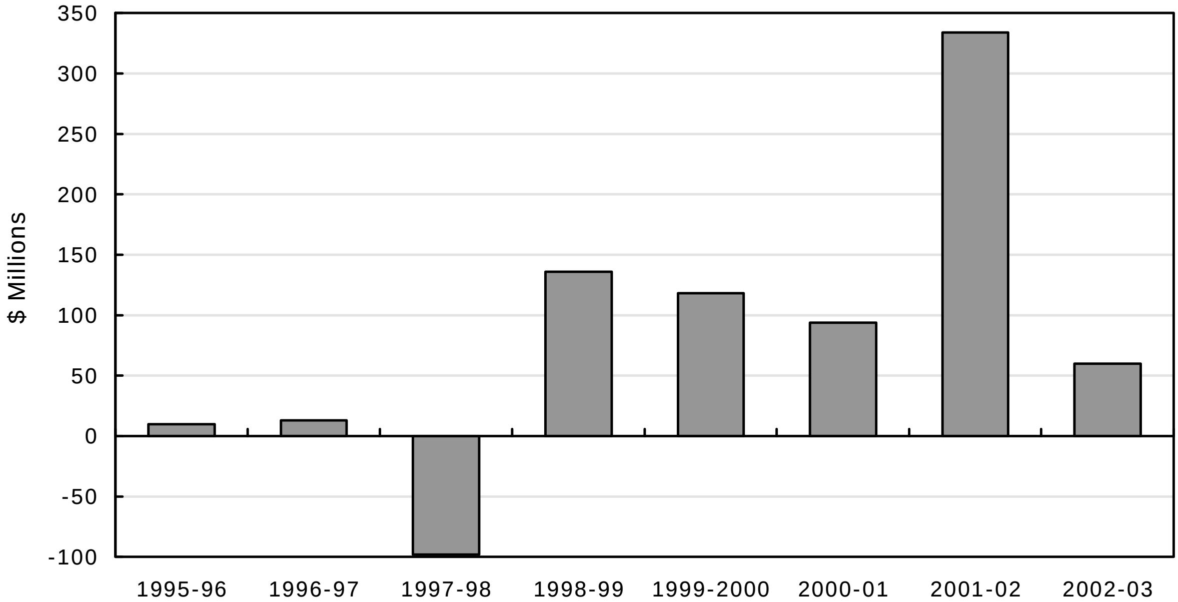
7.4.1 Overview

As mentioned in relation to revenue, the Budget Statement 2003-04 provides detailed consideration of various risks to the expenditure budget and acknowledges the management task for achieving budgeted outcomes. Some of the key risks reported are:

- ***Change in service needs*** — demand for services may change as a result of numerous factors; including age demographics. This risk is being managed through ensuring budget measures are appropriately directed to high priority areas;
- ***Wages and salaries*** — salary increases as a result of enterprise bargaining above those already factored into the budget can adversely impact expenditure targets. To compensate, contingency amounts have been included in the Budget and forward estimates in case salary increases exceed expectations;
- ***Price increases*** — increases in factors such as interest rates, inflation rates and foreign exchange rates can all adversely impact future spending costs through higher interest payments or the cost of goods and services.

To provide a recent historic context, the following chart shows actual outcomes against estimates for the past eight years. The chart highlights that the Government has consistently overspent on its original budget targets in the last five years.

Difference Between Budget and Actual Operating Expenses



7.4.2 Savings

A number of times earlier in this Report recognition has been given to planned savings that have been included in the Budget estimates, and that form a significant part of the basis of trying to achieve the long term fiscal strategy.

The Budget includes a number of savings that have been identified by agencies, based on either achieving efficiency or reducing particular services. A summary of those savings for all departmental portfolios that have been identified is:

Table 7.2 - Summary of Budget Savings

	2003-04 $'million	2004-05 $'million	2005-06 $'million	2006-07 $'million
Premier and Cabinet	5	5	5	5
Business Investment and Trade	10	10	10	10
Treasury and Finance	7	7	8	8
Justice	6	14	9	9
Primary Industries and Resources	2	4	4	4
Administrative and Information Services	15	9	23	7
Human Services	10	11	11	11
Environment and Conservation and the River Murray	10	9	9	9
Transport and Urban Planning	20	30	35	33
Tourism	2	2	2	2
Further Education, Employment, Science and Technology	2	2	2	2
Education and Children's Services	5	5	5	5
	94	108	123	105

Coming out of both the initial savings measures identified above and any further savings identified as part of expenditure reviews will be a monitoring process to ensure that savings are achieved, and that there is no overspending in other areas. If the savings are not achieved, as demonstrated above, it is likely there will be stress on the overall Budget outcome.

7.4.3 Nature of Savings Initiatives

The Budget provides a highly detailed account of savings and revenue initiatives allowing any reader a detailed knowledge of the description of these initiatives.

It is not possible, however, to anticipate the relative ease with which various initiatives might be implemented or achieved. Neither is it necessarily easy to identify the consequences of some savings initiatives for both the service providers and receivers. Clearly, there are decisions that must be taken to operate within defined resource limits. Many decisions will raise risk issues. It is necessary for all agencies implementing savings initiatives to be well aware of the risks and consequences of their initiatives and indeed, where appropriate, to have conducted formal risk assessments.

The nature of savings initiatives range through reductions of staff, IT expenditure, administrative costs (including through the use of shared services), grants and maintenance. Some are in the nature of an exchange and deferral of capital for operating expenditure through private financing initiatives (PPPs). I have commented on these in Section 9.3.5 of this part of my Report.

Given that it is not possible to address the full breadth of activities included in the identified savings initiatives, I have made the following limited observations to highlight some principles I believe are important.

7.4.3.1 Considerations Regarding Savings Initiatives — Legislative Responsibilities

Many of the services or activities conducted by public sector agencies are by force of legislation. These are priorities established by Parliament and it is necessary for agencies to fully understand and fulfil their legislative responsibilities. There will be, in my opinion, little discretion available for agencies in some matters, and as a consequence there may be limited opportunities for cost savings.

7.4.3.2 Considerations Regarding Savings Initiatives — Shared Services

Shared services relates to the centralisation of administrative support services for a number of government agencies rather than each operating individual and possibly duplicative services and systems.

Shared services are certainly not a new concept either between public sector agencies or with private providers. In relation to the increasing use of such arrangements, I would observe that in order for such arrangements to be successful in both efficiency of costs and effectiveness for controlling and managing operations, their implementation needs careful planning and risk analysis.

Individual chief executives are responsible for ensuring the operation of effective control frameworks and mechanisms for their agencies.

Where shared services are in place, the service provider takes on responsibility to ensure that their obligations as a service provider are met. Users of shared services are also responsible to ensure they are receiving appropriate service and that the overall controls relevant for their agency are maintained.

Clarity of these roles and responsibilities is best served through well constructed service level agreements.

7.4.4 Control Environment

As highlighted, adequate control of expenditure is fundamental to achieving budget targets. The following initiatives relevant to the setting and monitoring of the budget are worthy of note.

7.4.4.1 Budget Monitoring and Reporting

Monitoring of progress against Budget targets to enable a timely response to any significant issues arising, is a vital element in managing budget risk. DTF has in progress a range of matters that will improve the budget monitoring process. Section 14 of this Part provides details of these matters.

7.4.4.2 Carryover Policy

For a number of years, governments have had a policy of allowing 'carryovers' of expenditure into future periods when there has been an identified underspend.

DTF have advised that the carryover policy has been tightened further in the 2003-04 Budget to reduce the overall level of carryovers, and to make some carryovers conditional upon agencies demonstrating actual future expenditure.

The intention of this change in policy is to strengthen controls over Budget outcomes by restricting access to previously unspent allocations.

It will be important, however, for DTF to monitor whether the tightening of the carryover policy (or any other significant policy change for that matter) has the unintended consequence of encouraging agencies to 'spend up', particularly at year end.

8 STATEMENT OF FINANCIAL POSITION

8.1 INTRODUCTION

The statement of financial position sets out the assets, liabilities and net worth (difference between assets and liabilities) of the State. The following sections 8 to 13 provide an analysis and interpretation of the data available regarding the State public sector financial position.[32]

Two sets of information are referred to within these sections namely:

- ***GFS Data*** — which is the focus of the Budget Papers. The GFS basis data is presented for both the General Government Sector and also the Non-Financial Public Sector, which consolidates the General Government and Public Non-Financial Corporations (formerly known as the public trading enterprise sector and including South Australian Water Corporation, Forestry SA and TransAdelaide).[33]

- ***AAS 31 (Whole-of-Government Financial Statements) Data*** — which provides the only whole-of-government presentation of financial position. Preparation of data on the AAS basis is such that data is not available for the 2002-03 year at the time of this Report. AAS data is generally completed about the end of December each year therefore the most recent available data at this time is as at 30 June 2002. Notwithstanding, references are made to highlight some of the differences in the presented positions.

A distinct difference in the presentation of these financial statements is that AAS 31 data includes asset revaluation increments made on non-current assets in the operating statement, whereas GFS data excludes revaluation effects from the operating statement because they are outside the control of government.

Full time series data is not presented in the Budget for the Non-Financial Public Sector forward years. While this would be useful in understanding the main elements, net worth data for the general government sector reflects the net assets of the Non-Financial Public Sector.

8.1.1 Key GFS measures

Three key GFS measures of the State's financial position, namely net worth, net financial worth and net debt were explained in section 3.2.1.

Specific commentary is provided in separate sections that follow on these key measures.

8.2 OVERVIEW OF THE STATE'S FINANCIAL POSITION

The following summarises the GFS financial position information for South Australia for the General Government and Public Non-Financial Corporation Sectors.

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[32] Budget Statement 2003-04, Budget Paper 3, Appendix A, includes the financial data in statements described as 'Balance Sheet'. This Report uses the title 'Statement of Financial Position'.

[33] Budget Statement 2003-04, Budget Paper 3, Appendix E details agencies within the respective sectors.

8.2.1 GFS - General Government Sector Financial Position

General Government Sector data for the seven year period to 2006-07 is presented below.

Table 8.1 — GFS - General Government Sector Financial Position (Nominal Terms)

	2000-01 Actual $'million	2001-02 Actual $'million	2002-03 Estimated Result $'million	2003-04 Estimate $'million	2004-05 Estimate $'million	2005-06 Estimate $'million	2006-07 Estimate $'million
Total financial assets	13 673	14 012	13 976	14 039	14 281	14 599	15 158
Non-financial assets	10 697	11 146	11 197	11 265	11 294	11 344	11 535
Total assets	24 371	25 158	25 173	25 303	25 575	25 943	26 693
Liabilities	9 583	10 453	10 885	10 976	11 069	11 114	11 355
Net worth	14 788	14 706	14 288	14 328	14 505	14 829	15 338
Net financial worth	4 091	3 559	3 090	3 063	3 212	3 485	3 803
Net debt	1 246	1 303	766	719	604	409	232

Of note is the expectation that:

- both assets and liabilities will increase across the forward estimates;
- net worth (assets less liabilities) decreased from 2000-01 to 2002-03 and increases thereafter as asset growth outstrips liability increases;
- net financial worth (financial assets less liabilities) will decrease until 2003-04 and then increase for the period of the forward estimates;
- net debt is estimated to decrease greatly over the forward estimate years.

