[P.P. 4

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 2000

Tabled in the House of Assembly and ordered to be published, 4 October 2000

Fourth Session, Forty-Ninth Parliament

PART A

Audit Overview

By Authority: M. G. O'Callaghan, Government Printer, South Australia

2000

29 September 2000

The Hon J C Irwin, MLC
President
Legislative Council
Parliament House
ADELAIDE SA 5000

The Hon J K G Oswald, MP
Speaker
House of Assembly
Parliament House
ADELAIDE SA 5000

Gentlemen,

AUDITOR-GENERAL'S REPORT 1999-2000

Pursuant to the provisions of the *Public Finance and Audit Act 1987*, I herewith provide to each of you a copy of my 2000 Annual Report. This Report includes the Honourable the Treasurer's Statements for the financial year ended 30 June 2000.

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 a 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 and III 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 and III of Part B.

Independent Audit Opinion

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 2000;

(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.

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 principals 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 seven instances. The agencies concerned are:

- **Administrative and Information Services — Department for**
- **Education, Training and Employment — Department of**
- **Environment and Heritage — Department for**
- **Justice Information System Services**
- **South Australian Motor Sport Board**
- **South East Catchment Water Management Board**
- **Water Resources — Department for**

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 Volume I, II or III 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, Riverside 2000 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

TABLE OF CONTENTS

TABLE OF CONTENTS

TABLE OF CONTENTS

TABLE OF CONTENTS

TABLE OF CONTENTS

Page

PUBLIC SECTOR WIDE ISSUES: SPECIFIC AUDIT ISSUES AND MATTERS OF IMPORTANCE AND INTEREST

TABLE OF CONTENTS

TABLE OF CONTENTS

MEMORANDUM TO PARLIAMENT

A well-instructed conscience is no longer an adequate guide to legally correct conduct.[1]

INTRODUCTION

During the 1999-2000 financial year major resource commitments have been deployed by Audit to meet the statutory obligations associated with the sale/lease of the ETSA assets and matters associated with the requirement to report pursuant to section 32 of the *Public Finance and Audit Act 1987* on matters associated with the Hindmarsh Soccer Stadium Redevelopment Project. These matters will be the subject of separate reports during the 2000-01 financial year.

THE CHANGING NATURE OF THE AUDIT RISK IN GOVERNMENT

Over the past several years there has been a substantial change in the size of the public sector and in more recent times, a reconsideration of its role. Notwithstanding the fact that government holds assets that are of considerable value, having regard to the extensive range of asset sales that have been made in the past decade, and particularly in the last six years, there is now, because of the narrower asset base, a need for close prudential management. In particular, prudential management is essential to ensure that liabilities are controlled and that the operational arrangements of government are managed so as to minimise the prospect of contingent liabilities being created that will need to be addressed at a future time through either increased taxation and/or borrowing.

In essence, it is essential to develop within the public sector a 'culture' that recognises the importance of 'control' and 'transparent accountability' as fundamental elements in public administrative arrangements.

SUPPLEMENTARY REPORT RELATING TO THE ELECTRICITY ASSETS LEASE/SALE PROGRAM

It had been my intention, subject to completion of procedural fairness processes, to table a number of Reports prepared by this Office regarding the lease/sale process of electricity assets under the *Electricity Corporations (Restructuring and Disposal) Act 1999* at the same time as the presentation of this Annual Report. It is not appropriate that I now take this

---

[1] T Daintith and A Page; 'The Executive in the Constitution' (1999) OUP p. 207.

course until such time as I am satisfied regarding the advice that has been obtained from the Electricity Reform and Sales Unit (ERSU) of the Department of Treasury and Finance. Several Reports on this matter will now be tabled throughout the next Parliamentary session.[2] It is anticipated that these Reports will include the following:

- Electricity Businesses Disposal Process in South Australia: Introductory Audit Comment: *The Public Finance and Audit Act 1987.*
- Electricity Businesses Disposal Process in South Australia: Arrangements for the Conduct of the Bidding Process for ETSA Utilities Pty Ltd and ETSA Power Pty Ltd: Some Audit Observations.
- Electricity Businesses Disposal Process in South Australia: Arrangements for the Conduct of the Final Bidding Process ETSA Utilities Pty Ltd and ETSA Power Pty Ltd: Some Audit Observations.
- Electricity Businesses Disposal Process in South Australia: Review of Project Documentation for the disposal of ETSA Utilities Pty Ltd and ETSA Power Pty Ltd: Some Audit Observations.
- Electricity Businesses Disposal Process in South Australia: Engagement of Lead Advisers: Some Audit Observations.
- Electricity Businesses Disposal Process in South Australia: Engagement of Legal Advisers: Some Audit Observations.
- Electricity Businesses Disposal Process in South Australia: Engagement of Accounting Advisers: Some Audit Observations.
- Electricity Businesses Disposal Process in South Australia: Review of Vendor and Buyer due diligence processes for the disposal of ETSA Utilities Pty Ltd and ETSA Power Pty Ltd: Some Audit Observations.

Notwithstanding the fact that the issues raised in these reports related to the electricity lease/sale process and have been communicated to the ERSU, many of these issues continue to be of relevance for public administrative arrangements in this State where asset sales and/or contractual relationships are involved.[3]

---

2 This is, of course, subject to the right of any person with a justiciable interest to take steps that may prevent this intention being fulfilled.

3 Other possible asset sales include the following:

- the South Australian Totalizator Agency Board;
- the South Australian Ports Corporation;
- the South Australian Lotteries Commission.

REPAYMENT OF DEBT FROM PROCEEDS OF THE LEASE/SALE OF ELECTRICITY ASSETS

In June 1999 the Parliament passed the *Electricity Corporations (Restructuring and Disposal) Act 1999* which provided for the disposal of the State's electricity assets. A substantial proportion of the electricity assets disposals program was completed as at 30 June 2000 and the announcement of a lease in relation to ElectraNet SA means that the disposals program is nearly complete at the time of this Report. $3 761 million in cash proceeds were received by 30 June 2000 and after setting aside funds to meet various operating and disposals costs $3.7 billion (including interest received) was available for debt retirement. Of this amount $2.4 billion had been applied to debt retirement as at 30 June 2000 with the balance $1.3 billion expected to be fully utilised by the end of the calendar year 2000.

I have included an overview in this Part of the Report that summarises matters relevant to managing the receipt of the disposal proceeds and the financial effects of the disposal process to-date. The commentary covers, an overview of the proceeds received, the use of the proceeds and the net effects, to the extent they are measurable, on the State's finances to the date of this Report. I would emphasise that as the disposals process is not complete at the time of this Report, there will be a thorough review of all relevant matters in reporting at the conclusion of the disposals program.

EXAMINATION REPORT ON THE HINDMARSH SOCCER STADIUM REDEVELOPMENT PROJECT

In December 1999 I received a formal request from the Treasurer of South Australia, pursuant to section 32 of the *Public Finance and Audit Act 1987* to examine and report on dealings relating to the Hindmarsh Soccer Stadium Redevelopment Project. The formal request of the Treasurer was consistent with a request embodied in a motion passed by the Legislative Council in November 1999.

Audit's examination of the Hindmarsh Stadium Project has been extensive, involving:

- Relating in a formal manner with persons and organisations within government and external to government to obtain access to accounts, records and documents relating to the redevelopment, operation, financial affairs and management of the Hindmarsh Soccer Stadium.

- Reviewing, cataloguing, analysing and evaluating the contents of all information obtained relative to the Terms of Reference of the examination.

- Conducting formal interviews with various persons to further explore and clarify specific issues that have arisen in the course of the examination.

The examination is nearing completion with the natural justice process to be finalised. The report on the examination is anticipated to be tabled during this Parliamentary session subject to satisfactory completion of the natural justice process.

THE COMPLEXITIES OF LEGAL COMPLIANCE

An issue of continuing importance for government is the need to ensure the legality of its conduct. To my mind the following commentary succinctly states the relevant issues in this regard.[4]

> *In the age of complex social and economic regulation, the question 'Is this legal?' presents itself with increasing frequency to individuals and corporations alike, and may be impossible to answer without reflection, research, or even professional advice. A concern for legal rectitude, supported by expert advice is however of peculiar importance to government, for at least three reasons. First, the Executive relies, for much of its capacity to govern on legal powers which exceed those enjoyed by other persons, notably the power to coerce and control its citizens. It claims to be a monopolist so far as the resource of force is concerned, and must accept the associated legal constraints. Second, the use of the resources which it does share with others — notably the financial power that it possesses in common with any wealthy subject — is, … subject to special and sometimes obscure legal restrictions. Third, illegal conduct, or even oppressive or unlawful use of powers, is likely — quite aside from any litigation it might engender — to provoke damaging criticism, in the media, the legislature, or elsewhere.*
>
> *These considerations, of course, only operate on that minority of governments that profess to operate, and do in fact operate, according to the tenets of democracy and the rule of law.*

Over the past two (2) years matters have been raised in the Annual Audit Report to Parliament that indicate that certain governmental administrative arrangements may be unlawful in that they are contrary to statutory provisions. No changes have been made and no reasons have been publicly advanced for maintaining the existing arrangements. Whilst it is open to the Executive Government to take a different view of its legal obligations, in my opinion, in the context of these circumstances, it would be expected that the reason for not acting would be explained. In this situation, it must be assumed that the Government, as a matter of law, holds a different view. With respect, if this is the case, the legal basis and the reasons for its position should be publicly known.

K I MacPherson
AUDITOR-GENERAL

---

4 Daintith and Page op cit at p. 207.

SUMMARY OF MAIN POINTS

THE STATE'S FINANCES AND RELATED MATTERS

AN OVERVIEW OF PUBLIC SECTOR FINANCIAL REPORTING ARRANGEMENTS

A Change in Public Sector Financial Reporting — Accrual Based GFS

From April 2000 the Australian Bureau of Statistics (ABS) introduced accrual-based GFS reporting. This reporting framework allows all jurisdictions to report on an economic, rather than an accounting, accrual basis. The Budget Papers indicate that the Commonwealth and some States have adopted this basis for their key budget indicator.

In this State the Government has continued with the cash-based result as its focus in the third of its four-year budget strategy. The Government has indicated that future fiscal plans will consider the appropriate fiscal target to adopt.

The issue that arises is whether the State should change its budget reporting targets. Notwithstanding the adoption of accrual based financial reporting throughout governments, it is notable that few of the jurisdictions have adopted similar key targets.

What is clear is that jurisdictions and the ABS do not have cash based key budgetary targets. While this State will report the accrual based GFS information in accordance with uniform reporting arrangements as agreed by all jurisdictions, unless specific targets are established, the uniform reporting simply puts the State's financial outcomes into a particular format rather than having the outcome as a focus for achievement.

In my opinion, the matter of appropriate fiscal targets for the State, needs to be resolved in the near future so that appropriate planning for the implementation of the necessary support mechanisms for revised targets can occur.

AN OVERVIEW OF THE STATE'S FINANCES

1999-2000 year saw two significant events that have changed the structure of the State's finances from the past. They are the implementation of national tax reform and the part completion of the disposal of the State's electricity assets. The magnitude of the change is evident by the fact that Commonwealth general purpose funding increases in 2000-01 by over $800 million with offsetting reductions in State taxes. Asset disposals have brought immediate reductions in net debt, estimated at $3.5 billion as at 30 June 2000.

These are regarded as improving the financial position. Notwithstanding, the Budget data indicate in a number of ways that there remain issues to be resolved in the long term. How this occurs will need careful consideration for the best long-term outcome.

The 1999-2000 Underlying Result

The 2000-01 Budget (introduced in May 2000) revised estimate was that the underlying result for 1999-2000 would be a deficit of $39 million compared to the original Budget surplus of $1 million.

The Department of Treasury and Finance have advised that the forecast 1999-2000 outcome is likely to be a slight improvement from the revised estimated deficit.

The revised estimate was determined after taking into account the deferral of a dividend of $186 million from the South Australian Asset Management Corporation (SAAMC).

The outcome reflects a net improvement of approximately $198 million in the cash position of agencies. The improved cash position was used to make payments amounting to $100 million towards funding past superannuation liabilities. There were also further deferrals of anticipated dividends from SAAMC and the South Australian Government Financing Authority.

The 2000-01 Underlying Result

The 2000-01 Budget estimates a deficit before abnormals of $32 million and an underlying surplus of $2 million.

Of crucial importance is whether the means by which forecast outcomes are achieved can be sustained, in the long-term, and not be the result of continuous balancing by one-off adjustments.

The Budget includes substantial increases in Commonwealth funding from national tax reform arrangements offset by corresponding reductions in State taxation revenues. The Budget includes an estimated premium of $109 million from electricity assets disposals.

The Budget includes revenues from SAAMC of $109 million and the South Australian Government Financing Authority of $50 million. This is the largest total contribution from these two entities over the period of the forward estimates.

The 2000-01 Budget also benefits from the deferral of $86 million of past superannuation payments due to a profit on sale of the Adelaide Casino. This deferral frees up funding for other purposes. In contrast, $67 million of unfunded superannuation liabilities transferred to the non-commercial sector on disposal of electricity businesses will be funded as part of the ongoing funding program over a number of years.

2000-01 Accrual Based Estimates

The 2000-01 Budget sets out the following accrual based estimates for the non-commercial sector:

	2000-01 **$'million**
Net assets	**5 490**
Operating deficit before abnormals	**94**
Cash at 30 June 2001	**1 556**

The operating statements for 1999-2000 and 2000-01 indicate that superannuation expense decreases from $615 million in 1999-2000 to $461 million in 2000-01, a decrease of $154 million, which is in itself material to the operating result.

COMMENTARY ON THE STATE'S BUDGET OVER THE PERIOD 1997-98 TO 2003-04

Audit analysis indicates that outlays, excluding abnormals and Commonwealth specific purpose payments (SPPs), are expected to grow significantly in real terms from 1997-98 to 2000-01 and then to be generally maintained at that higher level. The 2000-01 Budget total outlays, excluding abnormals and SPPs, are consistent in real terms across the forward period with the estimates in the 1999-00 Budget.

The 2000-01 Budget highlights the impact of national taxation reform on the composition of the State's revenues with a significant increase in the proportion of total State revenues from the Commonwealth.

The 2000-01 Budget shows that discretionary use of dividends and returns from financial institutions and deferral of discretionary outlays such as past superannuation liability funding have been required to achieve the underlying balanced Budget targets.

A broad summary of significant factors is:

- The forward estimates indicate deficits (before abnormals) will be incurred for 1999-00 and 2000-01 notwithstanding small underlying surpluses.
- Total unadjusted outlays (excluding SPPs) decrease in real terms over the period 1999-00 to 2003-04 by $74 million.
- Total outlays (excluding SPPs) adjusted after deducting some outlay items that vary substantially from year-to-year, including 'abnormal items', net interest payments and internal payments for tax equivalents, show an increase over the period 1998-99 to 1999-2000 in real terms of $119 million (2.8 percent), and from 1997-98 to 2003-04 of $850 million (22.1 percent).
- Capital outlays (excluding SPPs and net advances) are estimated to be higher in 2000-01 and the forward years compared to 1997-98 and 1998-99. Historically, this item has been subject to considerable slippage each year compared to budgets set and this is again evident in the 1999-00 estimated result.
- Projected payments towards unfunded superannuation liabilities were reduced by $86 million in the 2000-01 Budget to take advantage of a profit earned on the disposal of the Adelaide Casino.

- The non-commercial sector took responsibility for unfunded superannuation liabilities of $67 million from former electricity businesses which will be funded as part of the long term funding program.

- Revenue from gaming machines is expected to contribute about $211 million in 1999-00 and decrease to $183.4 million in 2001-01 due to national tax reform changes.