Further commentary is provided on each of these matters in the following sections.

8.2.2 GFS - Non-Financial Public Sector Financial Position

The following table provides available time series data for the Non-Financial Public Sector.

Table 8.2 — GFS - Non-Financial Public Sector Financial Position (Nominal Terms)

	1999-2000 Actual $'million	2000-01 Actual $'million	2001-02 Actual $'million	2002-03 Estimated Result $'million	2003-04 Estimate $'million	2004-05 Estimate $'million	2005-06 Estimate $'million	2006-07 Estimate $'million
Total financial assets	5 012	3 666	3 720	3 336	3 413	n/a	n/a	n/a
Non-financial assets	21 431	21 925	22 622	23 177	23 400	n/a	n/a	n/a
Assets	**26 444**	**25 592**	**26 342**	**26 514**	**26 813**	n/a	n/a	n/a
Liabilities	**13 998**	**10 776**	**11 622**	**12 226**	**12 485**	n/a	n/a	n/a
Net Worth	**12 445**	**14 816**	**14 721**	**14 288**	**14 328**	**14 505**	**14 829**	**15 338**
Net Financial Worth	**(8 986)**	**(7 109)**	**(7 902)**	**(8 890)**	**(9 072)**	**(8 992)**	**(8 796)**	**(8 461)**
Net Debt	**4 355**	**3 223**	**3 317**	**2 824**	**2 905**	**2 741**	**2 525**	**2 217**

This table highlights that:

- there is a major change in composition of the statement of financial position compared to the General Government presentation, with the consolidation of the public sector non-financial assets dominating the financial position;

- net financial worth is negative as liabilities exceed financial assets and is estimated to increase in 2003-04 but improve thereafter to 2006-07;

- net debt is estimated to increase from 2002-03 to 2003-04 and improve thereafter to 2006-07.

Further detailed commentary on the statement of financial position, is provided, concentrating on the specific aspects of categories of data for:

- Assets
- Liabilities
- Net Worth and Net Financial Worth
- Net Debt.

9 ASSETS

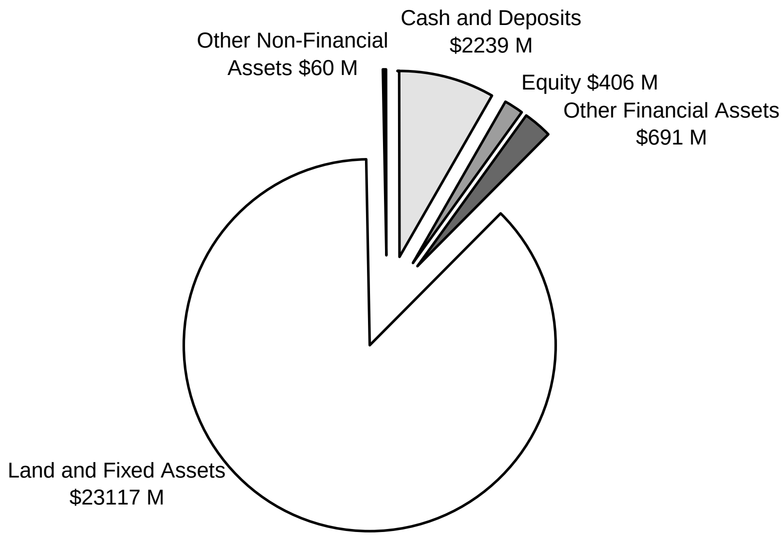
9.1 INTRODUCTION

Historic information shows that the State's financial position does not materially vary from year to year in the absence of major asset disposals or revaluations. The most significant assets held by the State Government are land, buildings and improvements; water and transport infrastructure; and financial assets such as investments. This position is similar to interstate jurisdictions, where similar trends are noted.

9.1.1 GFS - Non-Financial Public Sector Assets

The following chart shows the estimated composition of assets under the control of the State as at 30 June 2003 for the Non-Financial Public Sector.

GFS - Non-Financial Public Sector Assets at 30 June 2003 ($'million)



Non-financial assets clearly represent the vast majority of State assets being 87 percent of the total. These assets are approximately evenly divided between the General Government and Public Non-Financial Corporations Sectors. Assets in the General Government Sector tend not to be used for revenue raising purposes.

9.2 FINANCIAL ASSETS

Financial assets comprise cash and deposits, investments and equity.

9.2.1 GFS - General Government Sector Financial Assets

In terms of the time series set out in table 8.1, the stand out item is the increase of financial assets by $1.5 billion from 2000-01 to $15.2 billion in 2006-07. This increase is in the form of increased cash deposits, $1 billion and equity interests in Public Non-Financial Corporations, $0.6 billion offset by decreases in other financial assets.

9.2.1.1 WorkCover Corporation

General Government Sector financial assets are estimated to decrease for 2002-03 by $36 million. This net movement results from a large decrease reflecting the inclusion of WorkCover Corporation as an entity controlled by the Government, offset by other increases.

The Budget papers note:

> *WorkCover Corporation is now classified as an entity controlled by the Government requiring that its net liabilities or assets be recorded as part of general government equity. WorkCover currently has net liabilities of $384 million causing a once off deterioration in the general government's net financial worth and net worth in 2002-03. This effect is one of presentation rather than substance as the State was always ultimately responsible for the liabilities of WorkCover.*[34]

WorkCover has not previously been reported in the Government's financial reports, including the whole-of-government AAS based reports. This has been a matter noted in Audit correspondence over a number of years.

Most recently, with respect to the 2001-02 whole-of-government AAS based reports, Audit commented:

> *Audit is of the view that WorkCover is part of the government entity for reasons including:*
>
> — *The Corporation is subject to the general control and direction of the Minister (sub-section 4(4) of the WorkCover Corporation Act 1994 (the Act));*
>
> — *The Corporation holds its property on behalf of the Crown (sub-section 4(3) of the Act)*
>
> — *In Audit's view there is a possibility that there would exist an implied guarantee from the government in the event that the Corporation became insolvent.*
>
> *The exclusion of WorkCover Corporation from the whole-of-government financial statements is, in Audit's view, inconsistent with AAS 31 'Financial Reporting by Governments' which requires all assets, liabilities, equities, revenues, expenses and cash flows of all entities controlled by the Government to be included in the whole -of government financial statements. As a result, I am unable to form an opinion on the impact of this entity's financial position, results of operation and cash flows on the Government of South Australia's consolidated financial report.*

The inclusion of WorkCover, in Audit's opinion, properly acknowledges the Government's responsibilities and exposures.

9.2.2 Agency Financial Assets

The majority of the Government's financial assets are held by agencies mainly classified as financial institutions. Accordingly, the gross value of those financial assets are not

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[34] Budget Statement 2003-04, p5.2

directly evident in the General Government Sector financial statements. The main financial asset holding agencies are:

- Funds SA
- Motor Accident Commission (MAC)
- South Australian Asset Management Corporation (SAAMC)
- South Australian Government Financing Authority (SAFA)
- South Australian Government Captive Insurance Corporation (SAICORP).

A large proportion of these investments are held to fund longer-term liabilities such as superannuation and insurance claims against the State.

These investments comprise a range of different classes of assets, and depending on the investment policy or framework of each organisation may include investments in cash, fixed interest, marketable securities, domestic and international equities, property and/or inflation linked assets.

The following table shows the major holdings of investment assets as at 30 June 2003 for the above named agencies:

Table 9.1 — Investments held by Public Sector Agencies [(a)] [(b)]

	Domestic Equities $'million	International Equities $'million	Fixed Interest $'million	Other Investments $'million	Total 30 June 2003 $'million	Total 30 June 2002 $'million
Funds SA [(c)]	1 728	1 905	484	1 293	5 410	5 182
MAC	226	149	773	112	1 260	1 211
SAICORP	42	33	63	10	148	131
SAAMC	-	-	-	765	765	1 189
SAFA	-	-	-	2 106	2 106	1 380
Total	1 996	2 087	1 320	4 286	9 689	9 093

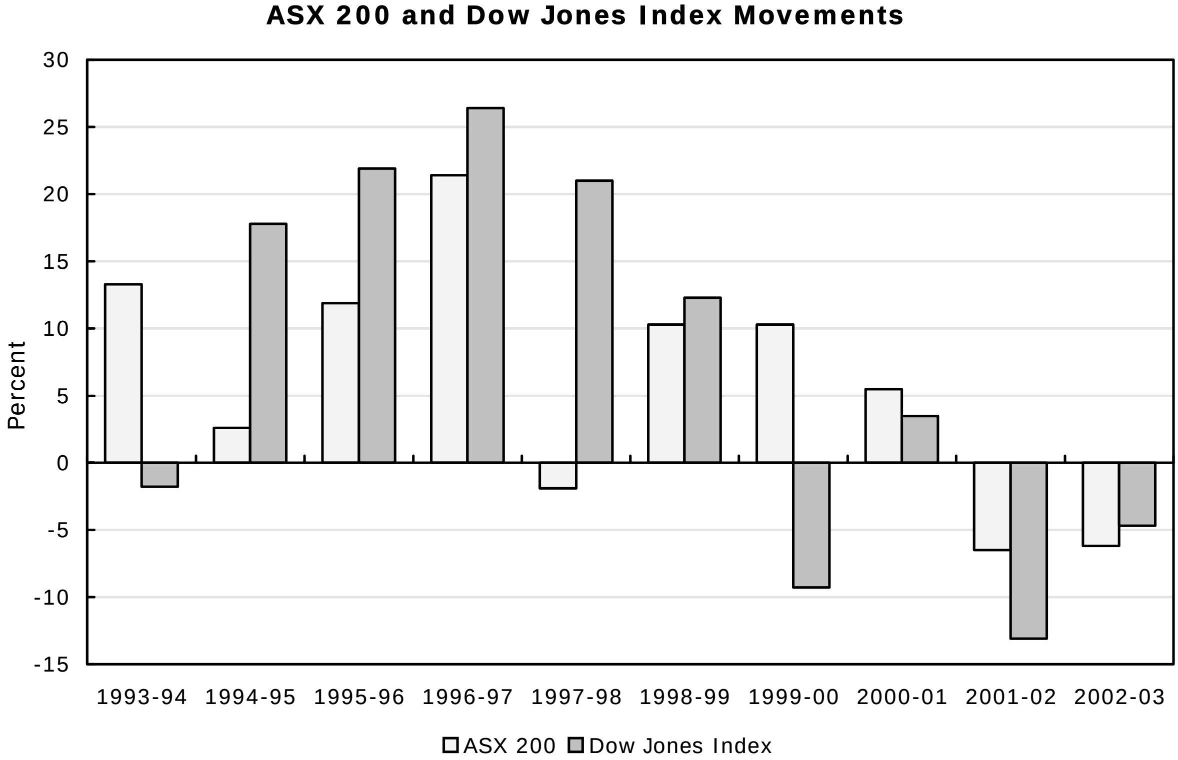
(a) Market values have been used in determining the above amounts and are sourced from their respective financial statements for the year ending 30 June 2003.
(b) Excludes WorkCover.
(c) These amounts relate to superannuation assets set aside for funding future superannuation benefit payments.

9.2.3 Domestic and International Equities

As shown above, a large proportion of the State's investment assets are placed in both domestic and international equities. Investments of this type and nature are managed through the development of agency specific investment strategies, which are ratified by the relevant agencies' Boards. International and domestic equity investments are subsequently managed by external fund managers on behalf of the organisations.

Over the long term, equities are capable of providing large returns through increases in the share prices' market value. This has been exhibited over the past 10 years. Equities are, however, inherently risky assets, and are subject to volatility over the short to medium term including negative returns in some years.

The above agencies have diversified portfolios and hence have exposures to other countries' equity markets and investment instruments. For the purposes of this discussion, however, the following chart shows the volatility of investing in equity markets as reflected in the ASX 200 and the Dow Jones Composite Index and the differing annual returns that have been received for the past 10 years.



There have been average returns over the 10 year period to 2003 of approximately 6 percent per annum on Australian equity markets and 7 percent per annum returns on the United States' markets. Within this time period, negative returns have also been incurred for three out of the 10 years (four in US markets).

Funds SA, with assets of $5.4 billion at 30 June 2003, has by far the greatest value of investments and exposures to international and domestic equity markets. Negative investment returns made during a year, especially on superannuation assets, can have a large adverse impact on the State's short term financial position as discussed in section '10.3 - Unfunded Superannuation'.

9.2.4 Management of Other Financial Assets

With regards to the other types of financial assets that the State holds, a number of mechanisms and derivative instruments are used, where possible and economical, to manage risks to the value of these assets from adverse economic events. Different risk management approaches and policies also take into account the extent of exposures respective organisations have.

Funds SA use derivative instruments to hedge approximately 33 percent of their foreign currency exposures on their international equities portfolio. Motor Accident Commission hedges certain financial assets and claim liabilities denominated in foreign currencies but does not hedge foreign equity investments. SAICORP does not hedge any of its international equity portfolio.

Each of these entities are therefore accepting and subjecting themselves to the risk of unfavourable movements in exchange rates but are also in a position to take advantage of favourable movements. Such movements affect the overall returns gained from these investments.

Many of the above organisations also hedge against specific risks such as interest rate and general consumer prices (such as CPI increases) through investing in fixed asset securities, inflation linked securities and derivatives.

9.3 NON-FINANCIAL ASSETS

9.3.1 Composition and Valuation of Non-Financial Assets

The State's non-financial or physical assets comprise mainly plant, equipment and infrastructure (including roads and water infrastructure) and land and improvements. These assets are evenly held by the General Government and Public Non-Financial Corporation Sectors.

In accordance with the Treasurer's Accounting Policy Statements, major assets are subject to regular revaluation. Valuation of public sector assets, particularly General Government Sector (Non-Commercial) Assets, is a subjective process. Valuations will reflect the specific circumstances of individual government entities operations. The general purpose is to provide users of financial reports with an understanding of the extent of assets employed by government agencies in their operations. In this regard the majority of General Government Sector assets will not reflect market values. Further most assets are not realisable. These are vastly different circumstances than that applying to financial assets.

9.3.2 GFS - General Government Sector Non-Financial Assets

Table 8.1 shows that non-financial assets are estimated to increase continuously over the forward estimates period and in total by $0.8 billion from 2000-01 to $11.5 billion in 2006-07.

The main increase over the period 2000-01 to 2006-07 was in 2001-02 and related to an asset revaluation done on the State's land and buildings assets, which resulted in an net increase in total assets of approximately $0.5 billion.

Net acquisitions (gross fixed capital formation less depreciation), account for the majority of other movements from year to year. For the four years to 2006-07, net acquisitions are estimated to amount to $275 million of which $155 million is budgeted for 2006-07. The larger growth expectations in 2006-07 simply reflect projected spending provided in the Budget.

9.3.3 GFS - Non-Financial Public Sector Non-Financial Assets

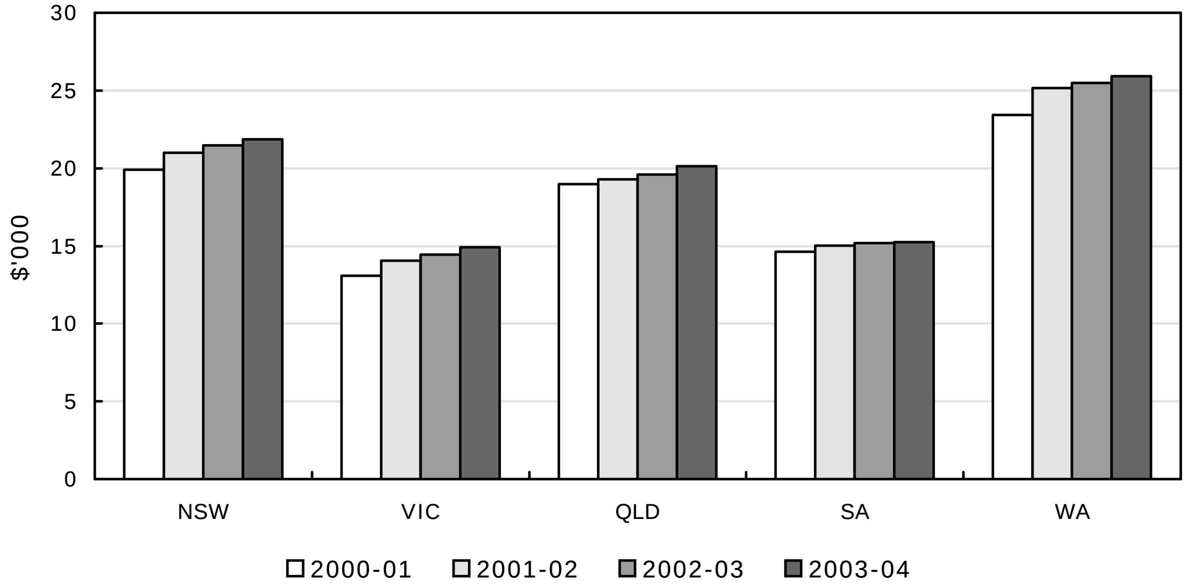
Table 8.2 shows that the value of non-financial assets for the Non-Financial Public Sector are estimated to increase by $555 million in 2002-03 to $23.2 billion and a further $223 million in 2003-04 to $23.4 billion.

The main reasons for the increase are revaluations for the State's other major water, sewerage and drainage systems which increased by $322 million in 2002-03.

9.3.4 Comparison to Other States

The following chart compares the State's non-financial assets per capita against the other mainland states.

GFS - Non-Financial Public Sector Non-Financial Assets per Capita



The chart demonstrates the slow rate of change that is inherent for the various state's large asset bases. South Australia and Victoria are notably lower than other states reflecting in part asset disposal programs.

9.3.5 Public Private Partnerships (PPP)

Non-financial assets can be acquired directly by the Government or by various methods through the private sector. Depending on the arrangements in place, assets may or may not be recognised as being owned by the Government.

PPP is a government initiative that commenced in 2001 with the intention to investigate the possibility of using public-private partnerships for the development of infrastructure and for the provision of services.

The current Government has indicated in the Budget Papers its intention to pursue partnership opportunities with the private sector.[35]

The partnership arrangement is based around a commercial agreement where risks in the arrangement are shared among the party best able to manage these risks (ie the Government or private sector organisation). The private sector organisation is paid on the basis of meeting pre-determined performance and quality standards. Experience has shown that clear identification and specification of outputs required and allocation of risks and returns are critical issues in achieving value for money outcomes from such arrangements. In this regard identification and understanding of relevant risks and their costs is crucial.

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[35] Capital Investment Statement 2003-04, Budget Paper 5, p.1.

Potential projects that qualify for consideration under this initiative are required to meet a value for money test, and where this is absent, conventional procurement options are considered.

The Department of Treasury and Finance has released detailed guidelines of the principles applying to these arrangements.[36]

9.3.5.1 Projects Under Investigation

The following projects have been investigated during 2002 and 2003 for their feasibility to be delivered as PPPs:

- Regional police stations and courts
- State Swimming Centre
- Adelaide Women's Prison
- Youth Detention Centre.

The Government has indicated that rigorous analysis of any public-private partnership will be undertaken to ensure that the Government will receive better value for money from such an arrangement than from developing infrastructure by conventional means.

While my Department has not conducted an audit on any PPP project to date, indications are that project initiation processes being applied to PPPs currently under investigation, are at a standard that is likely to surpass that applying to traditional build and operate arrangements.

9.3.5.2 On or Off Balance Sheet

An important characteristic of projects successfully implemented as PPPs is that they may not be included in capital expenditure. If so, pursuing such projects allows government to provide public facilities that could not otherwise be made available at the time because of fiscal limitations. Whether or not this is the case will be determined having regard to where the principal risks lie for any project - with government or the private sector.

If projects are off-balance sheet, to the extent that new services are provided to the Government by the private sector, a cost will be reflected in current expenses.

I have made some further observations in relation to PPPs in my Memorandum to Parliament this year.

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[36] Department of Treasury and Finance Public Private Partnership Unit 'Private Sector Participation in the Provision of Public Services - Guidelines for the Private Sector', operative 1 September 2002.