- Taxation policy changes other than gaming machines are expected to contribute about $143 million and natural increases in taxation revenue about $78 million in 1999-2000 over 1998-99. Contributions of $130 million and $55 million respectively are expected in 2000-01.

- The 2000-01 estimates rely on a dividend distribution from SAAMC of $109 million. It is not identified as an abnormal item.

- Commonwealth general purpose funding is anticipated to increase between 1998-99 and 1999-2000, in real terms by 0.9 percent or $14.5 million. From 1999-2000 to 2000-01 general purpose grants are forecast to grow by $745 million or 43.5 percent in real terms due to national tax reform arrangements.

ELECTRICITY ASSETS DISPOSALS AND THE STATE'S FINANCES

The Proceeds of Disposals and the Application of those Proceeds

Electricity asset disposals to 30 June 2000 have achieved announced disposals values totalling $3 879 million. After adjustment to take account of retained liabilities from the electricity entities and non-cash transfers to the private sector of unfunded superannuation liabilities, $3 014 million was available to meet State liabilities other than those relating to disposed of electricity entities.

As the retained liabilities are already included in the State's net debt figures, the gross proceeds less the cost of disposal will therefore reduce State net debt.

Gross cash proceeds (that is not adjusted for retained liabilities) were $3 761 million.

To 30 June 2000 the application of the gross cash proceeds included $191.8 million for stamp duty, operating and disposal costs. The Government has determined to use the stamp duty receipts for retirement of debt and to 30 June 2000 had appropriated $103.9 million for this purpose.

Proceeds including interest set aside in a special deposit account to 30 June 2000 specifically for debt retirement amounted to $3 705 million. Physical debt retirement to 30 June 2000 was $2 410 million. The balance of the account at 30 June 2000 was $1 295 million.

Estimated Interest Savings and the Estimated Premium

Estimated interest savings to 30 June 2000 arising from electricity asset disposals amounted to $77.2 million. It is estimated that savings in 2000-01 will be $210 million excluding the effects of any further completed disposals in 2000-01.

An estimated net benefit or premium on disposal of electricity assets to 30 June 2000 was $115 million of which $100 million had been built into the forward estimates in the 1998-99 Budget. This excludes the effects of any further completed disposals in 2000-01.

All estimates will be reviewed once the asset disposals are finalised and all actual data can be concluded.

Reduction of Risk Exposure

Apart from the estimated premium, the State has reduced its risk exposure to operating in the National Electricity Market by the disposal of the electricity businesses. This is offset by eliminating the opportunity to earn revenues and profits in that market and reducing the State's limited own source revenue base.

The State has also, by reducing debt, reduced debt management related risks and in particular outright interest rate risk. Following the announcement of the first electricity asset disposals in December 1999, the State achieved an improved credit rating to AA+.

Accounting Gain

The accounting gain from the disposal using the book value of assets disposed of from the disposal was $1 048 million reflecting the receipt of proceeds of $3 373 million for assets with a net book value of $2 325 million.

In addition, proceeds of $276.2 million were received with respect to future operating lease rentals relating to land with a book value of $30.8 million.

Net Reduction in the Treasurer's Indebtedness

For the non-commercial sector, the net reduction in indebtedness of the Treasurer, which is the base for net interest payments in the Budget, for 1999-2000 was $1 395 million.

Related net interest payments in 2000-01 are expected to decrease due to the reduction in indebtedness offset by a rise in the average interest rate paid in that year. Interest payments are projected to fall further in 2001-02 due to a decrease in the average interest rate paid in that year as high yield debt matures or is retired.

The Matter of whether a Fair Price was Received

In relation to whether the State received a fair price for the assets disposed of in 1999-2000, information provided to Cabinet on the valuation of assets before each disposal, indicated that, overall, because of the results for the two major disposals, the State had virtually achieved the upper limit of the estimated total valuations of the assets.

THE TREASURER'S FINANCIAL STATEMENTS FOR THE PERIOD ENDING 30 JUNE 2000

The result on the Consolidated Account for 1999-2000 was a deficit of $217.5 million. The deficit was financed by borrowings from the South Australian Government Financing Authority (SAFA).

The deficit was due mainly to the deferral of receipts of approximately $232 million from SAAMC and SAFA and additional payments of $100 million towards past superannuation liabilities.

Flexibility in expenditure, is provided by the Governor's Appropriation Fund (GAF) ($166 million) and contingency provisions ($144 million).

For 1999-2000 the actual amount used from the GAF was $70 million and for contingency purposes was $111 million.

There was an increase in total cash funds as at 30 June 2000 of $1 237 million from the previous year dominated by the balance of unutilised proceeds from the disposal of electricity assets in 1999-2000 of $1 295 million.

Notwithstanding the electricity proceeds account balance, it is evident that other accounts continued to accumulate large balances for the year ie the large decreases were offset by other large increases. This continues a trend over six years of increasing balances in these accounts.

Indebtedness of The Treasurer decreased by $1.4 billion.

The decrease comprised repayment of borrowings of $2.4 billion offset mainly by electricity debt assumed ($620 million) Consolidated Account borrowing ($218 million) and SAFA book losses ($187 million).

STATE DEBT

The Reduction in Net Debt

There has been a major reduction in the order of $3.5 billion in net debt in 1999-2000 and this has been effected both through physical retirement of debt and a temporary increase in financial assets pending debt retirement in 2000-01. Estimated net debt at 30 June 2000 is $4.2 billion ($7.7 billion at 30 June 1999).

Even with the addition of unfunded superannuation liabilities, which were projected to rise by some $120 million, the overall decrease of net debt and unfunded superannuation liabilities remains in the order of $3.4 billion. Estimated total net debt and unfunded superannuation liabilities at 30 June 2000 is $8.3 billion.

This is a major change in the State's financial position in as much as exposure to the burdens of net debt is reduced — following the exchange of income earning assets, that were themselves subject to a variety of operational risks, for cash.

The Debt Position Relative to Other States and Territories

The reduction in net debt has enabled the State to show significant improvement in a range of debt burden indicators and to improve its relative position to the other States and Territories, matching some debt burden indicators and continuing to lag in relation to some others. In regard to those where this State lags the position of the main States, the ability to match their position in a number of indicators, if there is such a requirement, seems limited or at least difficult, needing further large asset disposal proceeds, and it seems appropriate to consider other possible priorities.

Care needs to be taken in evaluating changes in debt burden indicators as they can be subject to variations in calculation and do not necessarily reflect an improved financial position.

Nonetheless, having achieved an improvement in debt burden indicators, this emphasises the need for strict risk management processes in protecting against the incurrence of large liabilities in the future.

Determining an Appropriate Level of Debt

South Australian public sector net debt has reduced markedly since the post State Bank peak in 1994 in both absolute (total debt) and relative (ratios) terms. The data show the ratio of net debt to Gross State Product is now below the 1990 level.

In view of the success in reducing debt and the magnitude of future debt reduction probably needed to further improve the State's relative position to other States and Territories, questions arise as to what is an appropriate level of debt for the State and what strategies are relevant for the future.

Audit is not aware of any public debate on what an appropriate debt level for a State is — this is also perhaps not to be unexpected given the recency of change and the focus necessary to achieve that change. Nonetheless, the matter is perhaps worthy of consideration given the recent major changes in the debt burden.

Future Application of Proceeds from Asset Disposals

In view of the improved position now existing, it is considered appropriate to consider or review current strategies in relation to the use of future disposal proceeds and/or premiums should they arise to ensure the best advantage is gained from those assets.

In this regard, augmented funding of past superannuation liabilities is worthy of consideration against other priorities.

Debt Management

Following the significant change to the State's financial position the Department of Treasury and Finance is well down the track to implementing a revised debt management policy tending to a lower policy benchmark duration than in the immediate past.

While continuing to meet the Treasurer's policy requirements, the revisions to policy being considered provide the opportunity for lower ongoing interest and administrative costs in the future, notwithstanding the reduced level of net debt.

ASSET DISPOSALS

The Motor Accident Commission and the investment grade part of HomeStart Finance's portfolio are no longer part of the Government's asset sales agenda.

The Department of Treasury and Finance was responsible for oversight of the scoping reviews for these government-owned enterprises.

A number of bills that provide for the sale of the Lotteries Commission of South Australia, the South Australian Totalizator Agency Board and the South Australian Ports Corporation are currently before the Parliament.

The Department for Administrative and Information Services is responsible for the possible sale of these government-owned enterprises.

The sale of SAGRIC International Pty Limited (SAGRIC), Central Linen Service and a sale of assets and outsourcing in relation to State Print have been completed.

The Department for Administrative and Information Services is responsible for these sales. Sale proceeds received were:

- $3.6 million for the sale of SAGRIC shares and recovery of receivables, with further recoveries due;
- $11.3 million for Central Linen Service; and an insignificant amount for the sale of the assets of State Print as in essence, printing services were outsourced and not sold.

The operating profit after income tax of the South Australian Asset Management Corporation (SAAMC) for 1999-2000 was $30.2 million.

As in the previous year, no distribution was required by the Treasurer for 1999-2000. SAAMC has retained profits available for distribution at 30 June 2000 of $243.3 million.

PUBLIC SECTOR WIDE ISSUES: SPECIFIC AUDIT ISSUES AND MATTERS OF IMPORTANCE AND INTEREST

WHOLE-OF-GOVERNMENT FINANCIAL STATEMENTS

Existing Framework

During the year the Department of Treasury and Finance formally prepared and presented a complete set of Whole-of-Government Financial Statements for the period ending 30 June 1999.

The position and results were:

- **total assets $37.1 billion**
- **total liabilities $26.6 billion**
- **net assets $10.5 billion**
- **total revenues $11.0 billion**
- **total expenses $11.4 billion**
- **operating deficit $340 million**

Until such time as relevant legislative provisions are passed that will provide for the audit of these statements, I am unable to issue a formal Independent Audit Report containing an audit opinion.

Notwithstanding the absence of a mandate to issue a formal audit report in respect of Whole-of-Government Financial Statements, I considered it appropriate that such financial information should carry some form of independent commentary regarding its creditability and validity. Consequently, a management letter was forwarded the Department of Treasury and Finance with a view to providing an indication of the important financial reporting considerations that would need to be addressed in order to receive an unqualified Independent Audit Report including:

- the statements had excluded certain entities that Audit consider should have been included;
- limitations on the scope of the audit process as a consequence of unaudited health data being used in the consolidation process;
- uncertainty as to the carrying values ascribed to plantation forests;
- uncertainty in provisions brought to account for contract losses.

Financial Results of Past Years and an Analysis

Highlights for the 1998-99 year were:

- **An operating deficit for the period of $340 million; a turnaround of $629 million from the previous year's surplus. This was due principally to superannuation expenses of approximately $655 million in 1998-99.**
- **Net assets have fallen marginally and primarily as a result of the deficit from operations during the year.**

Within any financial year, the magnitude of changes made to the unfunded past superannuation service liabilities significantly contribute to the operating result for the period. Changes are mainly due to investment returns on superannuation assets and reassessments of assumptions in superannuation liability estimations.

I have observed that while the data may be unavoidably imperfect in detail, it is correct as to order of magnitude, and is meaningful, highly relevant, and useful in understanding the broad structure of the State's financial position and the overall relationship between the State's assets and liabilities.

PUBLIC GOVERNANCE: THE GOVERNMENT MANAGEMENT FRAMEWORK (GMF) AND BUDGETARY REFORM

Cessation of the GMF Project Board and Changed Responsibility Arrangements

The GMF Project Board was essentially vested with primary responsibility for progressing the aims of the GMF. A key outcome during 1999-2000 was the cessation of the GMF Board and upon its demise, de facto ownership passed onto the Senior Management Council and central agencies (Department of Premier and Cabinet (DPC) and Department of Treasury and Finance (DTF).

The GMF concepts encompassed the activities of Ministers and their agencies and had the potential for improved accountability of Executive Government to the Parliament and between Ministers and their agencies.

Success in achieving the GMF aims is dependent on the roles and approaches of all the participants in the public sector. In this regard, I consider that DPC, as well as DTF, in their current role as the primary administrators of public sector policy and financial management, have a most important role in leading and inspiring the adoption of various aspects of the reform agendas.

The individual success of DTF and DPC will in turn depend on their own actions, but also, and most importantly, the response of the other key participants. Audit's review highlighted a range of areas which need to be addressed to facilitate that success.

Leadership

At its introduction in late 1996, the GMF represented a major change in the financial management reforms in the South Australian public sector. As with any reform or change agenda of this magnitude, strong, clear and capable leadership was imperative.

I raised the issues of authority, leadership and accountability as discernable risks in 1998-99, yet it was not apparent how, with the cessation of the GMF Board, these risks will be mitigated so that the significant resources already committed to the GMF and Budget Reform would achieve their aims.

Change Management

Certain principles embodied within the GMF are also included within the Financial Management Framework. Specifically, central to both frameworks are the reinforcement of devolution and decentralisation approaches to management, administration and control.

Any reform agenda which seeks to devolve decision-making authority and empower agencies requires a sound framework of accountability, supported by development (training, etc), and communication. Cultural transformation is a bi-product of this process. Structured change management implementation plans are considered to enhance the prospect of success for such a reform agenda and to assist the achievement of its aims in the most effective and efficient manner.

Role of Central Agencies

Audit's review suggested that DTF remained a key participant in the ongoing reform process but, have yet to more clearly define their role.

The DTF spearheaded the Budget Reform project and effectively have carriage of its outcomes as manager of the State's finances. In positioning itself for life after Budget Reform, the DTF has undergone significant internal change.

DPC has a central leadership role for the whole-of-government and in government policy development. The nature of the GMF implies an important role for DPC.

While the audit review did not focus on DPC processes in this regard, the audit findings were forwarded to DPC to ascertain their current role.

The key aims, objectives and outcomes of the GMF all had views of achieving a fundamental shift in both attitude, behaviour and process. In order to achieve this, in such a large and diverse sector of operations, takes considerable time, but imperative to the process is strong and collaborative leadership from key stakeholders with the will and power to achieve such change.

A Reassessment of GMF: Cabinet Priorities and Experiences to Date

GMF/FMF Overlap

There appears to be a large degree of overlap in the principles promulgated by both the GMF and FMF frameworks.

In the absence of the GMF Board, or at present any other authoritative body to ensure the original principles and aims of the GMF Board continue to be pursued, Audit suggested that perhaps the GMF and FMF could be packaged as one integrated reform tool.

Deferral of Measurement of Outcomes

A decision to not pursue, for the 2000-01 Budget, the measurement of outcomes, in Audit's view created uncertainty as to the validity of the overall reformed budget process. That is, the effectiveness link between outputs and outcomes would not form part of the accountability chain.

Ministerial accountability to Parliament is a fundamental element to assessing the achievement of strategic priority outcomes. Measurement of outcomes, to the extent it could be practically and effectively achieved, could enhance the accountability of Executive Government to the Parliament and this matter needs to be monitored for progress in ensuing years. In the absence of effective, external performance measurement, the current model for budget formulation and measurement does not, in my opinion, provide the improvement in accountability that was envisaged in the original agenda objectives.

Agency Survey — A Snapshot

Given it has now been more than three years since budget reform was first initiated, it was considered reasonable to expect that the planning and monitoring elements of the overall process would have progressed to a substantial degree.

The current budget formulation and reporting processes are seen by the majority of sampled agencies as primarily fulfilling external processes and do not uniformly reflect internal business and strategic level planning processes deemed necessary for agencies to achieve their objectives. As such, the degree of synergy in the overall budgetary preparation and monitoring process to government objectives is diminished.

There is an obvious question as to the quality of the information being reported for Budget Paper presentation, its relevance to operational decision making and DTF's role in ensuring commitment and congruence to the process. The current situation perhaps reflects the fragmented approach by agencies to budget reform; that is, in terms of their ability to understand and achieve the right cultural transformation within their organisations at all levels of operation, management, reporting and decision making.