10 LIABILITIES

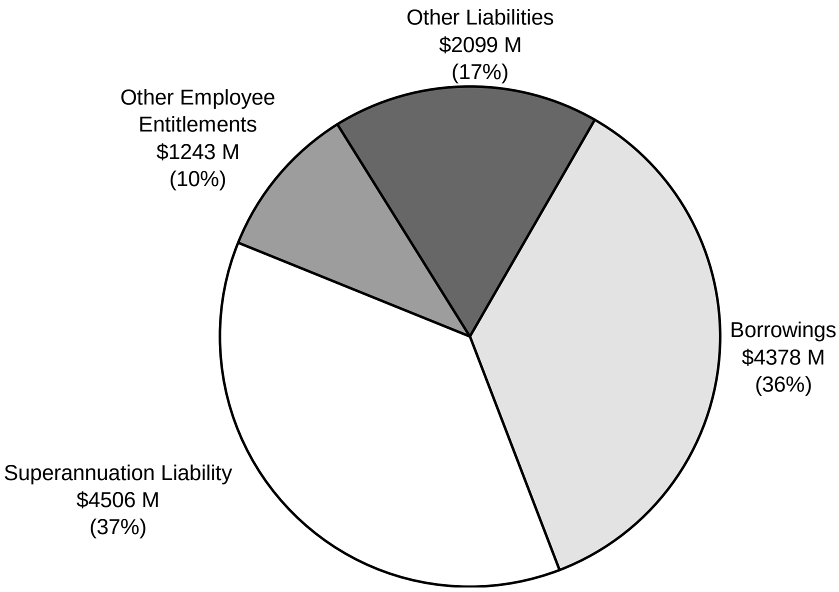
10.1 INTRODUCTION

The 2003-04 Budget, reaffirmed a number of fiscal principles set out in the 2002-03 Budget relevant to the State's liabilities. These principles were identified in section 4.1.

This section considers past and projected liabilities and discusses superannuation liabilities in some depth. A later section '12 - Net Debt' provides detailed commentary on that matter.

The following chart shows the estimated composition of liabilities of the State as at 30 June 2003 for the Non-Financial Public Sector.

GFS - Non-Financial Public Sector Estimated Liabilities at 30 June 2003 ($'million)



The chart highlights that the two main categories of liabilities are borrowings and superannuation liabilities.

10.2 ANALYSIS OF LIABILITIES

10.2.1 GFS - General Government Sector Liabilities

Table 10.1 GFS - General Government Sector Liabilities (Nominal Terms)

	2000-01 Actual $'million	2001-02 Actual $'million	2002-03 Estimated Result $'million	2003-04 Estimate $'million	2004-05 Estimate $'million	2005-06 Estimate $'million	2006-07 Estimate $'million
Borrowing	3 123	3 359	3 029	3 080	3 080	3 009	3 128
Superannuation	3 242	3 980	4 506	4 611	4 707	4 804	4 897
Other employee entitlements	983	1 075	1 175	1 223	1 204	1 229	1 247
Other	2 235	2 038	2 174	2 062	2 078	2 072	2 083
Total Liabilities	9 583	10 453	10 885	10 976	11 069	11 114	11 355

This table highlights the expected growth in total liabilities over the period of the forward estimates, with all categories showing some increase in nominal terms. The most significant is the estimated growth in the superannuation liability of $391 million over the four years to 2006-07. It should be noted, however, that net debt (borrowings less financial assets) improves over the forward estimates period.

10.2.2 GFS - Non-Financial Public Sector Liabilities

The following table shows trends in liabilities for this sector.

Table 10.2 GFS - Non-Financial Public Sector Liabilities (Nominal Terms)

	1999-2000 Actual $'million	2000-01 Actual $'million	2001-02 Actual $'million	2002-03 Estimated Result $'million	2003-04 Budget $'million
Borrowing	6 668	4 386	4 623	4 378	4 534
Superannuation	3 556	3 262	3 999	4 506	4 611
Other employee entitlements	974	1 055	1 136	1 243	1 291
Other	2 800	2 073	1 864	2 099	2 050
Total Liabilities	13 998	10 776	11 622	12 226	12 485

The major reduction in liabilities from the application of proceeds from asset disposals in 2000-01 is clearly evident.

This table also highlights the expected growth in total liabilities over the period under review. The major increase in 2002-03 is due to superannuation liabilities that are estimated to increase $612 million over the two years to 2003-04.

10.3 UNFUNDED SUPERANNUATION

10.3.1 Background to Unfunded Superannuation Liabilities

Superannuation liabilities are regarded as unfunded when specific assets have not been set aside to meet superannuation liabilities as they fall due. It is now commonplace for governments to have a long-term funding strategy and this is the case in this State.

Superannuation liabilities are determined on long-term estimates of total liabilities - they are not liabilities that will be called on in total in the immediate future - thus there is the ability to seek to fund them over many years.

In estimating the liabilities, a range of variable factors are taken into account, key among them are assumptions of salary earnings, investment earnings on superannuation assets, inflation and demographic details such as mortality rates. Also important are the scheduled past service contributions by the Government.

In relation to assets set aside to fund these liabilities, they are predominantly invested in such a way that the market value can be assessed at any point in time and the annual returns on investment are immediately added to the available assets. Returns on investments can have a very significant impact on the unfunded liability.

The superannuation liability may change periodically as assumptions and experience change. This is an accepted fact for this type of liability. It is, however, important to understand that the change to liabilities in this instance results from a best estimate process based on assumptions and expectations based on past circumstances and performance in calculating the liability.

In the 1999-2000 Budget, the target with respect to fully funding superannuation liabilities was extended from 2024 to 2034.

10.3.2 Superannuation Schemes of the State

There are two main superannuation schemes of which present and past employees of the State Government are covered by:

- Defined benefit schemes (Pension and Lump sum schemes)
- Accumulation schemes (such as the Triple S scheme).

Under the defined benefit schemes, members are required to partly contribute towards the funding of this scheme, however the majority of the accrued benefits of these two schemes are required to be met by the Government. As at 30 June 2003, the estimated unfunded liability is $3.9 billion.

Under these schemes, poor or negative investment returns on funds invested results in a higher than projected level of unfunded liabilities affecting the Government's financial position in two ways.

Firstly, to maintain its projected fully funded target of 2034, the Government may need to increase funding contributions above what it had previously estimated.

Secondly, a higher level of unfunded liabilities results in increased expenses to the Government in the form of nominal superannuation interest expense. The higher expense affects the annual operating result.

With the accumulation scheme, the Government contributes at a rate of 9 percent of salary for non-contributing employees or 10 percent of salary where employee contributions exceed 4.5 percent of salary. For this scheme, Government employees bear the risk of poor or negative investment earnings on funds invested for these schemes.

The majority of the following discussion will be based around the defined benefit schemes as this has the largest impact on Government finances and the funding scheme of unfunded liabilities.

10.3.3 Actual Unfunded Superannuation Liability at 30 June 2002

In the 2002-03 Budget, unfunded superannuation liability as at 30 June 2002 was estimated to be $3.8 billion. This estimate has been revised to an actual outcome. The following table shows the major adjustments that comprise the movement in the estimated and actual unfunded superannuation liability at 30 June 2002.

Table 10.3 — Estimated and Actual Unfunded Superannuation Liabilities As at 30 June 2002

	$'million	$'million
Estimated Unfunded Liability (2002-03 Budget)		3 784
Add: Shortfall in earnings against assumed	50	
Less: Corrections using 1998 actuarial basis	(21)	
Add: 2001 triennial review of Superannuation schemes	155	
Add: Other	18	
Total changes		202
Actual outcome 30 June 2002		3 986

As shown, the most recent triennial review that was performed on the superannuation schemes as at 30 June 2001 resulted in an increase of $155 million in the liability. This increase relates to a change in assumptions such as revised pensioner mortality rates, contributor decrements and investment earnings in 2001-02.

The shortfall in earnings against assumed of $50 million is the difference between the estimated earnings (negative 4 percent in 2002-03 budget) and actual investment earning rates (negative 5.54 percent).

10.3.4 Estimated Unfunded Superannuation Liability at 30 June 2003

The following table sets out the major elements that comprise the movement for the actual unfunded superannuation liabilities at 30 June 2002 to the 30 June 2003 estimated liability.

Table 10.4 — Estimated Unfunded Superannuation Liabilities As at 30 June 2003

	$'million	$'million
Actual 30 June 2002		3 986
Add: Nominal interest	299	
Less: Past service payments	(183)	
Add: Shortfall in earnings against assumed	332	
Add: Difference between actual experience and assumed	49	
Add: Other	11	
Total changes		508
Estimated Closing Balance June 2003		4 494

The estimated unfunded superannuation liability as at 30 June 2003 is $4.5 billion. This is an increase of $508 million from the 30 June 2002 actual liability, due mainly to negative investment earnings from assets managed by Superannuation Funds Management Corporation of South Australia (Funds SA) during the year. This was due principally to negative returns on international and domestic equities (shown as shortfall in earnings against assumed) that comprise a large proportion of superannuation assets. The assumed investment earnings in the 2002-03 Budget for the year ending 30 June 2003 was 7.5 percent, while the revised estimated earning rates used this year were negative 3.7 percent for all superannuation scheme assets. The notional interest expense for 2002-03 also contributed to this increase.

In the two years to 30 June 2003, the unfunded superannuation liability is estimated to have increased by $1.3 billion. This significant movement in the liability amounts shows the inherent volatility of that amount and the influence that assumptions such as investment earnings has on the estimated amount.

10.3.5 Analysis of Investment Earnings Assumptions

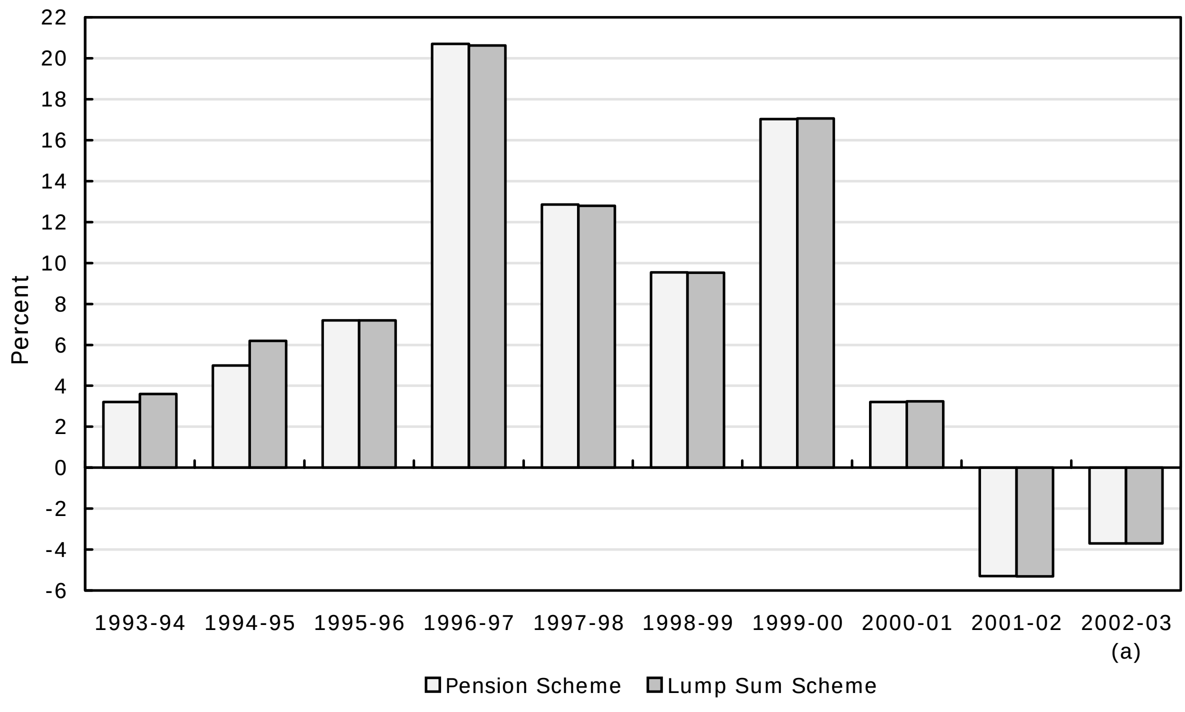
A number of assumptions are used when determining the estimated unfunded liability. A summary of these is as follows:

- Return on Investments — 7.5 percent per annum
- Inflationary salary increases — 4.0 percent per annum
- CPI increases — 2.5 percent per annum

The assumed rate of return on assets in the 2001 triennial review was 7.5 percent per annum. It is important to note that a major investment objective of Funds SA is to achieve long-term returns of 4.5 percent in excess of inflation. That being the case, any assessment of the appropriateness of the assumed investment return rate needs to be made over the long-term.