Given the three years elapsed, there is a need for greater ownership of the entire process, by all its participants, in order to achieve both internal and external alignment and perhaps a repackaging of the approach to align with experiences to date and changes in direction.

Pricing and Contestability

Audit has argued in the past that the concept of output-pricing lacks the required pragmatic robustness required to achieve the aims of contestability and benchmarking: two key aims of GMF (Budget Reform).

Two issues were referred to DPC and DTF, namely:

- How much value is there in pursuing price as a key stimuli to service enhancement?
- What processes will serve as the stimuli for achieving service enhancement in the absence of price?

Performance Oriented Management in the Public Sector

Performance management is a key determinant of the success of the GMF/Budget Reform aims. It answers such fundamental questions as: have we achieved what we set out to achieve within the defined parameters?

It was anticipated that significant work would be undertaken in further refining the Key Performance Indicators (KPIs) and making them a core management philosophy throughout agencies.

Development of KPIs for Government outcomes was not pursued for the preparation of the 2000-01 Budget. I am of the view that significant advancement in relation to the matters identified in last year's Report has not been achieved during 1999-2000 for the 2000-01 Budget. It also appears that the momentum to continue and progress such work in this area has slowed.

In addition to these matters:

- **there is no basis for frequent reporting in a monitoring sense to Cabinet on a current year's budget**
- **it is not apparent that formal reporting of actuals is a requirement for agencies.**

The consequence of these matters is that the aim for improvement in accountability may not be achieved to the degree that might have been anticipated for both internal and external (ie Parliament) purposes.

Accrual Budgeting

One aspect highlighted in the audit review of the budget monitoring processes was the ongoing dominant focus on the cash bottom line and that the accrual concepts remain in transition/implementation status.

Both cash and accrual measures are important in managing the State's finances. It is considered that little advancement has been made on the original accrual appropriation model implemented in the 1998-99 Budget process. The related issues surrounding balance sheet reforms (ie cash management, asset management and planning et cetera) have not been progressed as might have been expected.

Capital Budgeting

A major element of Phase 2 of the Budget Reform process was, amongst other things, to '… integrate the Government's planning processes with its budgeting processes for the 1999-2000 Budget for both operating and capital investment activities …'.

The Corke Report (in December 1998) discussed a number of issues and presented a number of recommendations regarding the capital works program for the whole-of-government. Subsequently, Cabinet approved several key recommendations from that Report: the relevance to DTF was their allocated responsibility to monitor and report on the Capital Budgets.

Despite the fundamental importance of improving this area of the budget process, there has not been sufficient momentum to significantly change the situation that existed prior to the Corke Report.

THE FINANCIAL MANAGEMENT FRAMEWORK: MANAGEMENT AND ACCOUNTABILITY OF RESOURCES AND RISKS: AUDIT COMMENT ON PROGRESS STATUS

The Financial Management Framework (FMF) which became operative in July 1998 provides agencies with broad guidance on critical processes and controls to be put in place to enable the exercise of good financial management and accountability practice. It focuses on cost effective controls of risks pertaining to the particular agency and aims to improve the control environment of the agency and the Government overall.

The FMF describes five basic components:

- control;
- transaction processing;
- asset and liability management;
- reporting;
- planning and analysis.

In establishing a control framework, four further elements are described namely:

- control environment;
- risk management;
- internal controls;
- monitoring and reporting.

The FMF and External Audit

As the FMF sets out prescribed guidance for agencies on the essential processes and controls required for good financial management and accountability, it is fundamental to this Department's audit mandate and auditing activities.

Audit's assessment of an applicable agency's internal control structure must now consider whether the controls in operation are consistent with the prescribed principles of the FMF. The opinion issued for relevant agencies in Part B of this Report now states this requirement.

Status of Implementation of the FMF in Agencies

Audit considered agency progress with respect to the implementation of the FMF.

In an overall context, Audit has observed that developmental work that was commenced and proceeding within agencies in 1998-99 was progressed during 1999-2000. The level of progress, however, has not been substantive in most instances. Only a few agencies have addressed to a satisfactory level most of the integral components of the FMF. Most agencies have not completed implementation of a structured approach to risk management practice. This is evident by the absence of agency endorsed risk management policies and plans.

The commitment of agencies to the preparation for readiness for the Year 2000 matter and the new Goods and Services Tax have been factors that have restricted the rate of progress of implementation of the requirements of the FMF. The restrictive factors are now past and agencies should now direct some attention and available resources to the implementation of outstanding aspects of the integral components of the FMF. The development of an implementation plan (where absent) with targeted time outcomes would demonstrate complete commitment to implementation.

CAPITAL WORKS: MONITORING AND CONTROL

The Capital Works Program

Capital Works expenditures involve a considerable outlay of taxpayers' money and therefore require adequate monitoring and control at both central and individual agency levels of government.

The 2000-01 Budget Statement (Budget Paper 2) indicates an estimated result for 1999-2000 capital outlays for the non-commercial sector at $537 million.

Audit reviews in 1999-2000 have identified deficiencies with respect to this significant area of government operations.

At the central level of government (Department of Treasury and Finance) there is a need for implementation of improvements in information and monitoring processes associated with the overall Government's Capital Works Program.

At the Human Services Portfolio/Agency level there was a breach of a fundamental control practice within government, that of only making payment for goods and services received. The portfolio processed advanced payments in the order of $20 million which had the potential to misrepresent the outcomes achieved by the portfolio in implementing its capital program.

The Public Works Committee

By virtue of the *Parliamentary Committees Act 1991*, the role of the Public Works Committee is elevated beyond that of mere deliberation and review to the exercise of powers of inquiry and recommendation as an integral component of the carrying out of public works by the South Australian Government.

Any ambiguity in the legislation which provides loopholes for a project (public work) to escape the scrutiny of the Public Works Committee should be removed.

The Football Park Grandstand Project of the South Australian National Football League, to which the Government is providing financial assistance of $12.15 million in total over 15 years, was not referred to the Public Works Committee for review. It is strongly arguable that it is a public work pursuant to the *Parliamentary Committees Act 1991* and should have been referred to the Public Works Committee for examination.

Last year's Report referred to two other projects that were not referred to the Public Works Committee because of interpretation issues associated with the definition of 'public work'.

As suggested in last year's Report, given the public importance of the role of the Public Works Committee and the integral role it discharges in providing a control mechanism for the expenditure of public money, it is recommended that Parliament give consideration to removing what has been identified as an ambiguity with respect to the definition of a 'public work' in the *Parliamentary Committees Act 1991*.

PROCUREMENT REFORM: LEGAL AND POLICY FOUNDATIONS: SOME AUDIT OBSERVATIONS AND COMMENTS

The Government's Procurement Reform which commenced in 1998-99 represents a significant reform program of government. Its implementation is expected to achieve millions of dollars of savings annually.

The reform change involved changed roles and responsibilities of the State Supply Board and public sector agencies. A government endorsed policy framework underpins much of the reform change. No change was made to the State Supply Act.

The reform change has resulted in an extended role for the State Supply Board from principally 'goods' procurement to both 'goods' and 'services' procurement.

During the year Audit commenced a review of certain aspects of the Procurement Reform Strategy. Audit has finalised that component of the review relating to the legal and policy framework on which the Procurement Reform Strategy implementation is based.

Certain issues have been identified and referred to the State Supply Board in August 2000 for clarification to ensure the soundness of the overall implementation framework. Audit is of the view that certain steps taken regarding the implementation of the reform change may not be sufficient to confer upon the State Supply Board functions in relation to the procurement of services as distinct from goods. These issues are currently under immediate review by the State Supply Board.

Audit is now proceeding to review other operational and accountability matters associated with the Procurement Reform Strategy.

PUBLIC GOVERNANCE: EMPLOYMENT CONTRACTS FOR CHIEF EXECUTIVES: SOME FURTHER AUDIT COMMENTS

Performance was the fundamental principle driving the reforms that introduced employment contracts for Chief Executives.

The continuing absence of contractual provisions relating to performance in Chief Executives contracts is a matter of concern.

The lack of any benchmark of expected performance together with the absence of any other public record of performance expectations runs contrary to the purpose of the legislation which introduced performance contracts in 1995.

It is disappointing to note that the protocol documents between Ministers and delegate Ministers have not been included or referred to in the contracts governing the terms of appointment of Chief Executives so that the lines of accountability and responsibility are clear and form part of the basis of the engagement of the Chief Executives.

In last year's Report, Audit recommended that the conditions of appointment of Chief Executives of administrative units for which a Cabinet and delegate Minister are responsible should reflect the terms of the Ministerial protocol documents.

No action has been taken by the Government during 1999-2000 to address this matter.

CONSULTANTS AND CONTRACTORS: MANAGEMENT AND CONTROL ARRANGEMENTS: AUDIT COMMENTS

Audit again stresses the need for public authorities to ensure that sound public administrative processes are adhered to at all times in the engagement and management of consultants and contractors.

Previous Reports have highlighted areas of concern with respect to the engagement and management of consultants and contractors by a number of public authorities.

During 1999-2000, Audit again noted some areas of concern with respect to the engagement and management of consultants by a public authority.

INFORMATION TECHNOLOGY POLICY AND MANAGEMENT ARRANGEMENTS

Increased Government and Audit Risk — Need for Policy and Guidance

Emerging technologies may increase the risk profile of government through uncertainties inherent within legal, control and management practices associated with these technologies.

The risk inherent within emerging technological environments demands attention be directed at ensuring there are adequate strategic planning, policy guidance and legislative arrangements in place to facilitate the implementation and control of major IT initiatives of government and its agencies.

Need for Finalisation of IT Strategic Plan for Public Sector

The Department for Administrative and Information Services (DAIS) is in the process of developing an Information and Communications Services (ICS) Strategic Plan, to be known as ICS Directions, for application across government portfolios.

The need for finalisation and communication of an Information and Communication Services (ICS) Strategic Plan for the public sector has been the subject of comment in previous Report's. Development of a plan which communicates the Government direction and expectations for Information Technology management and use and reflects significant initiatives and projects of government agencies is well overdue.

Need for Improved Contract Access and Audit Arrangements

Contracts with the private sector need to incorporate provision of right of access and review for the agency, and accommodate the right of access and audit under the *Public Finance and Audit Act 1987* for the Auditor-General.

It is essential that private sector service providers considering projects involving the storage, processing and security of government information and systems, be advised at an early stage of both government agency and Auditor-General rights in regard to access and audit. This matter requires due contractual and legal consideration by the Government and its agencies to ensure the adequacy of safeguards over the security, integrity and control of government information and processes, and to accommodate the Auditor-General's statutory audit responsibilities.

INFORMATION SYSTEMS CONTROL: AGENCY RESPONSIBILITIES AND AUDIT REVIEW DIRECTION

Agency Control Responsibility

The changed Information Technology environment within which government agencies operate requires effective management and control.

Agency systems need to operate within a sound Computer Processing Environment to ensure safeguards are in place over agency information and systems. As required by the Financial Management Framework, it is obligatory for Chief Executives to ensure that effective internal controls are in place and operating within their agency.

Audit Review Methodology and Direction

Audit, in responding to the changed environment, is implementing a more advanced audit methodology which requires it to more fully evaluate and document the risk/control attributes associated with Information Systems and the Computer Processing Environment in forming opinions on agency internal controls and financial statements.

Audit will concentrate over the next two years on the extended review and documentation of agency key Information Systems and related Computer Processing Environments and on agency compliance with standards set by the Financial Management Framework.

THE STATE'S FINANCES

AND RELATED MATTERS

AN OVERVIEW OF PUBLIC SECTOR FINANCIAL REPORTING ARRANGEMENTS

INTRODUCTION

Public sector financial reporting arrangements provide the basis for accountability statements on the financial operations of the Executive Government to the Parliament and the public.

There is now presented in various sources — including the annual Budget and Budget Outcome Papers, annual reports of government agencies, and my Report — a range of public sector financial information both at a detailed and a summary level. The various sources all represent elements contributing to accountability. Concurrently, the different scope (sectors) and bases (cash and accrual, accounting and economic) used in reporting can counter, to a degree, the effectiveness of reporting because users need to be familiar with the different sets of information to keep them in context. While reporting formats have been essentially steady in the past two years, there remain a number of factors that can make them difficult to interpret and assimilate.

In 1999-2000 a significant change in public sector reporting took place with the adoption of accrual based economic reporting by the Australian Bureau of Statistics (ABS). This has implications for financial reporting in this State that will need to be addressed in the forthcoming year or at most two years.

In the last two years consolidated, whole-of-government financial reporting has been introduced and the Government has also introduced accrual based budgeting in the 1998-99 Budget following completion of the first stage of a budget reform program. Further significant changes were made in the 1999-2000 Budget papers with new detail on outputs, including non-financial information. These initiatives have added to, rather than replaced, previous reporting requirements.

In view of the varying purpose, nature, basis and content of existing material, it is relevant to commence this Part of the Report with a brief explanation of this information. The information that follows to a large degree repeats that provided in past years but it is updated for recent changes. It is intended to assist users of public sector financial information in the context of the application of such information.

KEY AREAS OF PUBLIC SECTOR FINANCIAL REPORTING

There are currently four key areas of financial reporting in the public sector, namely:

- budget aggregates;
- public authorities (includes government departments);

- the Treasurer's Financial Statements;
- whole-of-government statements.

Each of these areas is summarised in the following commentary.

BUDGET AGGREGATES

The Budget aggregates are currently a significant accountability statement on the financial activities of the public sector with aggregate data on revenues, outlays and certain assets and liabilities. They are significant in that they are the representations of the Government in the Budget session of Parliament. They are therefore the basis of Parliament's vote on the annual appropriation of money to the Government. Importantly, as the Budget session takes place in June of each year, no information on the actual results of the year prior to the Budget year is available, eg that is later available in for example, the Auditor-General's Report, the annual Budget Outcome document and the annual reports of agencies. Parliament's decisions are based on the data available in the Budget Papers, which is primarily the estimated result for the prior year and the budget for the next year.

A summary of the cash and accrual Budget aggregates is provided in the next section of this Report titled 'An Overview of the State's Finances'. A detailed commentary on the cash-based Budget aggregates is set out in the section in this Part of the Report titled 'A Commentary on the State's Budget over the Period 1997-98 to 2003-04'.

There are two principal presentations in relation to the Budget aggregates. These are the:

- Government's Non-Commercial Sector Budget Presentation;
- Uniform Statistical Presentation.

Government Non-Commercial Sector Budget Presentation

The Budget continues to focus on the non-commercial sector, ie the sector that is ultimately supported by taxes and Commonwealth general purpose funds. This focus is consistent with the Government's four-year plan announced in the 1998-99 Budget. The Budget remains a critical reporting format as the budget strategy sets the annual basis and targets for the delivery of goods and services to the public, ie that services are delivered within a balanced budget with expenditures limited to the available revenue.

There is no legislative basis for this form of reporting. The Government, at its discretion, has adopted it as it is directly relevant to its budgetary strategy and allows specific accountability for budget targets.

There are two separate areas of focus for the non-commercial sector, namely the:

- cash-based Government Finance Statistics presentation;
- accrual output presentation.

The Cash-based Government Finance Statistics Presentation

This is the primary budget planning presentation and is essentially cash based using modified[5] ABS definitions for government financial statistics (GFS) reporting. The Government's key financial objectives under this presentation are the maintenance of balanced budgets in the non-commercial sector, debt reduction and the long-term elimination of unfunded superannuation liabilities. The key Budget indicator is the cash-based deficit/surplus.

Agencies have been classified as non-commercial, commercial or financial institutions. Consolidated data is prepared from agencies' financial information but is not subject to audit.