In this regard, the following chart shows investment returns over the past 10 years for the State's defined benefit superannuation schemes.

Return On Defined Benefit Assets 1993 to 2003



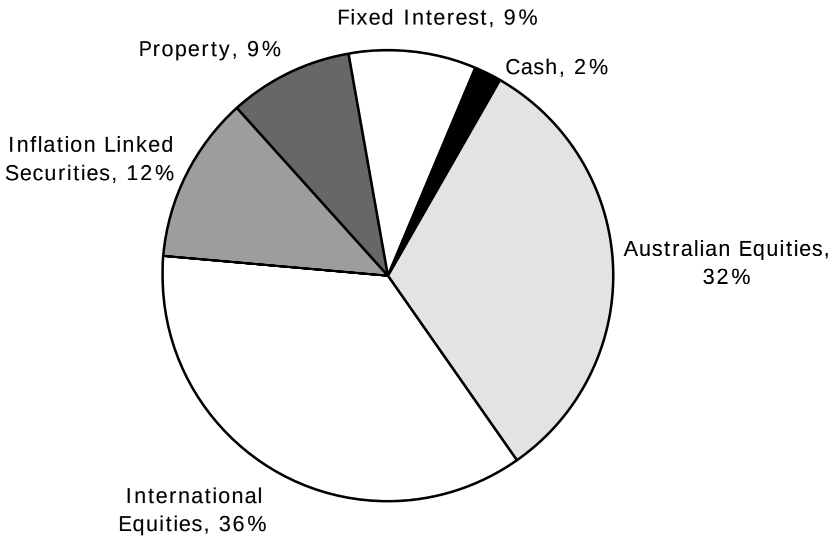
(a) Estimate at time of 2003-04 Budget

Average investment returns over the ten year period are 6.98 percent for the SA Pension Scheme and 7.12 percent for the Lump Sum scheme. Over the 10 year period examined, on average, investment returns have been lower than the budgeted investment-earning rate.

These past investment returns, however, provide no indication as to what future returns will be.

Investment earnings on superannuation assets are very much susceptible to economic conditions, financial markets and Funds SA's investment strategy. The following chart details the asset mix that was held as at 30 June 2003. The high percentage of domestic and international equities held partly explains the negative investment earning results for the two years ending 2002-03. For a discussion on the risks involved with this investment strategy, refer to the Superannuation Funds Management Corporation of South Australia (Funds SA) in Part B of this Report.

Funds SA Asset Allocation as at 30 June 2003



10.3.6 Sensitivity of Investment Rate Changes on the Unfunded Liability

A change in the long-term earnings rate assumption can greatly impact upon the unfunded superannuation liability in any one year. The following table shows the unfunded liability using different assumptions for the long term earnings rate, and in all cases, the assumed earnings rate for 2002-03 is negative 3.7 percent.

Table 10.5 — Unfunded Liability using different Long-Term Earning Rates (30 June 2003)

Assumed Long Term Earning Rate Percent	Unfunded Liability 30 June 2003 $'million	Difference From 7.5 Percent $'million
8.0	4 131	(363)
7.5	4 494	-
7.0	4 892	398
6.5	5 329	835

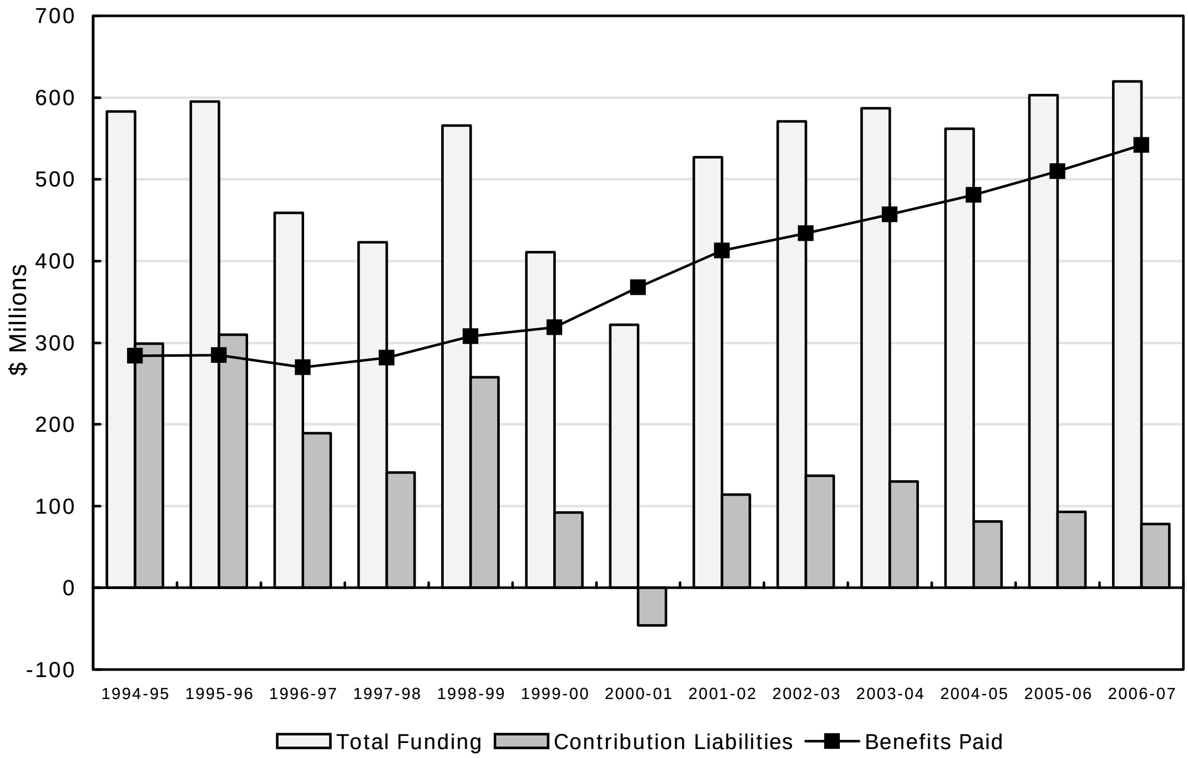
This analysis reinforces the inherent sensitivity that the unfunded liability calculation has upon its assumptions, in particular investment earning rates.

10.3.7 Superannuation Funding

In 2003-04, total superannuation funding is budgeted to be a significant part of cash outlays. Payments comprise amounts paid from agencies as contributions with respect to current employment new service and contributions reflecting lack of funding for current employment in previous years ('past service' contributions).

Audit's approach, so as to obtain a meaningful picture of developments over time, has been to deduct from the figures for total superannuation funding, the amounts paid as benefits so as to obtain consistent measures, over time, of the net contribution to the funding of superannuation liabilities currently accruing or which have accrued in the past. The following chart, showing the trends in total funding, benefits paid and net superannuation contributions over the period of the table has been prepared with this in mind.

Superannuation Benefits and Contributions



It can be seen that:

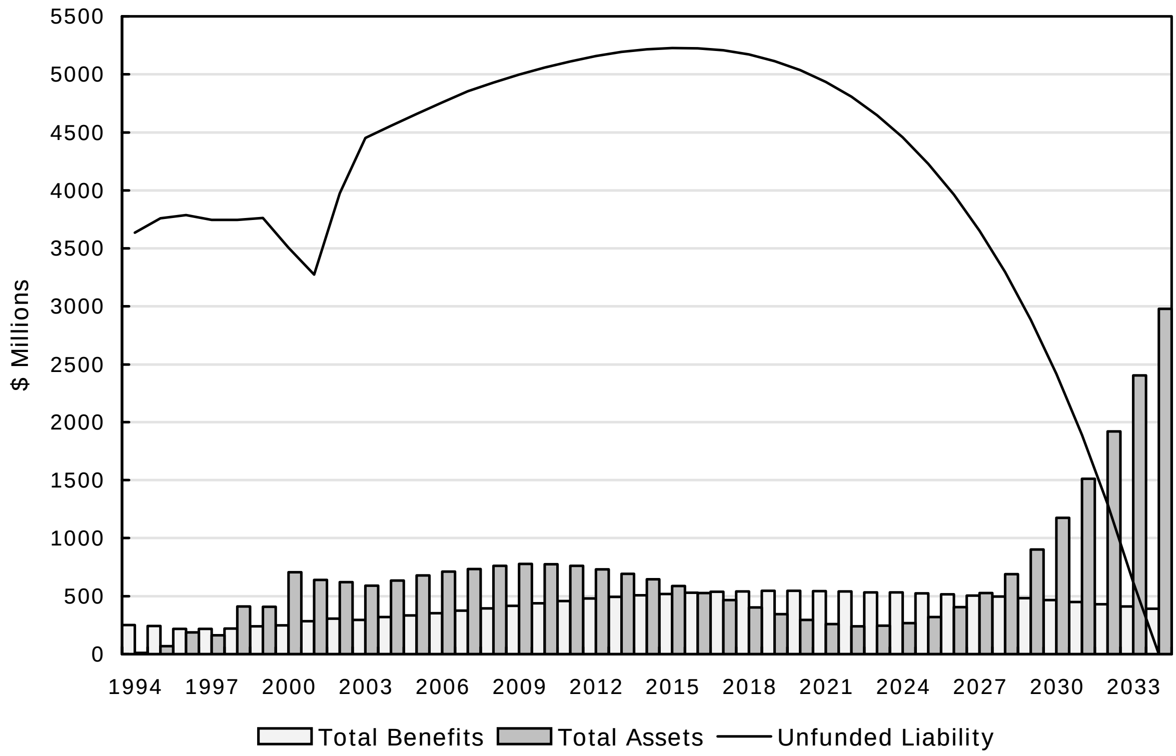
- total funding for superannuation is expected to increase over the period reviewed;
- benefit payments increase over the forward estimate period. Benefit payments for the major schemes (State and Police) are currently estimated to peak in 2018-19;
- net contributions to funding of superannuation liabilities are lower in the last three years to 2006-07 than in 2002-03 and well below the earlier years.

The commitment to fully fund unfunded liabilities was reaffirmed by the Government in the 2003-04 Budget Papers, with the position as at 30 June 2003 remaining consistent with the plan to eliminate unfunded superannuation liabilities by 2034. Additional funding contributions will be required, however, to compensate for reduced earnings in 2002-03 to remain on target. All other things being equal, investment performance above the long term earning assumption in any year may provide an ongoing benefit to future Budget results.

10.3.8 Peak in Unfunded Superannuation Liabilities

The following chart shows the current estimates of benefits payments, assets and unfunded liabilities for superannuation for the State Scheme and the Police Superannuation Schemes — the major and unfunded schemes.

Superannuation Benefit Payments, Total Assets and Total Unfunded Liabilities [(a)]



(a) Data includes closed Pension and Lump Sum Schemes

The chart shows that on current projections, unfunded liabilities are expected to continue to increase until peaking around the period 2014-15. It is estimated that benefit payments will peak in 2018-19.

The Government's target to fully fund superannuation liabilities by 2034 is on track based on these estimates.

10.4 OTHER LIABILITIES

Other liabilities include provisions for other employee entitlements (in particular long service leave provisions), workers compensation, and other liabilities of entities including outstanding insurance claims.

The following table shows the value of Non-Financial Public Sector other liabilities estimated for the five years to 2003-04.

Table 10.6 — GFS- Non-Financial Public Sector Other Liabilities

	1999-2000 Actual $'million	2000-01 Actual $'million	2001-02 Actual $'million	2002-03 Estimated Result $'million	2003-04 Budget $'million
Other employee entitlements	974	1 055	1 136	1 243	1 291
Other	2 800	2 073	1 864	2 099	2 050
Total Other Liabilities	3 774	3 128	3 000	3 342	3 341

Significant balances in these liabilities include amounts that are subject to estimation processes similar to that applying to the estimation of superannuation liabilities. They include:

- long service leave provisions amounting to $761 million for 2002-03 and $789 million in 2003-04. Long service leave is calculated by an estimation process in most cases subject to guidelines issued by the Department of Treasury and Finance;
- workers compensation totalling $206 million for 2002-03 and $208 million in 2003-04;
- outstanding claims for the South Australian Government Captive Insurance Corporation (SAICORP) estimated at $162 million for 2001-02 and $173 million in 2002-03. The majority of these liabilities are funded. There are two separate funds operated by SAICORP. The fund dealing with claims prior to 1 July 1994, when arrangements were formalised are not fully funded with the fund having a net negative equity of $48 million at 30 June 2003 ($63 million in 2002). Details of SAICORP's operations are included in Part B of this Report.

10.5 CONTINGENT LIABILITIES

As reported in the Budget Papers[37] contingent liabilities are those that have not been recognised in the statement of financial position, but rather in notes to the accounts, for one of the following reasons:

- there is significant uncertainty as to whether a sacrifice of future economic benefits will be required;
- the amount of the liability cannot be measured reliably;
- there is significant uncertainty as to whether an obligation presently exists.

Contingent liabilities of the Government can arise from:

- legislative provisions requiring the Government to guarantee the liabilities of public sector organisations eg financial institutions;
- the ordinary activities of the Government might give rise to disputes and litigation that remain unresolved at any given balance date.

[37] Budget Statement 2003-04, Budget Paper 3, p7.6.

Guarantees and contingent liabilities of the Government of South Australia as at 30 June 2002 were valued at $1.8 billion. This is at nominal values without adjustment for the probability of actual liabilities occurring.

Identification and reporting of contingent liabilities has been a matter raised by Audit over a number of years. Most recently, with respect to the 2001-02 whole-of-government AAS based reports, Audit commented:

> *Note 37 details contingent liabilities facing the SA Government. As raised in previous years, Audit believes that there is scope for further disclosure of non-quantifiable liabilities; in particular the nature of the types of potential liabilities that the Government is faced with e.g further guarantees, legal cases;*

The 2003-04 Budget Statement reports on a number of matters that have arisen over the past two years.[38]

These matters highlight the importance of reporting and managing contingent liabilities from their time of incurrence.

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[38] 2003-04 Budget Statement, p7.6-7.8.

11 NET WORTH AND NET FINANCIAL WORTH

11.1 NET WORTH AND OTHER MEASURES

I have stated in past Reports that net debt and unfunded superannuation liabilities are similar liabilities. Accordingly, to focus only on net debt will not necessarily provide a reader with an appropriate indicator of financial position. The following discussion incorporates measures of net worth and net financial worth that are used in GFS financial reporting. These are broader measures than net debt.

11.2 SOME QUALIFYING OBSERVATIONS

Before considering the measures, a number of observations might be made as to their usefulness. The purpose of the analysis is to draw attention to trends for this State over time and the relative differences between jurisdictions. No suggestions are made as to what is regarded as optimal. However, significant variations or negative trends would warrant consideration as to the related implications.

There are a number of points that should be noted in regard to the value of non-financial assets reported by jurisdictions. These values can reflect varying valuation approaches between states and higher asset values can also reflect higher infrastructure needs for population differences. Higher asset values can be associated with higher debt levels. A final observation is that infrastructure can be provided through the private sector and therefore not be included in government data.

11.3 NET WORTH AND NET FINANCIAL WORTH

Table 8.1 set out trends in net worth and the net financial worth for the General Government Sector.

The table highlights that:

- net worth is forecast to decrease by $418 million in 2002-03 and rise thereafter in the four years to 2006-07 with a net increase over the forward estimates period of $1.1 billion;

- net financial worth is also forecast to decrease in 2002-03 and increase annually over the forward estimates period, except for 2003-04, with a total increase of $713 million over the four years to 2006-07.

The main reasons for the decrease in 2002-03 is the increase in superannuation liabilities and the first time inclusion of the net liabilities of WorkCover Corporation.

The increase in net financial worth over the forward estimates period is because growth in unfunded superannuation liabilities is projected to be less than the growth in financial assets; in particular cash and deposits.

The Budget Papers for 2003-04 provide a reconciliation of movements in General Government net worth. That reconciliation highlights the change in net worth arising from operating transactions as shown by the item GFS Net Operating Balance in the Operating Statement. That item, the excess of GFS revenues over GFS expenses, is estimated to contribute $574 million toward the improvement in General Government net worth over the four years of the 2003-04 Budget.[39]

The reconciliation also highlights the impact of revaluations on net worth.

11.4 NET WORTH PER CAPITA

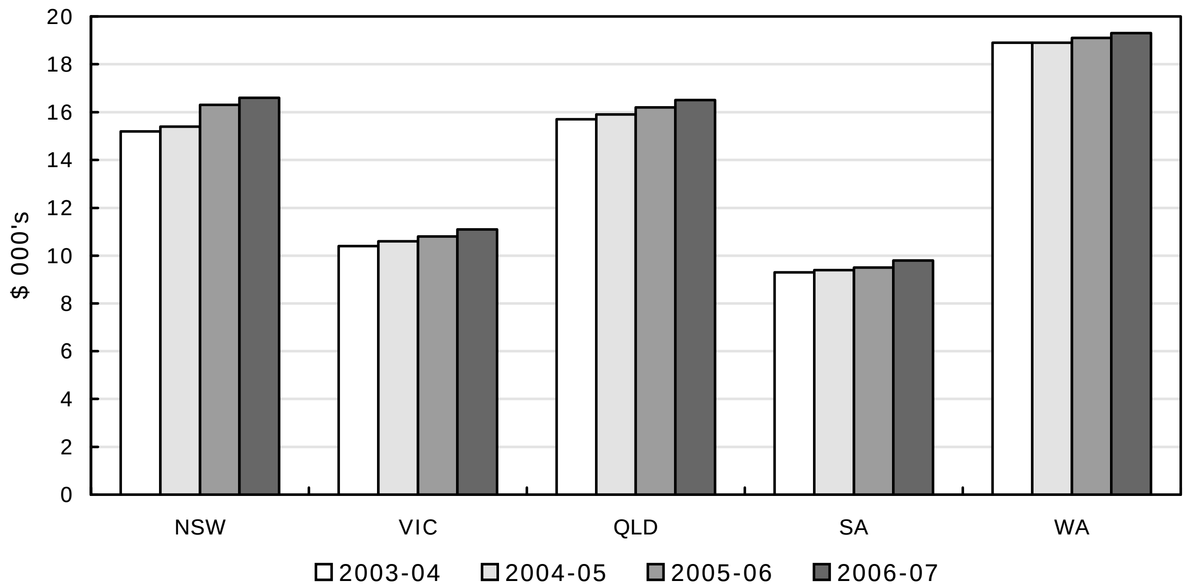
General Government Sector net worth is calculated as total assets (physical and financial) less total liabilities (debt, superannuation, other) and therefore highlights the net change in these items.

Financial assets include the equity of Public Non-Financial Corporations and Public Financial Corporations held by the General Government Sector.

As an indicator, net worth is subject to the influence of valuations of assets, which can vary widely for a range of reasons - eg markets, methodology adopted. Changes in net worth arise from transactions - the operating result and from revaluations of assets and liabilities.

The following chart plots the Budget data for the mainland States.

GFS - General Government Sector Net Worth per Capita



The chart shows the increase in net worth in this State through to 2006-07 based on current budget settings.

The positions of South Australia and Victoria again stand out. Differences arising between the states reflect the histories of policy decisions made and financial outcomes. More particularly, South Australia and Victoria suffered major losses in relation to financial institutions that severely eroded their net worth. Both States have also had major asset disposal programs.