The Government presents data at a summary level[6] with some supporting detail in the Budget Statement of the annual Budget Papers.

The outcome for the year is presented in an annual Budget Outcome document.

The Accrual-Output Presentation

This presentation was first adopted in the 1998-99 Budget as part of the budget reform process and is a supplementary presentation in the course of development. It is supplementary, in that the Government's key financial objectives are determined under the GFS presentation. Since the 1998-99 Budget it is, however, the basis of information directly supporting the annual parliamentary appropriation.

Information is presented at two levels being the non-commercial sector level and portfolio/agency level.

At the non-commercial sector level, projections are made for financial operations (ie revenue, expenses) and for the statement of financial position (ie assets and liabilities and net assets) for the four years to 2003-04.[7] It is notable that the targets set for the assets and liabilities do not take into account, at this early stage, changes in market values. While the non-commercial sector level information is a feature in the Budget Papers, to date no reporting of actual results is in place.

---

5 Modifications to the GFS cash-based reporting are the inclusion of net advances and the exclusion of asset sales and abnormal items from the underlying deficit/surplus.

6 For example 'Budget Statement 2000-01 Budget Paper 2', Table 2.2.

7 Budget Statement 2000-01 Budget Paper 2, Tables 3.4 to 3.6.

At the portfolio/agency level, very detailed information is presented in supporting budget papers on a portfolio basis.[8] Actual financial results for the major agencies are reported in Part B of this Report.

One of the aims of the Budget information is to improve accountability of public sector operations. Non-financial information is given increasing focus to facilitate users' understanding of the targets and achievements for the finances committed and consumed. While it offers potential benefits, there will be refinement of this information over time and users will have to become comfortable with the nature, integrity and relevance of such information. Further, to date no actual results reporting is in place across Government for non-financial data.

The section of this Part of the Report titled 'Public Governance: Government Management Framework and Budgetary Reform' provides further commentary on the budget reform process.

A Change in Public Sector Financial Reporting — Accrual Based GFS

It is notable that from April 2000 the ABS introduced accrual-based GFS reporting. This reporting framework allows all jurisdictions to report on an economic, rather than an accounting, accrual basis. The Budget Papers[9] indicate that the Commonwealth and some States have adopted this basis for their key budget indicator. In this State the Government has continued with the cash-based result as its focus in the third of its four-year budget strategy. The Government has indicated that future fiscal plans will consider the appropriate fiscal target to adopt.[10]

The change to accrual based reporting is of significance when compared to this State's key budget targets in two respects. In this State the budget focus is on:

- a cash based outcome;
- the non-commercial sector.

With the accrual based GFS approach, cash based data is not the prime focus, it is, however, a fundamental element of the presented information.

In terms of scope, the ABS categorises the public sector into the general government, public non-financial corporations and public financial corporations sectors rather than the

---

8 Estimates Statement 2000-01 Budget Paper 3, and Portfolio Statements 2000-01 Budget Paper 4, Volume 1 and 2 contain the detailed information supporting the *Appropriation Act 2000* and the Schedule to that Act.

9 Budget Statement 2000-01 Budget Paper 2, p. 3.6.

10 op cit.

non-commercial sector. Differences between these sectors and the non-commercial sector are set out in the Budget Papers.[11]

In addition to the preceding, the ABS accrual basis, because it is designed for economic measurement, differs in many respects to the Australian Accounting Standard (AAS) approach to accrual accounting which is the basis for the detailed portfolio/agency data. For example the approach does not include revaluations from change in market prices.

The issue that arises is whether the State should change its budget reporting targets. Notwithstanding the adoption of accrual based financial reporting throughout governments, it is notable that few of the jurisdictions have adopted similar key targets.

For example a brief review of the 2000-01 Budgets for New South Wales, Western Australia and Victoria indicate a mixture of GFS and AAS based accrual reporting has been adopted with New South Wales having both GFS and AAS key data, Victoria having AAS based key data and Western Australia GFS based key data.

The lack of uniformity is consistent with differing budget policies between jurisdictions but also reflect opinions on what the various indicators show. In this regard it was of interest to note that a GFS indicator regarded by New South Wales as the key result for the State's financial position was considered by Western Australia to be difficult to interpret from a state financial perspective.

What is clear is that jurisdictions and the ABS do not have cash based key budgetary targets. While this State will report the accrual based GFS information in accordance with uniform reporting arrangements described hereafter, unless specific targets are established, the uniform reporting simply puts the State's financial outcomes into a particular format rather than having the outcome as a focus for achievement.

In my opinion, the matter of appropriate fiscal targets for the State, needs to be resolved in the near future so that appropriate planning for the implementation of the necessary support mechanisms for revised targets can occur.

Uniform Statistical Presentation

Again, there is no legislative basis for this form of reporting. All States and the Commonwealth agreed to use this basis to facilitate comparison of activity and preparation of overall government financial statistics. In 1999-2000 all jurisdictions agreed to prepare this information on the accrual GFS basis. Data for this State is presented as an appendix to the Budget Papers and is not subject to audit.

---

[11] Budget Statement 2000-01, Budget Paper 2, Appendix C. Examples of agencies that would be included in the public non-financial corporations rather than the non-commercial sector are Adelaide Convention Centre, Lotteries Commission of South Australia and the South Australian Housing Trust.

PUBLIC AUTHORITIES

The financial reports of public authorities are accountability statements of their financial operations. The reports are prepared on the accrual basis of accounting and comprise an operating statement, statement of financial position and statement of cash flows. Where agencies exercise control over the financial affairs of other entities, consolidated financial statements of the group of entities are prepared. An example is the South Australian Government Financing Authority.

Public authorities are required, pursuant to the *Public Finance and Audit Act 1987*, to provide their financial statements to the Auditor-General following the end of a financial year for audit. The audited financial statements for authorities that meet the reporting criteria of the Auditor-General (refer to Part B Volume I for details) are set out in Part B of this Report. Also presented is commentary on the scope and findings of the audit of the authority and, where relevant, interpretation and analysis of the financial data. In addition, each public sector agency is required to prepare annual reports, including their audited financial statements, for delivery to Parliament.

TREASURER'S STATEMENTS

The purpose of the Treasurer's Statements is to provide an accountability statement of the financial operations of the Public Accounts. These comprise the Consolidated Account (which records the annual appropriation of public monies voted by Parliament and derived principally through State taxation and general purpose Commonwealth grants), Special Deposit Accounts and Deposit Accounts. The key aspect of the Treasurer's Statements is Statement A, which records compliance with the annual Parliamentary appropriations.

While these accounts record the activity of a significant proportion of public finances from year to year, as I have stated in past years, they do not represent all of the public sector financial operations and position. Consequently, it is necessary to review additional information for an overall understanding of the public finances.

The Treasurer's Statements are required, pursuant to the *Public Finance and Audit Act 1987*, to be prepared at the end of the financial year and be provided to the Auditor-General for audit. The audited Treasurer's Statements for 1999-2000 are set out in the Appendix to Part B Volume III of this Report. Some comments are also included in the section of this Part of the Report titled 'The Treasurer's Financial Statements for the year ending 30 June 2000'.

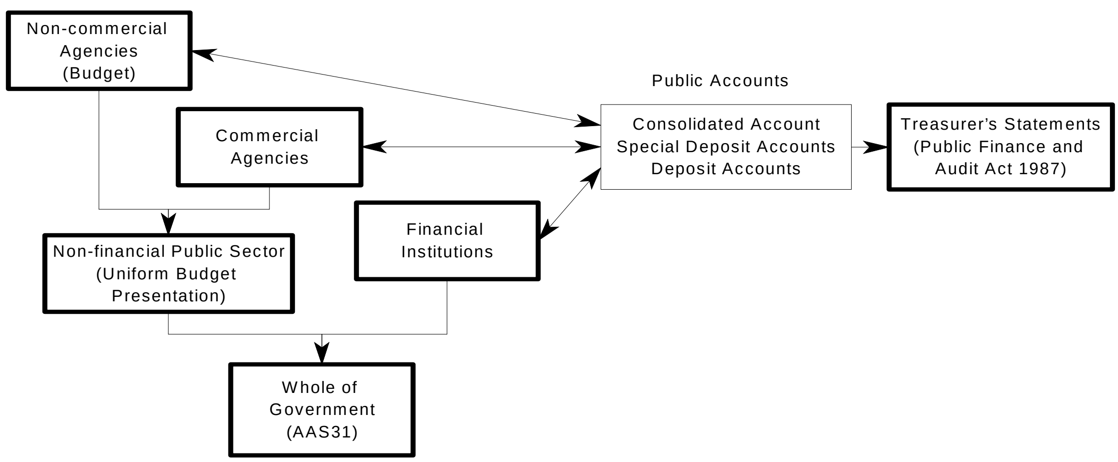
WHOLE-OF-GOVERNMENT FINANCIAL STATEMENTS

The purpose of the whole-of-government financial statements is to provide a complete summary of the public finances encompassing all entities defined as controlled by the Government. Notwithstanding the focus on the non-commercial sector, the Government influences the outcomes and financial position of commercial and financial entities through governance arrangements and performance requirements, eg debt/equity ratios and profit distributions. The effect of inter-sector transactions is eliminated in whole-of government financial statements.

The whole-of government financial statements are prepared in accordance with Australian Accounting Standard AAS 31 'Financial Reporting by Governments' on the accrual basis of accounting. As accrual accounting is successfully and completely implemented across government agencies, data integrity has improved. Brief commentary is provided in the section of this Part of the Report titled 'Whole-of-Government Financial Statements'.

PUBLIC SECTOR REPORTING INTER-RELATIONSHIPS

The following diagram summarises the principal categories of the public sector and their inter-relationships. Specific reporting areas are highlighted by bold borders.



CONCLUSION

Users of Public Sector Financial Information

My past observations that a user of public sector financial information must have regard to all the available information is, I believe, emphasised by the preceding summary of current public sector financial reporting methods.

Each form of financial reporting has a particular purpose. Nonetheless, if a user is assessing a particular part of the public sector, for example the non-commercial sector, it is essential that the overall view as presented in the total public sector and the whole-of-government statements, be also considered. This will ensure that the financial effects of all financial transactions within the public sector and with external parties can be understood.

In regard to non-commercial sector level accrual based information, while this features in the Budget Papers, there is to date, no actual results reporting of this information.

Non-Financial Information

The most recent development is the commencement of detailed non-financial output information as part of the budget information. This information aims to assist users about what has been achieved for the financial transactions reported. While it offers such potential benefits, users will first have to become comfortable with the nature, integrity and relevance of such information. To date no actual results reporting is in place across government for non-financial data.

Adoption of Accrual Based GFS

With the adoption of GFS accrual based reporting by the ABS and by jurisdictions for uniform reporting purposes, accrual based information is now established as the predominant form of reporting on public sector financial information. This State is in the third of a four-year financial plan with a cash based key budget target. The Government has indicated that future fiscal plans will consider the appropriate fiscal target to adopt. In my opinion, it would be timely for the matter of appropriate fiscal targets for the State to be addressed in the near future. This would assist to enable appropriate planning for the implementation of the necessary support mechanisms for such targets and for targets to be built into management practices as appropriate.

AN OVERVIEW OF THE STATE'S FINANCES

INTRODUCTION

The 1999-2000 year saw two significant events that have changed the structure of the State's finances from the past. They are the implementation of national tax reform and the part completion of the disposal of the State's electricity assets. Tax reform offers the prospect of long-term improvement in the revenue base. The magnitude of the change is evident by the fact that Commonwealth general purpose funding increases in 2000-01 by over $800 million[12] with offsetting reductions in State taxes. Asset disposals have brought immediate reductions in net debt, estimated at $3.5 billion or 45 percent and in interest rate risks and other risks, together with a net improvement in the non-commercial sector underlying outcome.[13] These are regarded as improving the financial position. Notwithstanding, the Budget data indicate in a number of ways that there remain issues to be resolved in the long term. How this occurs will need careful consideration for the best long-term outcome.

In past years I have reported on the Government's progress against its financial strategies commencing with the Financial Statement issued in May 1994, which, inter alia, laid down broad financial plans for the period 1994-95 through to 1997-98.

Last year, the Audit commentary summarised the various changes to strategies since May 1994 and discussed progress with the four-year strategy commencing with the 1998-99 Budget, the first to implement accrual output budgeting. Notwithstanding the accrual perspective, the key budget targets remained cash based. As a result of various changes in the budget presentation, comparative analysis was limited to the period commencing 1997-98.

This section of the Report looks forward, continuing to give an overview of the current four-year budget strategy, including both the cash and accrual-output based budgeting presentation. The overview contains some audit observations based on the more detailed work set out in the following sections dealing with specific aspects of the State's finances. I refer readers desiring additional details to those sections.

LONG TERM COMPARABILITY OF DATA

Accrual accounting has only been utilised by agencies since 1996-97 and the 1998-99 Budget was the first presentation of the Budget on an accrual basis.

---

[12] Budget Statement 2000-01, Budget Paper 2, Table 5.11.

[13] That is reductions in interest payments arising from the disposals are estimated to exceed revenues foregone.

Non-Comparability Between 1997-98 Revised Data and Beyond and Prior Years

One of the effects of the introduction of accrual accounting and budgeting is that agencies have amended the classification of certain items of outlays and revenues from that used in years prior to 1997-98. This reclassification has had a significant effect on the data presented for 1997-98 and on. Comparative data prior to 1997-98 is not available.

As a result of these changes, Audit analysis in this Report now compares only the 1997-98 year to forward years presented in the 2000-01 Budget.

While there will inevitably be changes that will affect the presentation of data from year to year I believe it is important to be able consider comparable data in the long term.

The availability of time series data in the future is affected by two key events relevant to the 2000-01 Budget, the implementation of national tax reform and the adoption of accrual based reporting by the Australian Bureau of Statistics (ABS). While tax reform is fundamental to the composition of revenue in the Budget, the ABS changes are presentational.

As I commented last year, I believe it would be appropriate for the Department of Treasury and Finance to keep a time series commencing 1997-98 on a comparable basis to the extent that is practicable.

THE UNDERLYING BALANCED BUDGET

The annual budget outcome is a cash based calculation of the sum of all financing transactions, (except provisions)[14] being the difference between recurrent and capital outlays and revenues and grants.

The underlying result excludes major 'one off' items ie of a non-recurring nature and other adjustments that for example by their size and nature, are abnormal. In 1999-2000 the estimated abnormal items are payments of $69 million for targeted voluntary separation packages and costs of $70 million associated with the Government's asset disposals program offset by stamp duty revenue of $110 million from the disposal of electricity assets.

This method of presentation has, and Audit considers properly so, also excluded the net proceeds of the sale of government businesses.

---

[14] This item represents increases in provisions of public trading enterprises included in the non-commercial sector. The provisions relate mainly to depreciation but include provisions for superannuation, long service and recreation leave.

The level of increases in provisions is treated as a financing transaction as the corresponding cost, which is a non-cash cost, of the items concerned is included in current/capital government expenditure.

THE 1999-2000 STATE BUDGET

I commented in my last Report that the State's Budget for 1999-2000, showed that additional flexibility through taxation legislation, discretionary use of dividends, and returns from financial institutions and deferral of discretionary outlays such as past superannuation liability funding had been required to achieve the underlying balanced budget targets.

The 1999-2000 Budget Papers set out key actions taken by the Government for the 1999-2000 Budget and forward estimates. The following extract sets out the key actions in 1999-2000 Budget Papers.

> *Managing these challenges within the context of an ongoing balanced budget objective, requires the Government to amend some of the current policy settings. These include:*
>
> - *increasing fees and charges by an average of 2.6 percent reflecting growth in the cost of providing services to the community*
> - *introducing the $100 million power bill increase following lack of Parliamentary support for the sale/lease of the electricity utilities*
> - *lifting the marginal rates of stamp duty on high value property transfers from 4 percent to 4.5 percent on that part of property between $500 000 and $1 million and from 4.5 percent to 5 percent on that part of property in excess of $1 million*
> - *continuing to rely on the return of dividends from the financial institution sector, for example surplus funds from the SAAMC, to offset lower Financial Assistance Grants and infrastructure projects deferred from the previous year*
> - *extending the period over which past service superannuation liabilities will be eliminated from 30 to 40 years or by 2034.*
>
> *The Government's commitment to a balanced budget is thus maintained on a basis which is sustainable into the future with sufficient budgetary flexibility to meet emerging cost pressures and finance new initiatives.*
>
> *As foreshadowed in the 1998-99 Budget, the new emergency service levy arrangements will come into operation from 1 July 1999*.[15]

---

[15] Budget Statement 1999-2000, Budget Paper 2, p. 1.3.

Importantly the Budget was framed excluding the impact of asset disposals. Subsequent to the Budget, Parliament passed legislation enabling the disposal of the State's electricity assets. This meant that the $100 million power bill increase would not occur. In the Government's view the disposals would produce a net ongoing benefit to the State's budget (referred to as a 'premium'). As reported in the 1997-98 Report,[16] an allowance for such a benefit had been built into the State's forward estimates in the 1998-99 Budget. The power bill increase was designed to cover this in built premium in the absence of disposals.

1999-2000 Actual Underlying Deficit

The Department of Treasury and Finance have determined that the forecast 1999-2000 Budget final outcome for the underlying deficit is of the order of $17 million, a slight improvement from the estimated deficit of $39 million which was revised at the time of the 2000-01 Budget[17] (the estimate at the time of the 1999-2000 Budget was a surplus of $1 million). The estimated deficit was determined at $39 million after a variety of adjustments the main one being deferring $186 million of a dividend from the South Australian Asset Management Corporation (SAAMC) of $200.6 million to the following and later years. In the calculation of the final result that entire contribution was deferred as it was in the previous year.

Achievement of the final outcome followed determination of various year-end adjustments. At the time of finalisation of the year's result, the Department of Treasury and Finance estimated that, based on agency data, there was an improvement against the revised estimate of a deficit of $39 million of $198 million.

To effect the final result, payments totalling $100 million were made to the South Australian Superannuation Fund Account, a special deposit account administered by the South Australian Superannuation Board, towards funding past service superannuation liabilities. The payments comprised primarily $94 million toward the unfunded superannuation liabilities of the Department of Administrative and Information Services (DAIS). Details of the payment are included in Part B of this Report in the section for DAIS.

Payments to the superannuation schemes represent outlays by the non-commercial sector to the financial institutions sector and are therefore reflected in the deficit.

I have made the observation in past years that the Government's ability to determine superannuation payments at the finalisation of the budget outcome, is a useful facility to be used at its discretion in the achievement of published estimated outcomes. As the budget outcome is determined on a cash basis, the use of these payments effectively brings forward payments budgeted for the next year. This offsets payments delayed due to slippage and smooths the result from year to year. To the extent that payments brought forward equal

---

16 Report of the Auditor-General for the year ended 30 June 1998, p. A.2-55.

17 Presented on 25 May 2000.

slippage, cash flows from year to year are matched. The slippage in capital payments has remained a consistent issue for a number of years.

This annual adjustment highlights the significance of timing issues to the cash based outcome.

Accrual Basis

The 1999-2000 Budget[18] set out accrual estimates for the non-commercial sector.

The following table compares the original 1999-2000 Budget to the 2000-01 Budget estimated result:

	1999-2000 Budget $'million	1999-2000 Estimated Result $'million
Consolidated statement of financial position		
Net assets	4 108	5 587
Consolidated opening statement		
Operating surplus (deficit) before 'abnormals'	70	(332)
Consolidated statement of cash flows		
Cash balance at 30 June	1 541	2 517

The differences between the 1999-2000 Budget and estimated result are explained in the Budget Papers. Revenues were expected to be lower due largely to the deferral of SAAMC dividends, lower distributions from the electricity sector as a result of the power levy not proceeding and additional relief for the Emergency Services Levy offset by higher interest revenue, Commonwealth grants and taxation revenue. Expenditure was expected to exceed budget due largely to the carry over of expenditure from 1998-99 into 1999-2000 and some reclassification of expenditure from investing to operating.[19]

The preceding table does not show the operating result after abnormal items which was estimated to be a surplus of $2 314 million. This result includes an abnormal profit of $2 646 million in relation to the disposal of electricity assets. This profit is the net gain to the non-commercial sector from the electricity asset disposals in 1999-2000. It is much higher than the net gain to the whole-of-government financial statements because the non-commercial sector's only electricity asset was the capital in the electricity entities, that is the non-commercial sector is regarded as the owner of commercial sector agencies.[20] On a whole-of-government basis, the gain is determined as the difference between the disposal proceeds and the net asset values including plant and equipment.

---

18 Budget Statement 1999-00, Budget Paper No. 2, Table 1.2 p. 1.3, Table 3.1 p. 3.2 and Tables 3.6 to 3.8 pp. 3.7 to 3.9.

19 Budget Statement 2000-01, Budget Paper 2, p. 3.1.

20 The net gain reflects the difference between the proceeds from disposal including the value of unfunded superannuation liabilities transferred to the private sector and costs of disposal including debt assumed from electricity entities.

The disposal of electricity assets in 1999-2000 resulted in a major reduction in net debt and reduction in exposure to a variety of financial market risks eg interest rates and operational risks eg the national electricity market. The 1999-2000 disposals are estimated to result in a $115 million premium in 2000-01 being the difference between interest savings and electricity business revenues forgone. Debt management activity in the course of 1999-2000 in the light of the electricity asset disposals, has also resulted in the early maturity of high yield borrowings and derivatives resulting in book losses of $186.9 million in 1999-2000 but allowing reductions in the non-commercial sector interest payments in the future due to lower ongoing interest rates on remaining debt.

Details of these matters are set out in the section in this Part of the Report titled 'Electricity Asset Disposals and the State's Finances'.

It is noted that although accrual information is presented for the non-commercial sector, actual data is not reported as part of the Budget Outcome document to date. Neither is performance against the accrual based, 'target operating surplus' discussed in this section.

2000-01 BUDGET

The following summarises the main points from the Audit review of the 2000-01 Budget. Detailed commentary is provided in the section of this Part of the Report titled 'A Commentary on the State's Budget over the Period 1997-98 to 2003-04'.

Cash Basis

The Budget Statement issued on 25 May 2000 as part of the State Budget for 2000-01, incorporated an underlying surplus for that year of $2 million, the same as was projected as a forward estimate in the 1999-2000 Budget.

An important aspect of the 2000-01 Budget is the implementation of national tax reform which has the effect of substantially increasing funding from the Commonwealth replacing offsetting reductions in State taxes. The Budget Papers note that tax reform is expected to be beneficial to the State from 2006-07.[21]

The 2000-01 Budget also takes account of the effect of electricity asset disposals completed in 1999-2000. As mentioned, it incorporates a premium from those asset disposals of $115 million meeting the premium of $100 million built into the 1998-99 Budget in anticipation of such disposals. The Budget does not take account of possible premiums that might arise in relation to electricity asset disposals to be completed during 2000-01.

---

21 Budget Statement 2000-01, Budget Paper 2, p. 1.1.

Projected outlays adjusted for abnormal items are estimated to increase over 1999-2000 in real terms, particularly when also adjusted for net interest payments, which are decreasing substantially following electricity asset disposals. In this regard the Budget Papers detail new operating initiatives that exceed past service superannuation payment deferrals and agency outlay savings.[22]

The Budget includes revenues from SAAMC of $109 million and the South Australian Government Financing Authority of $50 million. This is the largest total contribution from these two entities over the period of the forward estimates. The contributions from these entities are projected to be lumpy, varying from year to year. While this is so, the past two Budgets have incorporated distributions from these two entities that have almost wholly been deferred.

The 2000-01 Budget also benefits from the deferral of $86 million of past superannuation payments due to a profit on sale of the Adelaide Casino. This deferral frees up funding for other purposes. In contrast, $67 million of unfunded superannuation liabilities transferred to the non-commercial sector on disposal of electricity businesses will be funded as part of the ongoing funding program over a number of years. Notwithstanding these projections, historically, actual cash payments for funding past superannuation liabilities have exceeded budget due to the timing issues previously discussed.

Forecast Results

Of crucial importance is whether the means by which forecast outcomes are achieved can be sustained in the long term and not be the result of continuous balancing from one-off adjustments. As in past years I have made observations in this Report that are, in my view, relevant to understanding the long-term trends in the State's finances.

There are some overarching points that arise that are also of significance. The Audit analysis indicates that outlays other than interest and abnormals continue to grow in real terms, albeit slowly. The State has done three key things in recent years in getting to its current financial position. They are the reduction of the public sector workforce by some 21 500 targeted separations since 1991-92, the outsourcing of services that are responsible for large amounts of outlays, and the disposal of assets, most significantly, the recent electricity asset disposals. While improving the position they tend to limit the possibilities for future changes, that is, the prospects for further large outlay reductions and disposal of assets for debt reduction. Asset reductions also limit the already small revenue base that the State has. In this sense these actions increase the risk profile by reducing flexibility.

---

[22] Budget Statement 2000-01, Budget Paper No. 2, Table 2.4 — Policy changes — outlays. New operating initiatives over the forward estimates amount to $263 million while reductions due to superannuation payment reductions, aside from timing changes, and agency savings amount to $162 million.

Notwithstanding this, net debt, a key Budget target, has reduced substantially in 1999-2000 such that as a proportion of Gross State Product it is now below the level it was before the State Bank collapse. Accordingly, in this regard Audit is observing no more than the fact that existing and arising risks to the State's financial position must be kept under strict review. To the extent that further asset disposals are contemplated, there would need to be very clear evidence that the State's financial position would be improved. An as yet unknown, but projected longer term benefit to the State's finances, is the commencement of national tax reform arrangements. The projected benefits are, however, currently not projected to commence until 2006-07.

Overall, the Budget does not indicate much flexibility in cash terms and also when considering the accrual results discussed below. In each of the past few years cash surpluses have been possible but for deferral of revenues and bringing forward funding for superannuation liabilities. Nonetheless, these predominantly reflect timing matters rather than flexibility in the State's Budget.

Accrual Basis

The 2000-01 Budget[23] again sets out accrual estimates for the non-commercial sector.

The following shows the 2000-01 Budget estimates for the forward years:

	2000-01 Budget $'million	2001-02 Estimate $'million	2002-03 Estimate $'million	2003-04 Estimate $'million
Consolidated statement of financial position	5 490	5 469	5 425	5 398
Net assets				
Consolidated operating statement				
Operating (deficit) surplus after net	(94)	(30)	(57)	2
Revenue from disposal of assets (before 'abnormals')				
Consolidated statement of cash flows				
Cash balance at 30 June	1 556	1 638	1 760	1 840

The forward projections estimate that operating deficits on an accruals basis will be incurred each year until the last in the forward estimate period, 2003-04.

It is noted that as for the cash result, an important aspect on the result is transfers to and from the other sectors and in particular the financial institutions sector. The results take account of discretionary transfers from this sector as set out in the Budget Papers. Changes in these distributions, as discussed above, can change these results. Thus to an extent, the accrual basis of reporting, while generally regarded as the better form of reporting, is subject to discretionary changes. This arises from the sector base of reporting.

Another key area for variation is the change in superannuation expense from year to year, which will reflect the net change in unfunded superannuation liabilities. This in turn reflects

23 Budget Statement 2000-01, Budget Paper No. 2, Table 3.1 p. 3.2 and Tables 3.4 to 3.6 pp. 3.7 to 3.9.

the value of assets invested for superannuation liabilities and the valuation of liabilities, which can change substantially with changing market conditions and assumptions. The operating statement for 1999-2000 and 2000-01 indicate that superannuation expense decreases from $615 million in 1999-2000 to $461 million in 2000-01, a decrease of $154 million, which is in itself material to the operating result.[24]

Target Operating Surplus

Apart from the preceding aggregate targets, the 1998-99 Budget introduced the concept of the 'target operating surplus' that is the operating surplus required to meet all operating expenses from operating revenues and fund expenditure on capital investment from cash flows after provision for employee entitlements generated in the year of the investment.

The following table sets out the forward targets.[25]

	2000-01 Budget $'million	**2001-02 Estimate $'million**	**2002-03 Estimate $'million**	**2003-04 Estimate $'million**
Capital investment in property, plant and equipment	561	580	553	562
Less: Depreciation	434	437	443	451
Equals target operating surplus	126	143	109	111
Projected operating result before abnormal items	(94)	(30)	(57)	2

The table indicates that, notwithstanding an improvement, the target is not achieved over the forward estimate period.

Future Targets

As mentioned in the previous section, the Government has acknowledged that in formulating a future fiscal plan it will consider the appropriate fiscal target to adopt having regard to changes in public sector financial reporting in 1999-2000, ie ABS accrual reporting.

Accordingly, notwithstanding the projected cash and accrual results outlined above, there remains some work to be done to consider what are the best ongoing indicators of the financial results and position for the public sector in the new reporting environment.

---

24 Budget Statement 2000-01, Budget Paper 2, Table 3.4. The decrease in 2000-01 reflects primarily higher estimated investment earnings including a profit on disposal of the Adelaide Casino which reduces the net expense and that 1999-2000 included some increases to the liabilities from adjustment due mainly to GST inflation effects.

25 Budget Statement 2000-01, Budget Paper 2, Table 3.3.

A COMMENTARY ON THE STATE'S BUDGET OVER THE PERIOD 1997-98 TO 2003-04

INTRODUCTION

This section provides an analysis of, and comments on, in aggregate terms, trends and key factors in the State's Budget since 1997-98 including the forward estimates up to the year 2003-04 published as part of the State's Budget for 2000-01.

The focus is on the cash based Government Financial Statistics (GFS) form of reporting, which is the basis of the Government's key budget target. The cash based GFS basis provides for some offsetting of recoveries against outlays. The key areas of importance are:

- the offsetting of sales of goods and services against general government final consumption expenditure;
- the offsetting of capital repayments/recoveries against the item 'Advances';
- the offsetting of asset sales proceeds (excluding sale of government businesses) from capital outlays.

The analysis is based on data for the non-commercial sector, consistent with the principal emphasis in the Government's Budget presentation.

LIMITATIONS ON ANALYSIS

In past Reports I have commented that is important to recognise at the outset that analysis over an extended period is complex having regard to the multitude of items that may change and influence financial results. As mentioned, this is made more difficult by the introduction of accrual accounting and budgeting. Notwithstanding, this review has sought to take account of factors in the State's finances that can change, or that otherwise influence substantially, the annual outcome of the State's financial operations.

The analysis of the 1999-2000 Budget is affected by a number of important factors. The principal factors are discussed below. Other factors are mentioned where relevant.

The first factor is that the figures for 1999-2000 are revised estimates for the year rather than actual data. At the time of this Report, as indicated in the 'Overview of the State's Finances', there were some substantial changes to the estimated results for 1999-2000 such that there was the potential for a very large surplus.

The effect of these changes was offset by the bringing forward of past superannuation payments in 1999-2000 amounting to $100 million and deferring dividends from SAAMC and SAFA beyond the deferrals provided in the 2000-01 Budget. The revised estimated result for 1999-2000 is a deficit of $17 million compared to the estimated result of $69 million.

These changes are consistent with the Government's record in that it seeks to achieve the projected budget outcomes.