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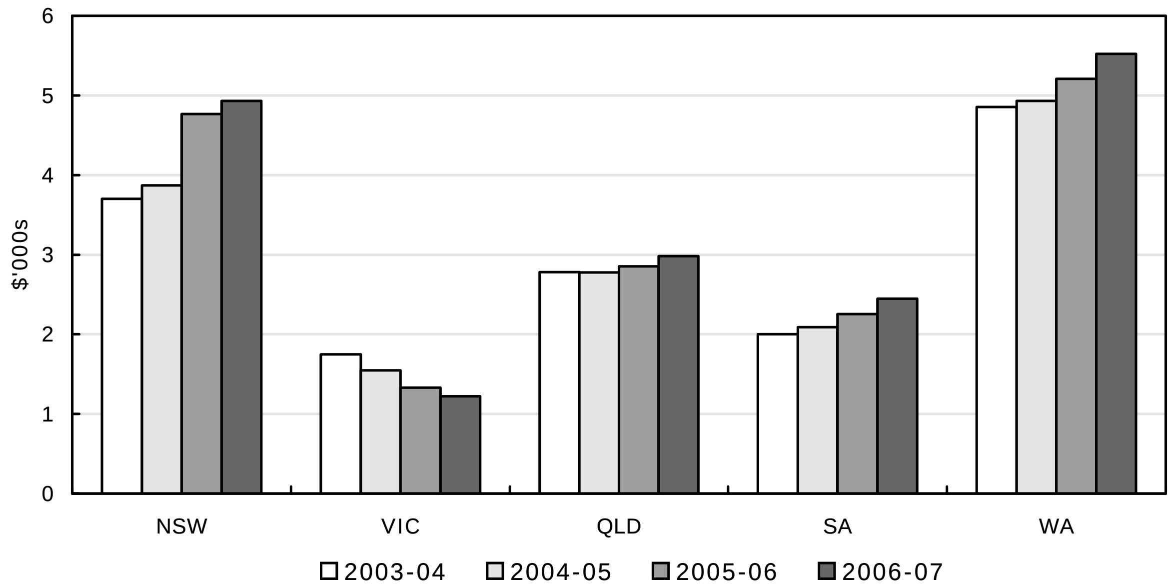
39 Budget Statement 2003-04, Table 5.3.

The data suggests that the states with the higher net worth have additional assets for provision of services or disposal notwithstanding differences that might arise from measurement issues. The differences between the high and the low are very significant and for example for South Australia to reach the average of the other four States for 2002-03 would require additional net assets in the order of $6.8 billion.

11.5 NET FINANCIAL WORTH PER CAPITA

The following chart plots Budget data for the mainland States.

GFS - General Government Sector Net Financial Worth per Capita



The chart shows the increase in net financial worth in this State through to 2006-07 based on current budget settings and its anticipated improvement against Victoria and Queensland over the period.

12 NET DEBT

12.1 INTRODUCTION

Since the collapse of the State Bank, management of net debt has been a major focus of fiscal strategy.

Disposal of publicly owned electricity assets over two years to 2001 resulted in $4.9 billion being used to retire debt of the State and lower interest payments by the State over the long term.[40]

Net debt is approaching historically low levels as a result the estimated net lending outcomes consistent with current fiscal strategy.

12.1.1 Definition of Net Debt

Net debt is calculated as financial liabilities less financial assets. It takes into consideration deposits held or on-hand, advances received or paid, investments, loans and placements and borrowings.

12.1.2 Indebtedness of the Treasurer

The indebtedness of the Treasurer as published in the Treasurer's Statements represents the amount the Treasurer has borrowed from or deposited with the State's Central Borrowing Authority, SAFA. This amount is linked with the GFS accrual numbers in that the GFS net lending position is generally reflected by a reduction in the indebtedness of the Treasurer.

12.2 CURRENT FISCAL STRATEGY AND NET DEBT

Current Budget strategy includes the goal of achieving, on average, zero net borrowings in the General Government Sector.[41] This strategy and other announced fiscal principles are consistent with maintaining no growth in debt. The strategy is expected to be achieved over the period of the 2003-04 budget and forward estimates.

Importantly, the fiscal principles adopted for the 2002-03 and 2003-04 Budgets highlight that reduction of net debt is no longer a primary Budget target but a by product of other specific principles. This is consistent with the much lower level of debt.

12.3 NET DEBT AND RELATED TRENDS

12.3.1 Debt and Other Liability Measures and Indicators

The following commentary provides some measures of net debt and related costs from both an historic and prospective view.

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40 Debt reductions achieved by the State in recent years would, all other things being equal, coincide with overall balance sheet reduction as they result from major asset disposals. A further aim of the Government with regard to commercial asset disposals was to reduce the Government's exposure to a range of operational, financial (including interest rate) and economic risks that had the capacity, if they could not be appropriately managed, to impact on future finances. These can be regarded as structural improvements in the State's financial position to the extent that risk is avoided.

41 Budget Statement 2003-04, Budget Paper 3, p1.2.

12.3.2 Longer Term Trends in the Level of Debt

The following table shows data on a long-term basis looking forward. The impact of the use of proceeds from the electricity disposal process is clearly visible, and sees a reduction in real terms of Public Sector net indebtedness of $5.7 billion since 1998. Forward projections show that net debt is projected to fall in real terms in 2005 and reduce from then to $2.0 billion in 2007.

Table 12.1 — South Australian Public Sector Net Indebtedness 1998 to 2007

New Series	General Government	PNFCs	Total (Nominal Prices) $'million	Real Terms [a] $'million	Per Capita (Real Terms) $	Percentage of GSP Percent
1998	na	na	7 589	8 527	5 723	19.0
1999	4 780	2 940	7 720	8 674	5 783	19.5
2000	1 920	2 435	4 355	4 786	3 169	10.6
2001	1 246	1 977	3 223	3 393	2 247	7.3
2002	1 303	2 014	3 317	3 420	2 250	7.1
2003[b]	766	2 058	2 824	2 824	1 853	5.6
2004[c]	719	2 186	2 905	2 848	1 859	5.5
2005[c]	604	2 137	2 741	2 636	1 713	5.0
2006[c]	409	2 116	2 525	2 382	1 541	4.4
2007[c]	232	1 985	2 217	2 034	1 310	3.7

(a) Estimated June 2003 values
(b) Estimated result
(c) Projections

Following the use of proceeds from the disposal of the State's electricity assets for debt retirement in 1999 through to 2001, at 30 June 2003 net debt of the Non-Financial Public Sector is estimated to be $2.8 billion (5.6 percent of South Australia's Gross State Product). This is now lower than the balance of unfunded superannuation liabilities, which is estimated to be $4.5 billion at 30 June 2003.

Total net debt is projected to steadily decrease in real and nominal terms over the period of the 2003-04 Budget to 2006-07.

Over the forward estimates net debt decreases in the General Government Sector by $534 million due to projected budget surpluses. Net debt of the Public Non-Financial Corporations remains relatively stable over the same period.

Most debt resides with the Public Non-Financial Corporation Sector. The main holders of debt in that sector are South Australian Water Corporation, the South Australian Housing Trust and TransAdelaide. Of these South Australian Water Corporation is a commercial business servicing its debt from business revenues.

12.3.3 Debt Affordability and Servicing

As discussed previously, lower interest payments are predicted over the forward estimates from the levels seen prior to the disposal of electricity assets starting in 1999.

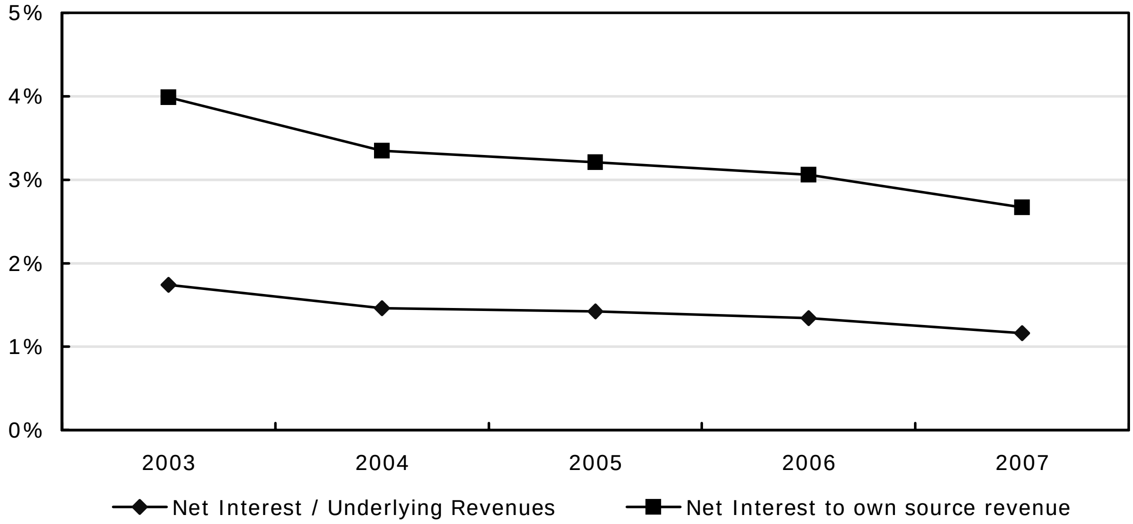
12.3.3.1 Net Interest Expenses to State Revenues

The following indicators, using the General Government Sector data, show the projected affordability of net debt by comparing net interest cost to State revenue measures:

- net interest cost to underlying revenues shows the proportion of total State revenues consumed in meeting net interest costs;

- net interest cost to own source revenues shows the proportion of State sourced revenues consumed in meeting net interest costs.

Debt Affordability Ratios



The chart shows that:

- net interest expenses absorb a very low proportion of total underlying revenues;
- over the forward estimates, net interest expenses are to decrease in comparison to total revenues and own source revenues as a result of projected cash surpluses and decreases in net debt.

12.4 DEBT MANAGEMENT

The South Australian Government Financing Authority (SAFA) has been delegated the responsibility for managing the debt of the South Australian Treasurer.

A portion of this debt is actively managed within limits authorised by the Treasurer, while other debt (CPI indexed debt and Commonwealth State Housing Agreement debt) is managed on a passive basis. Any losses or gains made on the settlement of these transactions is to the Treasurer's account, resulting in either an increase or decrease in the amount owed by the Treasurer. SAFA's debt management performance is measured against benchmarks approved by the Treasurer.

Following the disposal of electricity assets over the period to 2001 and various smaller transactions, there has been a net reduction of $3.6 billion or 50 percent in the balance of the Indebtedness of the Treasurer to SAFA from $7.2 billion at 30 June 1999 to $3.6 billion as at 30 June 2003. These amounts are published annually in the Treasurer's Statements.[42]

Past Reports have discussed debt management issues in considerable detail with a focus on matters relevant to the determination of policy and on performance. The following sets out the current status of policy related matters in the light of the asset disposals.

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42 Report of the Auditor-General for the year ended 30 June 2003, Part B, Volume IV, Appendix.

12.4.1 Debt Management Policy

A Government review of debt management policy was discussed at length in the 2000-01 Audit Report. In 2000-01 the Treasurer changed the policy benchmark duration from 2.8 years to in between 1 to 1.5 years. This policy has been retained and applied during the 2002-03 financial year.

What this means in practice is that the average maturity of the debt portfolio will be lower than it previously was. As noted in my last Report, the lower duration benchmarks offer lower average interest costs over the long-term but with possible higher short-term budget volatility.