In relation to the audit analysis, there are elements of expenditure that may be substituted, eg superannuation instead of capital in a year, and there is also an element of the estimated outlays not being achieved.

In Audit's view these adjustments are not so great as to invalidate the overall trend analysis from the Budget data, ie it is generally within reasonable limits. It may be the case that some of the disaggregated analysis can be affected by differences between actual results and estimated results. Where possible this is acknowledged in the text.

The second major factor for the 2000-01 Budget is that the Budget data does not take into account the conclusion of the electricity asset disposals.

This process is likely to impact on forward estimates for:

- net interest payments — now expected to reduce further;
- other revenue — which includes distributions from commercial public enterprises, also expected to reduce.

The effects of the remaining asset lease/sale process cannot be estimated reliably at the time of this Report and therefore the following analysis must recognise the possible influence of this process.

AUDIT APPROACH

The approach taken in the analysis is to provide more detail on certain of the budget data, to provide a longer time series where possible to assist in trend identification, and to adjust some of the aggregates to focus on trends without the influence of items such as Commonwealth specific purpose payments, abnormals and internal transactions. This is additional to similar data available in the Budget papers.[26]

SUMMARY OF THE AUDIT ANALYSIS OF CHANGES OVER THE PERIOD 1997-98 TO 2003-04

An Overview

Last year I noted that the 1999-2000 Budget had introduced a number of significant policy changes to the forward estimates from the previous year to maintain the overall budget strategy.[27]

---

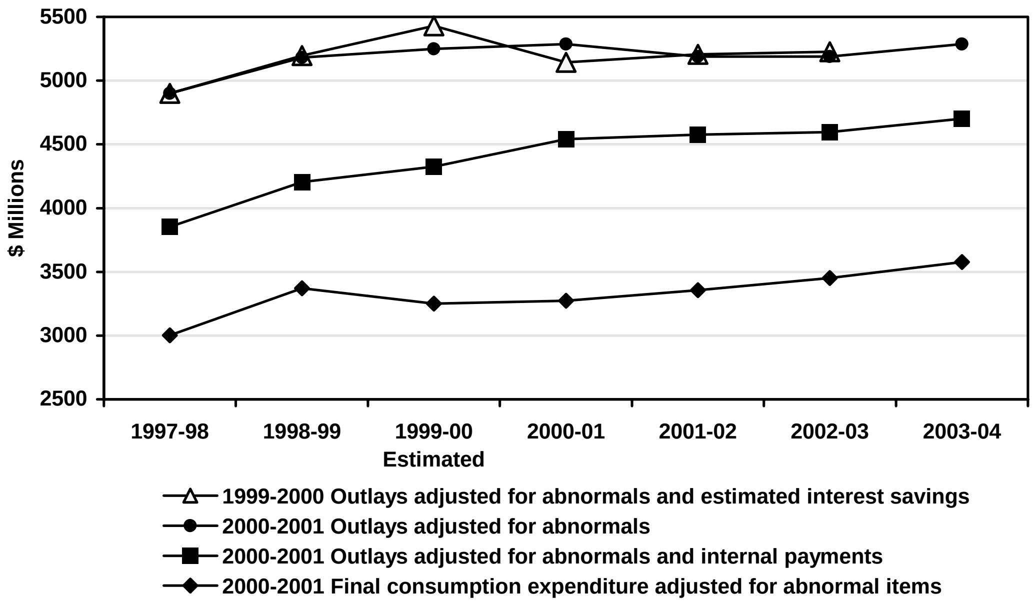
[26] For example 'Budget Statement 2000-01 Budget Paper 2' Table 2.1.

[27] Policy changes included increases in fees, charges and duties, introduction of a power bill levy and extending the period over which past superannuation liabilities will be eliminated from 30 to 40 years, ie by 2034.

The 2000-01 Budget incorporates the effects of electricity asset disposals completed in 1999-2000. In the absence of enabling legislation, no allowance was made for this in the 1999-2000 Budget although an electricity levy was to be introduced to compensate the Budget for the premium expected to be derived from such a disposal process.

The following chart highlights the trends that have emerged since 1997-98. All outlay data is net of Commonwealth Specific Purpose Payments. Data for 2000-01 total outlays is also adjusted for reclassified subsidy payments for comparative purposes.

Non-Commercial Sector Real Outlays (Adjusted)



The chart shows, from the top, the following in real terms:

- 1999-2000 Budget total outlays adjusted for abnormal items and estimated interest savings from the disposal of electricity assets in 1999-2000;
- 2000-01 Budget total outlays adjusted for abnormal items;
- 2000-01 Budget total outlays adjusted for abnormal items, interest and internal payments;[28]
- 2000-01 Budget final consumption expenditure adjusted for abnormal items.

The following explains the trends in the data.

2000-01 Budget Total Outlays Adjusted for Abnormal Items

2000-01 Budget total outlays adjusted for abnormal items demonstrates that, in real terms, adjusted outlays are expected to grow consistently from 1997-98 to 2000-01. Noticeably, the 2000-01 Budget projects total outlays adjusted for abnormals in 2000-01 to be higher

[28] Internal payments include payments to non-commercial public trading enterprises.

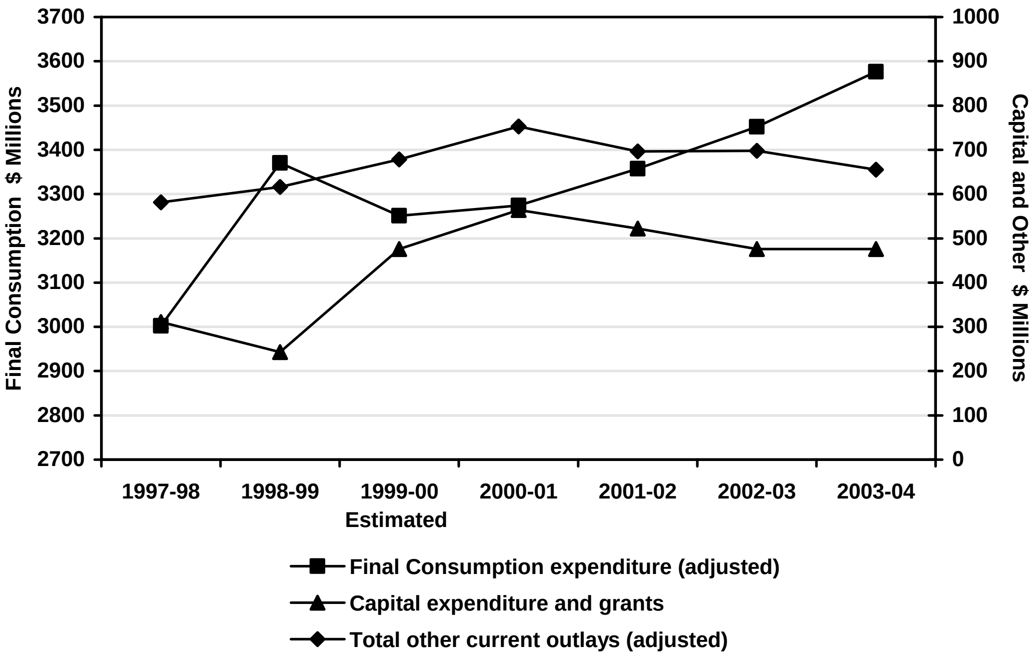
than was estimated in the 1999-2000 Budget notwithstanding a reduction for interest savings. This can be explained by previously unbudgeted payments associated with national tax reform (which extend over the full forward estimates period), an unexpected increase in interest costs in 2000-01 of $61 million,[29] unbudgeted separation payments and increased total capital outlays. In the forward years outlays are essentially the same as was projected in the 1999-2000 Budget with an upward trend in 2003-04 resulting in a small increase over the period.

2000-01 Budget Total Outlays Adjusted for Abnormals, Interest and Internal Payments

2000-01 Budget total outlays adjusted for abnormals, interest and internal payments shows a continuous increasing trend. This reflects the replacement to a large degree of the interest savings and abnormal expenditure in 1999-2000 for separation packages and asset sales with other expenditures. Payments associated with the national tax reform arrangements commencing 2000-01 exaggerate the increase but the increase is there in the absence of those payments. There is therefore a change in expenditure type while total outlays is relatively unchanged.

The causes of this trend vary over the forward estimates period and are best illustrated by the following chart.

Outlays Adjusted for Abnormals, Interest and Internal Payments (Real)



[29] Budget Statement 2000-01, Budget Paper 2, Table 2.4.

2000-01 Budget Final Consumption Expenditure Adjusted for Abnormal Items

2000-01 Budget final consumption expenditure adjusted for abnormals shows a reduction in real terms from 1998-99 to 2000-01. This essentially reflects lower superannuation payments than in 1998-99 as shown later in this section. In subsequent years real growth is projected annually.

Other Observations

Total revenues are expected to move in line with outlays thus generally maintaining the objective of balanced budgets. As with outlays, the composition of revenues over the forward estimates period is subject to major fluctuations due primarily to national tax reform.

The audit analysis shows, as it has in past years, that there have been, or are estimated to be, increases in expenditure in nominal terms over the period reviewed reflecting wages and salaries growth, other non-discretionary items, new policy etc[30] that have offset outlay reductions sought in past years and savings arising from asset disposals in net interest payments. In real terms net interest payments reduce by $250 million between 1999-2000 and 2003-04 which, when offset against the total other outlays increase of $176 million resulted in a net decrease in total outlays of $74 million in real terms over the period.

This has been offset by movements in revenues attributable in particular to Commonwealth funding. Important revenue contributions are made periodically, as necessary for the overall budget outcome, by financial institutions at the discretion of the Government. This is particularly so in 2000-01 and 2003-04.

While these are the projections, looking back, each year the estimated cash outlays have not been achieved without additional substantial payments toward unfunded superannuation liabilities. In 1998-99 this was $239 million and in 1999-2000 $100 million. Additionally, dividends from financial institutions have been deferred, in 1999-2000 all of the $201 million estimated contribution from SAAMC was deferred. The unfulfilled outlays are most often due to slippage in capital outlays.

Summary of Significant Factors in the 2000-01 Budget

The following is a broad summary of the significant factors included in the audit analysis.

Forward Estimates and Outcomes

- The forward estimates indicate deficits (before abnormals) will be incurred for 1999-2000 and 2000-01 (as was budgeted in 1999-2000) and small surpluses from 2000-01.

---

30 The 'Budget Statement 2000-01 Budget Paper 2' provides a reconciliation of items in nominal terms that affect the budget result (inclusive to 2002-03) in Table 2.4.

Outlays

- 2000-01 incorporates a premium estimated at $115 million from the disposal of electricity assets in 1999-2000. If the estimate is achieved, subject to actual interest rates,[31] this will cover the $100 million premium built into the Budget in 1998-99 and provide some additional capacity for outlays.

- Total outlays adjusted after deducting some outlay items that vary substantially from year to year, including 'abnormal items', net interest payments and internal payments for tax equivalents, show an increase over the period 1998-99 to 1999-2000 in real terms of $119 million or 2.8 percent and between 1999-2000 to 2000-01 of $216 million or 5.0 percent. Over the whole period from 1997-98 to 2003-04 the increase is $850 million (22.1 percent).

- The Government has reduced projected payments over the forward estimate period toward eliminating past unfunded superannuation liabilities to take advantage of a profit of $86 million earned on the disposal of the Adelaide Casino by Funds SA. The receipt of the profit on disposal means projected increases in superannuation assets have already been met. This provided a short term benefit to the Budget and essentially this has released funds for other purposes. The alternative was to maintain the projected contributions and improve the funded position for superannuation assets. While past service payments result in the establishment of assets, it is not clear what the freed up funding will be applied to ie recurrent or capital purposes. The non-commercial sector took responsibility for unfunded superannuation liabilities of $67 million from former electricity entities. This will be funded as part of the long term funding program.

- There is a reduction in net interest payments over the five years from 1998-99 estimated to be $307 million or 57 percent.

- There is an increase in other current payments in 1999-2000 over 1998-99 of $62 million in real terms or 10.1 percent and the projected increase for 2000-01 over 1999-2000 is $75 million or 11.1 percent.

- Capital outlays (excluding net advances) are estimated to increase in 2000-01 over the 1999-2000 estimated result and decrease in the forward years from 2001-02 to 2003-04. Historically, this item has been subject to considerable slippage each year compared to budgets set and this is again evident in the 1999-2000 estimated result.

---

[31] The premium is based on a market interest rate of 7 percent. Even a 0.5 percent decrease should not affect the achievement of the premium.

Own Source Revenues — Taxation

- Total taxation receipts for 1999-2000 are estimated to be $2.7 billion a real increase of $179 million or 7.0 percent over 1998-99. Taxation receipts for 2000-01 are estimated to be $2.1 billion a real reduction of $714 million or 26 percent from 1999-2000 due to national tax reform. From 1997-98 to 2003-04 the estimated reduction is $421 million or 17.7 percent. This is offset by increases in Commonwealth revenues.

- Revenue from the introduction of gaming machines is expected to contribute about $211.3 million for 1999-2000 a real increase of about $18.6 million over 1998-99 and decrease to $183.4 million in 2000-01 due to national tax reform changes. In the absence of these changes gaming machine taxes would raise the equivalent of $226.6 million in 2000-01.

- Taxation policy changes other than gaming machines are expected to contribute about $143.4 million to taxation receipts in 1999-2000 and $129.7 million in 2000-01 following changes to the emergency services levy.

- Natural increases in taxation revenue are expected to contribute about $77.6 million in 1999-2000 above 1998-99 and a further $54.6 million in 2000-01. These data add back the effects of national tax reform for comparative purposes.

Own Source Revenues — Contributions from State Undertakings

- The 2000-01 estimates rely on a dividend distribution from the South Australian Asset Management Corporation (SAAMC) of $109 million. This is part of an amount of $200.6 million deferred from 1999-2000. The amount is not identified as an abnormal item.

- The estimated distributions from financial institutions projected in 2003-04 have a substantial negative impact on the total accumulated reserves of those institutions. The reserves remain, however, in the order of $480 million in nominal terms at that time, down from $604 million in 2000-01.

General Purpose Revenues from the Commonwealth

- Revenues from the Commonwealth increase in nominal terms between 1998-99 and 1999-2000 by 3.4 percent equivalent to a real terms increase of 0.9 percent or $14.5 million as a result of national tax reform arrangements. From 1999-2000 to 2000-01 general purpose grants are forecast to grow in real terms by $745 million or 43.5 percent.

- For the period from 1997-98 to 2003-04 the increase in Commonwealth receipts is estimated to be $1 385 million or 90.6 percent in nominal terms or $1 046 million or 65.8 percent in real terms. Over the period the proportion of Commonwealth general purpose grants to total revenue excluding SPPs increases from 32.6 percent to 50.2 percent.

A Concluding Observation

It is relevant to note that the forward estimates indicate continuing small underlying surpluses through to 2003-04, allowing for the growth in underlying total outlays in real terms. As with recent Budgets, the implication of past outlay trends is that continuation of those trends may place pressure on the maintenance of projected outcomes in the longer term. While this is so, as mentioned in the recent past projected outlays have not been achieved without bringing forward additional past superannuation funding payments. The 2000-01 Budget continues to allow for realistic salary and wage outcomes and provides amounts for unplanned cost pressures and emerging priorities. Again, it is relevant to note that the Budget projections do not take account of the impact of future asset disposals.

Notwithstanding, the 2000-01 Budget shows a range of fluctuating items in both revenues and outlays and that periodic substantial contributions are provided from financial institutions to achieve budget targets.