For further details on the debt management policy, refer to the financial statements of the South Australian Government Financing Authority (SAFA) in Part B of this Report.

13 WHOLE-OF-GOVERNMENT FINANCIAL STATEMENTS (AAS 31)

The whole-of-government financial statements present a different view of the State's financial position when compared against the already discussed GFS presentation. The main difference is that data for the Public Financial Corporation Sector is included, which, in the case of South Australia, means that superannuation assets and funded superannuation liabilities are reported on the statement of financial position.

Due to the timing of the preparation of the whole-of-government statements, the last completed statements relate to the year ended 30 June 2002, and the following commentary has therefore been kept purposely brief.

The following summarises the financial position for the four financial years 1998-1999 to 2001-02.

AAS 31 (Whole-of-Government Financial Statements) Financial Position Data (Nominal Terms)

	1999 $'million	2000 $'million	2001 $'million	2002 $'million
Assets				
Cash and investments	6 009	7 577	4 988	4 659
Superannuation assets	3 996	4 916	5 175	5 057
Physical assets	22 825	20 817	21 934	22 621
Other	4 254	3 587	2 198	2 459
TOTAL ASSETS	37 084	36 897	34 295	34 796
Liabilities				
Unfunded superannuation	3 909	3 543	3 262	3 998
Borrowings	13 243	11 173	6 992	6 754
Employee entitlements	1 028	1 024	1 108	1 197
Superannuation liabilities	3 945	5 117	5 300	5 183
Other	4 476	4 111	3 347	3 736
TOTAL LIABILITIES	26 601	24 968	20 009	20 868
NET ASSETS	10 483	11 929	14 286	13 928

Of note here is the decrease in net assets for 2001-02. This was due to a rise in superannuation expenses of $1.1 billion, which was offset by an increase in the value of land and improvements.

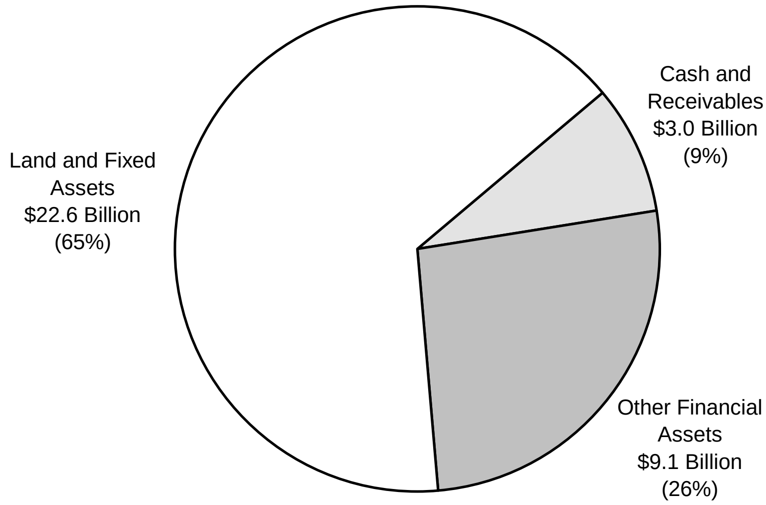
These movements mirror changes reported under the GFS methodology earlier in the Report.

13.1 WHOLE-OF-GOVERNMENT ASSETS

The most significant assets held by the State Government are land, buildings and improvements; water and transport infrastructure; and financial assets such as investments. This position is similar to interstate jurisdictions.

The following tables show the composition of assets under the control of the State.

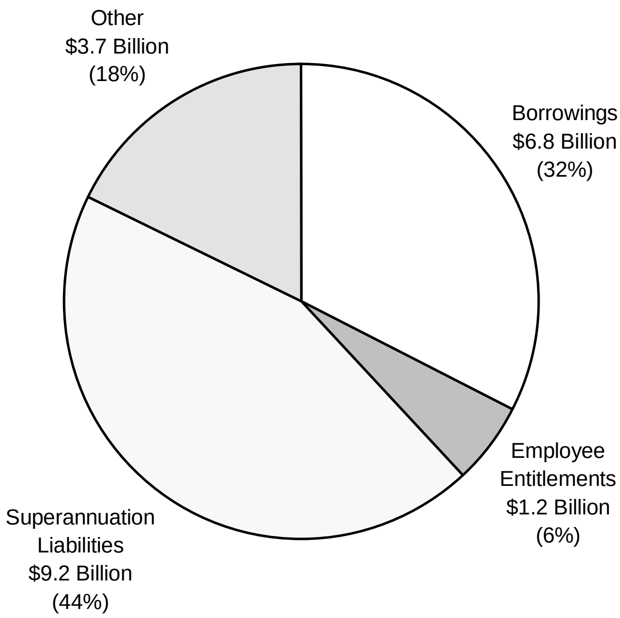
Composition of Total Assets as at 30 June 2002 ($'billion)



13.2 WHOLE-OF-GOVERNMENT LIABILITIES

The following table shows the Government's reported liabilities on a AAS 31 Whole-of-Government basis as at 30 June 2002. The table shows that borrowings and unfunded superannuation liabilities are the most significant liabilities. These make up 76 percent of the total liabilities as shown below.

Composition of Total Liabilities as at 30 June 2002 ($'billion)



14 BUDGET PREPARATION AND PERFORMANCE MONITORING

14.1 INTRODUCTION

In the 2003-04 Budget, the Government has adopted program reporting in place of outputs. Many of the attributes of outputs reporting remain, particularly with the presentation of both financial and non-financial information.

In this section of the Report I provide some comments on aspects of the budget reforms that have been in progress over a number of years.

In previous Reports, I have commented on the progress and performance of government management and budget reforms especially in relation to the timely collation, monitoring and reporting of monthly budget results, and ultimately the year end budget results.

Responsibility for the whole-of-government reporting is shared between individual and central agencies (principally the Department of Treasury and Finance).

The Financial Management Framework (FMF) recognises that while Chief Executives responsibilities relate primarily to the operations of their agencies, they also have some responsibility for whole-of-government financial management. As the holders of detailed information, the timely provision of quality data to the Department of Treasury and Finance (DTF) by individual agencies will always underpin the ability for the production and monitoring of consolidated whole-of -government information.

Notwithstanding this, as I have said in the past, given the complexity of the task, there needs to be, in my view, continued coordination and leadership by DTF to ensure that relevant, accurate and timely information is available to Executive Government to allow it to monitor government finances.

In last year's Report I noted that progress was being made by DTF towards improved monthly whole-of-government financial reporting. It was, however, evident that there was still considerable work to do to improve on that progress. In particular, Audit noted that there was a need to improve the:

- reporting regime;
- process for the collection data;
- quality of data;
- timeliness of reporting the information generated,

The following discussion provides some audit observations on progress in each of those areas together with some comments on the reporting of non-financial key performance indicators.

14.2 MONITORING REGIME

In previous Reports, I have indicated that there was a limited reporting regime in place, with the available reports only provided to the Treasurer.

In May 2002, Cabinet approved the establishment of a number of new Cabinet committees, including the Expenditure Review and Budget Cabinet Committee (ERBCC). One of the roles of that committee is to meet on a regular basis to monitor ongoing Government spending and programs against key performance and effectiveness criteria and to ensure that the Government's financial targets are met.

During 2002-03 the ERBCC was provided with regular reports, designed to give it an early indication of significant expenditure and revenue variations by agencies and portfolios compared to the 2002-03 Budget.

Evidence of follow-up of unexplained variances by the ERBCC, indicates that reports were being reviewed by the Committee and it was recognised that the ongoing review of monthly information by the Committee had the effect of raising the profile of the reports and encouraged agencies to provide data in a timely manner.

14.3 PROCESS FOR COLLECTING AND CONSOLIDATING INFORMATION

Bringing together and reviewing the financial results of almost 100 entities each month is a significant task and requires the presence of a sound underlying process.

In reviewing progress in whole-of-government reporting in 2002-03 there were two initiatives being undertaken by DTF that, in Audit's view, had the potential to significantly improve the ability of DTF to prepare relevant and timely information.

Firstly, during 2002-03 DTF reviewed the information and format required for reporting. The previous monitoring regime surveyed a large number of agencies but in practice data received from many of them represented a low portion of the total operating expenditure. Variations for these agencies were generally not material and provided little insight into the achievement of the overall budget strategy.

As a result, a new monitoring regime focuses on the agencies that have the greatest impact on total operating expenditure, with information from the other agencies collected less frequently during the year.

Although there is a risk that a smaller agency could have an unidentified impact during a particular month, the approach adopted by DTF is, in my view, an appropriate trade-off for more timely and better monitored results for the material agencies.

Secondly, DTF is in the process of reviewing the currently mandated financial systems, with a view to entering into new contractual arrangements by the end of 2004. As part of this review, consideration is being given to the whole-of-government processing and reporting requirements, as well as the requirements of the individual agencies who will be using the system(s) for their operations, to ensure that there is a better alignment of all users information needs.

The consideration of these issues as part of the development, selection and implementation phases should lead to reductions in the duplicative and manual processes required under the current arrangements, which compromise accurate and timely reporting.

14.4 DATA QUALITY

Data quality has been an issue for DTF in the past, and considerable effort was required to improve the initial information provided by the agencies. Audit understands that the quality of data received by DTF has improved and is now less of an issue, particularly with a more focused attention on material agencies.

However, it is understood that there remain problems with explanation of variances, which were often lacking and required detailed follow-up with the agencies to ensure that explanations were reasonable.

14.5 TIMELINESS

Audit has made comment in the past about the lack of timeliness with respect to monthly reporting, which was not available until well after the end of the following month.

Significant improvements have been made with respect to this matter over the course of the last two years, whereby reports are now available for review five to six weeks after the end of the month. To enable this, agencies are now required to submit data by the 21st day of the following month with data analysed and variances reviewed and documented prior to the ERBCC meeting.

14.6 NON-FINANCIAL KEY PERFORMANCE INDICATORS

The Portfolio Statements are seen as a key element of budget information as they outline financial and non-financial information about the services provided to and on behalf of the community by each portfolio.

In last year's Report I recommended that consideration be given to developing a reporting regime for output measures. This was to be achieved by:

- publishing of results against budgets for the same period;
- publishing actual outputs (as opposed to estimates).

Previously, the information in the Portfolio Statements with respect to output indicators included the estimated year end result (as the Budget Papers are tabled prior to the finalisation of actual data), together with the target result for the following year.

Audit noted that the 2003-04 Budget portfolio statements have now given consideration to my recommendations and that actual results are now being published in the Portfolio statements.

14.7 CONCLUSION

Although there has been a marked improvement in the budget reporting and monitoring process, there is still a need for continued work in:

- Improved timing of monthly budget results and subsequent reporting;
- Continued coordination and leadership by DTF to ensure ongoing improvements in the quality and timeliness of whole-of-government reporting.

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