OVERVIEW OF KEY 2000-01 BUDGET CHANGES

I turn now to discuss some of the aggregates identified in the following tables (nominal terms), provided by the Department of Treasury and Finance that incorporate adjustments to improve comparability over time. In both tables, universities and the South Australian Government Financing Authority (SAFA), have been excluded. In the second table, used for most of the audit commentary and analysis, the receipt and expenditure of Commonwealth specific purpose payments has also been removed. The elimination of these specific purpose payments allows the analysis to focus on the effects of State decision-making.

Non-Commercial Sector (Nominal)

(Excludes Net Proceeds of the Sale of Government Businesses, SAFA and Universities)

	1997-98 Actual $'million	1998-99 Actual $'million	1999-2000 Budget $'million	1999-2000 Estimated Result $'million	2000-01 Budget $'million	2001-02 Estimate $'million	2002-03 Estimate $'million	2003-04 Estimate $'million
Current Outlays								
General government final consumption expenditure	3 845	4 232	4 243	4 279	4 316	4 508	4 721	4 988
Net interest payments	640	539	544	460	347	251	240	232
Subsidies paid	483	550	541	619	659	595	573	579
Other (a)	800	877	871	949	1 003	994	1 019	1 039
Total Current Outlays	5 768	6 198	6 200	6 307	6 326	6 348	6 553	6 839
Capital Outlays								
Gross fixed capital expenditure and other capital outlays	394	322	665	558	561	580	553	562
Grants	3	23	56	28	74	45	45	39
Advances	-182	-15	-13	-49	-33	-1	2	-7
Total Capital Outlays	215	330	708	537	602	624	599	594
Total Outlays	5 983	6 528	6 907	6 843	6 928	6 972	7 152	7 433
Own Source Revenues								
Taxes	2 297	2 504	2 640	2 746	2 089	2 032	2 102	2 173
Net operating surplus of non-commercial public trading enterprises	87	109	90	99	59	52	49	61
Income from commercial public trading enterprises				372	279	268	283	282
Other revenue	781	655	986	320	430	316	258	371
Own Source Revenues	3 165	3 268	3 716	3 536	2 857	2 669	2 692	2 887
Grants Received (b)	2 894	3 052	3 068	3 169	3 962	4 225	4 382	4 467
Total Revenue and Grants Received	6 059	6 320	6 784	6 705	6 819	6 894	7 074	7 354
Financing Transactions								
Provisions	74	75	82	70	77	79	81	80
Deficit/(Surplus)	-150	133	41	69	32	-1	-3	-1
Abnormal Items								
Stamp duty on electricity sales/leases				110	0	0	0	0
Separation payments	-41	-51	-40	-69	-20	0	0	0
Cost associated with asset sales	-9	-27	-2	-70	-14	0	0	0
SAFA return of capital	150							
UNDERLYING DEFICIT/(SURPLUS)	-48	55	-1	39	-2	-1	-3	-1

(a) Grants on-passed to Local Government, personal benefit payments etc.

(b) Includes $166.8 million of loans from the Commonwealth in 2000-01 under the guaranteed minimum amount arrangements in the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations.

Non-Commercial Sector (Nominal)

(Excludes Net Proceeds of the Sale of Government Businesses, SAFA and Universities and Revenue and Expenditure in relation to Commonwealth Specific Purpose Payments)

	1997-98 Actual $'million	1998-99 Actual $'million	1999-2000 Budget $'million	1999-2000 Estimated Result $'million	2000-01 Budget $'million	2001-02 Estimate $'million	2002-03 Estimate $'million	2003-04 Estimate $'million
Current Outlays								
General government final consumption expenditure	2 933	3 358	3 352	3 359	3 378	3 536	3 726	3 957
Net interest payments	640	539	544	460	347	251	240	232
Subsidies paid	442	495	485	562	596	531	507	513
Other (a)	486	521	547	581	625	625	642	657
Total Current Outlays	4 501	4 912	4 928	4 962	4 946	4 943	5 115	5 360
Capital Outlays								
Gross fixed capital expenditure and other capital outlays	296	220	585	455	513	513	477	496
Grants	3	17	49	21	67	37	37	31
Advances	-182	-15	-13	-49	-33	-1	2	-7
Total Capital Outlays	117	222	620	426	547	550	516	520
Total Outlays	4 618	5 134	5 548	5 388	5 493	5 493	5 631	5 880
Own Source Revenues								
Taxes	2 297	2 504	2 640	2 746	2 089	2 032	2 102	2 173
Net operating surplus of non-commercial public trading enterprises	87	109	90	99	59	52	49	61
Income from commercial public trading enterprises	0	0	0	372	279	268	283	282
Other revenue	781	655	986	320	430	316	258	371
Own Source Revenues	3 165	3 268	3 716	3 536	2 857	2 669	2 692	2 887
Grants Received (b)	1 529	1 658	1 709	1 714	2 527	2 746	2 861	2 914
Total Revenue and Grants Received	4 694	4 926	5 425	5 250	5 384	5 415	5 553	5 801
Financing Transactions								
Provisions	74	75	82	70	77	79	81	80
Deficit/(Surplus)	-150	133	41	69	32	-1	-3	-1
Abnormal Items								
Stamp duty on electricity sales/leases		0	0	110	0	0	0	0
Separation payments	-41	-51	-40	-69	-20	0	0	0
Cost associated with asset sales	-9	-27	-2	-70	-14	0	0	0
SAFA return of capital	150							
UNDERLYING DEFICIT/(SURPLUS)	-48	55	-1	39	-2	-1	-3	-1

(a) Grants on-passed to Local Government, personal benefit payments etc.

(b) Includes $166.8 million of loans from the Commonwealth in 2000-01 under the guaranteed minimum amount arrangements in the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations.

It is to be noted that the 'Abnormal Items' shown in the Tables, and on which the calculation of the 'Underlying Deficit' figures are based, are as identified by the Department of Treasury and Finance. Past Reports have commented on whether these figures necessarily represent the best available analysis of underlying developments in the State's financial position. The following Audit commentary relates to specific factors that influence the trends shown by the data and identifies some factors additional to the abnormal items. This process aims to assist readers' understanding of significant components rather than restate the underlying deficit calculation.

It is also repeated that the above figures for 1999-2000 and later years and the analysis that follows are based on the Government's budget estimates. Past experience shows that actual outcomes may differ substantially from estimates.

CURRENT OUTLAYS

General Government Final Consumption Expenditure

This item represents a net figure that is derived from the total of expenditure by government agencies on wages and salaries, purchases of goods and services and employer contributions to superannuation schemes less the value of sales of goods and services provided by government agencies.

Final consumption expenditure is by far the largest component of State outlays.

In analysing this item of expenditure, it is necessary to take account of three particular aspects — superannuation funding, separation packages, and the cost of asset sales — that are discussed in turn. Information is also provided on sales of goods and services, which are offset against consumption expenditure.

Superannuation Funding

The term 'superannuation funding', in this context, refers to the extent to which the annual budget of the State 'pays for' superannuation out of taxation and other revenues.

I have observed in past Reports that there have been various changes in the way superannuation has been funded in recent years.

To take account of these important changes it is useful, so as to obtain a meaningful picture of developments over time, to deduct from the figures for total superannuation funding from the non-commercial sector the amounts paid as benefits so as to obtain consistent measures, over time, of the net contribution by the non-commercial sector to the funding of superannuation liabilities currently accruing or which have accrued in the past. The following table has been prepared with this in mind.

Superannuation Funding from Non-Commercial Sector

	(1) Total Funding (a) $'million	(2) Benefits Paid (b) $'million	(3) Net Contribution to Past and Currently Accruing Liabilities (c) $'million	(4) Real (June 2000) Terms (d) $'million
1993-94	544	280	264	294
1994-95	583	284	299	323
1995-96	595	285	310	323
1996-97	459	270	189	195
1997-98	423	282	141	146
1998-99	566	306	260	267
1999-2000 Budget	406	301	105	105
1999-2000 Estimated Result (e)	295	301	-6	-6
2000-01 (f)	433	321	112	109
2001-02 (f)	458	345	113	107
2002-03 (f)	520	374	146	135
2003-04 (f)	567	401	166	150

(a) Amounts paid from non-commercial sector as benefits to former employees, as contributions with respect to current employment and contributions reflecting lack of funding for current employment in previous years ('past service' contributions).

(b) Met from non-commercial sector in 1993-94 and from the Superannuation Funds Management Corporation (Funds SA) in subsequent years. Does not include benefits paid from employees' contributions.

(c) That is, column (1) minus column (2).

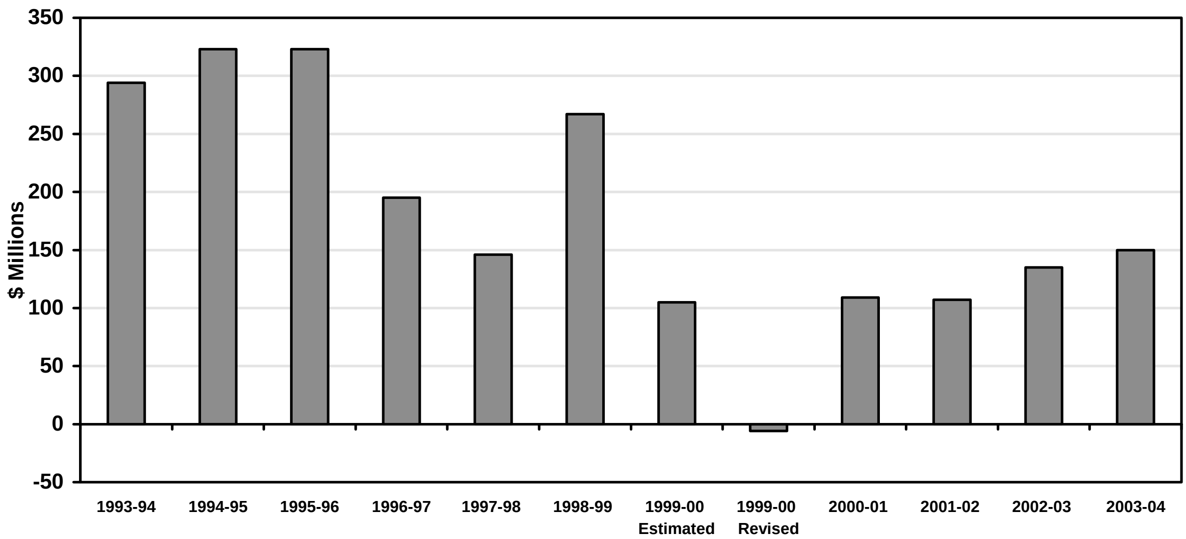
(d) Deflators as provided by the Department of Treasury and Finance.

(e) Revised estimates incorporated in the 2000-01 Budget; Payments of $100 million were brought forward from 2000-01 after the 2000-01 Budget.

(f) Estimates/projections included in the 2000-01 Budget.

The following chart shows the trend in net superannuation contributions in real terms over the period of the table.

Net Superannuation Contributions (Real)



It will be seen that:

- On this basis, net superannuation funding contribution by the non-commercial sector was maintained at high levels in the three years 1993-94, 1994-95 and 1995-96 (in both nominal and real terms) but then fell substantially to 1997-98. The large increase in 1998-99 reflected a prepayment of past and accruing liabilities in that year. In regard to the 1993-94 figures, $138 million of the total amount has been reported in the Budget Papers as an abnormal item as it represented funds accumulated over a number of years.

- The amount included in the forward Budget estimates for subsequent years also remains below the pre-1996-97 levels, especially if measured in real terms. This is consistent with the change in the 1999-2000 Budget to extend the period of eliminating superannuation liabilities.

- The three years before 2003-04 also reflect reduced projected payments (ie compared to pre-1997-98 levels) over the forward estimate period toward eliminating past unfunded superannuation liabilities to take advantage of a profit of $86 million earned on the disposal of the Adelaide Casino by Funds SA. The receipt of the profit on disposal means projected increases in superannuation assets have already been met. This provided a short term benefit to the Budget and essentially this has released funds for other purposes. The alternative was to maintain the projected contributions and improve the funded position for superannuation assets. While past service payments result in the establishment of assets, it is not clear what the freed up funding will be applied to ie recurrent or capital purposes.

- In 1999-2000 the non-commercial sector took responsibility for unfunded superannuation liabilities of $67 million from electricity entities disposed of during the year. These need to be funded from the Government's program and adjustments have been made commencing in 1999-2000 with an amount of $1.8 million rising to $3.7 million in 2003-04.

It is important to note that the payments toward funding superannuation liabilities have exceeded the original budget in each of the past few years as additional payments have been made to utilise surplus cash due to other timing differences. The Estimated Result figure for 1999-2000 reflects the prepayment in 1998-99. In the event, an amount of $100 million was prepaid in 1999-2000 primarily from the Department of Administrative and Information Services, to assist achieving the cash budget target. A corresponding decrease in actual amount paid in future years will follow from this, subject to any adjustments next year.

Further discussion in relation to past superannuation funding is provided in the section in this part of the Report titled 'State Debt'.

Separation Packages

The Department of Treasury and Finance has, in Audit's view, correctly recognised these payments as an abnormal item in the Financial Statement each year.

A part of these payments are recorded under the item Subsidies Paid. This represents payments in relation to TransAdelaide employees.

Cost of Asset Sales

The estimates included in the 2000-01 Budget have allowed for costs associated with asset sales which peaked in 1999-2000 when the major electricity asset disposals took place. These are identified as 'abnormal items'. To obtain expenditure data on a comparable basis over time it is necessary to 'add back' these amounts.

Final Consumption Expenditure on a Comparable Basis

The following table adjusts the data for the three factors referred to above.

General Government Final Consumption Expenditure

	(1) Total Expenditure $'million	(2) Superannuation Funding	(3) Separation Packages	(4) Cost of Sale of Assets	(5) (1) Minus (2), (3) and (4)	(6) (5) in Real Terms*
1997-98	2 933	423	33	9	2 468	2 563
1998-99	3 358	566	43	27	2 722	2 790
1999-2000 Budget	3 352	406	16	2	2 928	2 928
1999-2000 Estimated Result	3 359	295	38	70	2 956	2 956
2000-01	3 378	433	-	14	2 931	2 853
2001-02	3 536	458	-	-	3 078	2 923
2002-03	3 726	520	-	-	3 206	2 970
2003-04	3 957	567	-	-	3 390	3 064

* Based on deflators provided by the Department of Treasury and Finance; data in 1999-2000 terms.

The following table shows how these expenditures, after adjustment, have changed or are forecast to change from year to year.

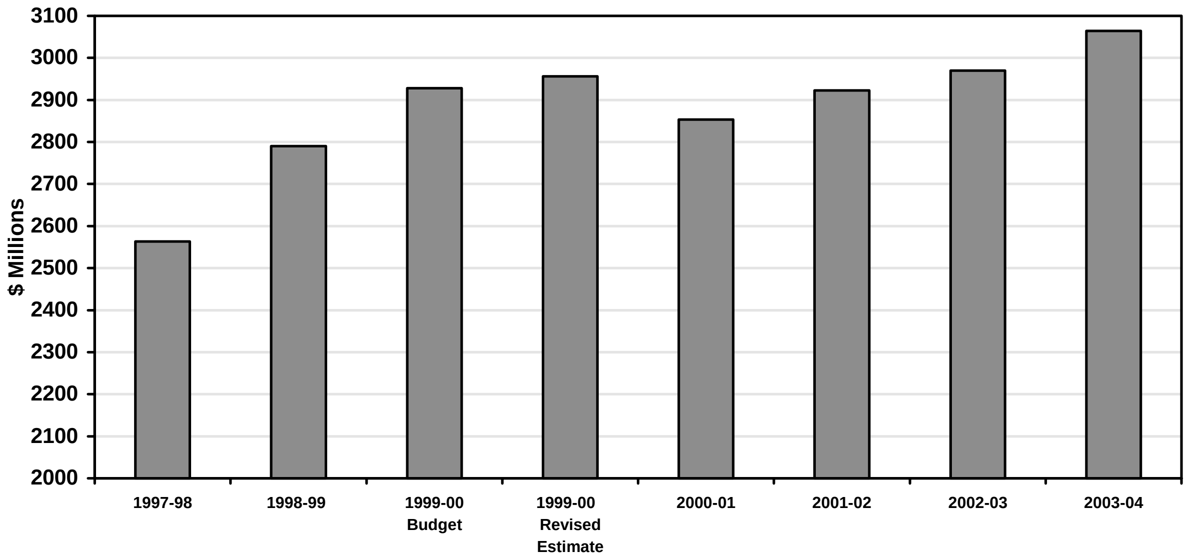
General Government Final Consumption Expenditure as Adjusted
Increase Over Previous Year

	Nominal Terms Percent	Real Terms* Percent
1997-98	-	-
1998-99	10.3	8.9
1999-2000 Budget	7.6	4.9
1999-2000 Estimated Result	8.6	5.9
2000-01	-0.8	-3.5
2001-02	5.0	2.5
2002-03	4.2	1.6
2003-04	5.7	3.2

* Deflators as provided by the Department of Treasury and Finance.

The following chart shows the trend in general government final consumption expenditure (as adjusted) over the period of the table.

Adjusted Final Consumption Expenditure (Real)



It will be seen that, on the basis of this data:

- there was a very marked increase from 1997-98 to 1999-2000 including an increase of $166 million in real terms in the 1999-2000 estimated result over 1998-99. While actual results for 1999-2000 have not been finalised, an amount of $100 million for additional past superannuation payments was made that is not included in the revised estimate;

- the 2000-01 Budget incorporates a substantial decrease of $103 million or 3.5 percent in real terms from 1999-2000;

- the forward estimates for the subsequent years show continuing increases in expenditure in real terms with total outlays in 2003-04 being $501 million or 19.5 percent higher than 1997-98. Most of this increase occurred up to 1999-2000 with the increase from 1999-2000 to 2003-04 estimated to be $108 million or 3.8 percent in real terms.

This data, while calculated on a slightly different basis, is consistent with the 2000-01 Budget papers.[32]

Sales of Goods and Services

As explained earlier, the above estimates of final consumption expenditure are on a net basis — ie after deducting the proceeds of the sale of goods and services.

The following table shows data made available by the Department of Treasury and Finance on sales of goods and services.

Sales of Goods and Services

	Sales of Goods and Services $'million	In Real Terms $'million	Percentage Change Over Previous Year Percent
1997-98	903	938	-
1998-99	1 094	1 121	19.6
1999-2000 Budget	1 020	1 020	-9.0
1999-2000 Estimated Result	1 375	1 375	22.6
2000-01	1 267	1 233	-10.3
2002-02	1 272	1 208	-2.1
2002-03	1 288	1 193	-1.2
2003-04	1 300	1 175	-1.5

It is notable that sales are estimated to decrease over the period following 1999-2000, in fact representing a decrease in real terms from 1999-2000 to 2003-04 of 14.6 percent.

Available data are not adequate to determine the significance of the trend in the table. To the extent that charges and fees merely recover related costs, decreases in sales of goods and services would be neutral to the budget as costs would also be expected to decrease. To the extent that recoveries vary from related costs, decreases in sales of goods and services would add to growth in net outlays.

[32] Budget Statement 2000-01 Budget Paper 2, Table 2.1 (in particular, Final Consumption Expenditure — excluding superannuation).

Contingencies

The estimates for 1999-2000 and beyond also provide quite large amounts 'to provide Government with funding capacity to meet unplanned cost pressures and high priority initiatives as they emerge'.[33] I noted in my last Report that this positive practice commenced with the 1998-99 Budget.

In 1999-2000 almost 50 percent of the total amounts set aside for the four year estimates period 1999-2000 to 2002-03 were committed to various purposes.

An amount, in line with the annual contingency amounts in the 1999-2000 Budget, was set aside in the 2000-01 Budget for the estimates period to 2003-04 being the uncommitted amounts to 2002-03 and an additional amount for 2003-04.

Public Sector Wage Growth

Public sector wages represent a very high proportion of the total current outlays. The Budget also provides sums for anticipated public sector wage increases. The amount identified is to meet reasonable but realistic wage outcomes over the forward estimate period. The provision set aside for the 2000-01 Budget is consistent with that in the previous Budget.

Summary Comments on Final Consumption Expenditure

Insufficient data is available to enable a full and precise explanation of the trends in consumption expenditure identified above. As commented in my 1998-99 Report, several broad points can be made.

Although there has clearly been a substantial reduction in the number of public sector employees (approximately 21 500 targeted voluntary separations over the period from 1991-92 to 1999-2000 based on data maintained by Audit from the Office of the Commissioner for Public Employment), increases in wage and salary rates have contributed to an increase in total expenditure on wages and salaries. Given the magnitude of wage and salary costs as a proportion of total outlays, this represents an important factor.

Other factors that influence the trends include new spending initiatives and spending on items other than wages and salaries (eg consultancies, outsourcing arrangements, eg computing). Some of these substitute contract payments for previous direct salary and wage payments or capital payments, eg lease of assets in lieu of purchase; changes in cost recovery rates associated with the sale of goods and services; the introduction of contingency provisions in the 1998-99 Budget; and changes in Commonwealth funding between general and specific purpose grants.

---

[33] Budget Statement 1999-2000 Budget Paper 2, p. 1-2.

Net Interest Payments

The estimates indicate a very large decrease expected in the net interest payments for 1999-2000 and 2000-01 from 1998-99 and that by 2003-04 net interest will be $408 million less than in 1997-98 thereby freeing up funds for other purposes to the extent that savings exceed revenues foregone from asset disposals. As mentioned an amount of $100 million was built into the 1998-99 Budget in anticipation of a premium from asset sales in that Budget. This now seems achievable.

Estimated net interest payments are much lower than was estimated in the 1999-2000 Budget as shown in the following table.

Change in Budgeted Net Interest

	1997-98 $'million Actual	1998-99 $'million Actual	1999-2000 $'million Budget	1999-2000 $'million Estimate*	2000-01 $'million Estimate	2001-02 $'million Estimate	2002-03 $'million Estimate	2003-04 $'million Estimate
1999-2000 Budget	640	547	536	536	544	496	466	468
2000-01 Budget	640	539	544	460	347	251	240	232
Difference	0	-8	8	-76	-197	-245	-226	-236

* Estimated result

As is evident interest payments are expected to reduce significantly each year to 2001-02.

I have commented in earlier Reports that there are many factors affecting these figures, including:

- the effect of major asset sales;
- the effects of changes in the State's debt level due to other factors, including the annual deficits;
- changes in debt arrangements between the non-commercial sector and the commercial sector;
- changes in interest rates over the period;
- the effects of debt management and of changes in the State's net debt profile.

The reasons for the decreases shown in the table are as follows:

- 1999-2000 reflects the part year effect of the receipt of proceeds from the disposal of electricity assets offset by the effect of internal transfers of debt from the electricity businesses to the Government before disposal. This is discussed in the section of this Part titled 'Electricity Assets Disposals and the State's Finances';

- 2000-01 reflects the full year effect of the receipt of proceeds and their application to debt retirement offset by a projected 2.3 percent increase in the average non-commercial sector net interest rate cost to the Government. The Government is charged the Common Public Sector Interest Rate (CPSIR), which is the average net cost of borrowings[34] to finance the Government's loans from SAFA. The Government also receives interest income based on rates relevant to the deposits. The net of these amounts is the average net interest rate cost and is projected to increase in 2000-01 because of an increase in interest rates[35] and because the majority of borrowings retired in 1999-2000 approximated current market rates leaving a larger proportion of higher yield debt than in the past thereby increasing the average rate;

- the reduction in 2001-02 primarily reflects a projected three percent decrease in the non-commercial sector net interest rate cost (as explained above), the balance of debt is not projected to be significantly different from the previous year. This decrease in the average interest cost is due partly to additional debt retirements of high yield debt in 2000-01.

The reduction in net interest payments over the five years from 1998-99 is estimated to be $307 million or 57 percent.

As mentioned, the remaining disposals of electricity assets are expected to change net interest payments further in the future. The effects of the remaining disposals are not taken into account in the published estimates.

Other Current Outlays

This category comprises current expenditure other than final consumption expenditure and interest payments. It includes subsidies of various kinds, grants to local government, and personal benefit payments.

These figures include certain 'internal' payments, such as payments to public trading enterprises in reimbursement of expenditure on separation packages, a reimbursement to the South Australian Housing Trust for its tax equivalent payment and payments to the South Australian Water Corporation for community service obligations.

---

[34] The CPSIR is essentially the net interest cost, ie the difference between interest expense and interest income, divided by the average principal outstanding. It also includes a margin for SAFA's costs.

[35] Budget Statement 2000-01, Budget Paper 2, p. 2.9.

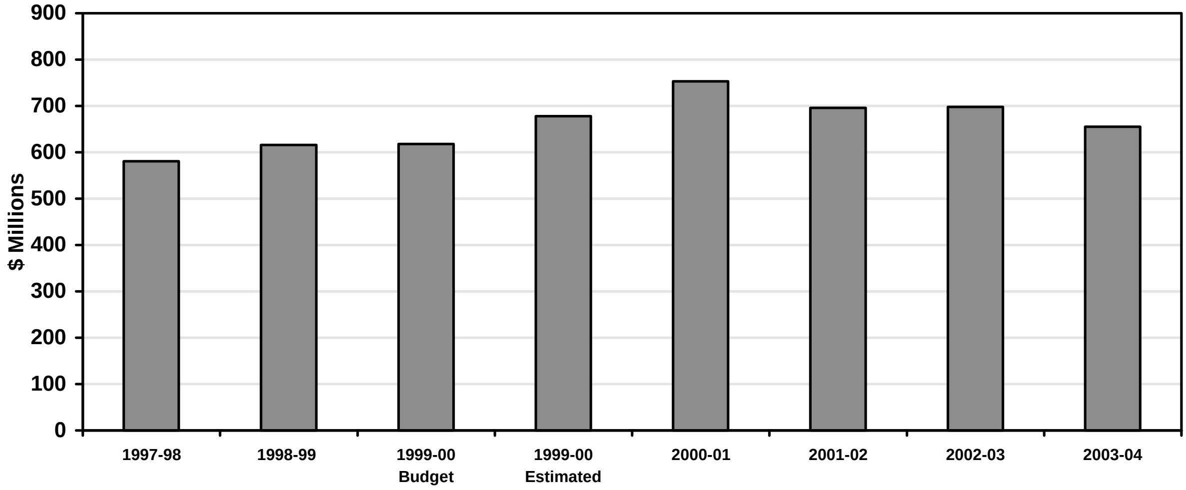
The following table adjusts for these factors.

Other Current Outlays

	(1) Total Other Current Outlays $'million	(2) Minus Payments to PTEs $'million	(3) Other Payments(1) Minus (2) $'million	(4) (3) in Real Terms $'million
1997-98	928	369	559	581
1998-99	1 016	415	601	616
1999-2000 Budget	1 032	414	618	618
1999-2000 Estimated Result	1 143	465	678	678
2000-01	1 193	419	774	753
2001-02	1 127	394	733	696
2002-03	1 119	398	721	668
2003-04	1 139	414	725	655

The following chart shows the trend of adjusted other current outlays in real terms.

Adjusted Other Current Outlays (Real)



The increase in 1999-2000 over 1998-99 was $62 million in real terms or 10.1 percent and the projected increase for 2000-01 over 1999-2000 is $75 million or 11.1 percent.

In real terms, the 1999-2000 estimated result and the 2000-01 budget also represent a substantial increase over 1997-98, (16.8 percent and 29.8 percent respectively) while there is an increase by the end of the forecast period over 1997-98 estimated at $75 million or 12.9 percent following decline over the period from 2000-01.

The preceding data has been adjusted for subsidy payments over the period 2000-01 to 2003-04 that are included in the Budget aggregates in gross terms for the first time. The initial increase in other current outlays in 2000-01 over 1999-2000 primarily is due to payments made under the national tax reform arrangements. These are the First Home Owners Scheme and the State's share of GST administration costs. These total $126 million in 2000-01 and $92 million in each of the remaining forward estimate years. The cost of these payments is compensated by increased Commonwealth general purpose grants.

CAPITAL OUTLAYS

The principal tables at the beginning of this section show that capital outlays consist of three main components:

- gross fixed capital expenditure;
- capital grants;
- net advances.

Net advances have varied considerably over the period from very large negative amounts to small negative amounts. This reflects transactions, in particular loans and repayments of loans, between the non-commercial sector on the one hand and, on the other, the private sector, the State commercial sector, the State financial institutions sector and the local government sector. The large negative amounts in 1997-98 reflect repayments by the South Australian Government Financing Authority (SAFA). The SAFA repayment was classified as an abnormal item in that year.

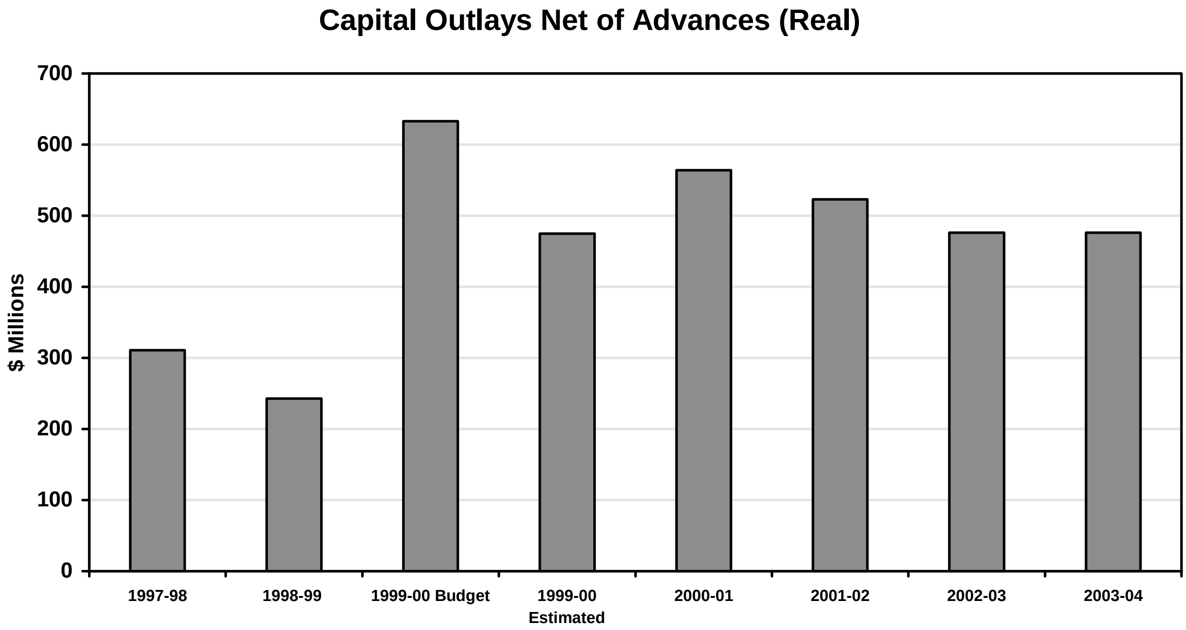
Audit considers that net advance transactions are different from other outlays in that they represent ‘switches’ in the level and location of financial assets and liabilities within the public sector as distinct from expenditure on goods or services or transfers out of the public sector. In analysing trends in non-commercial sector outlays it is therefore most useful to exclude these transactions. The Department of Treasury and Finance already excludes the effects of sales of businesses in the Budget presentation.

The following table shows capital outlays other than net advances.

Capital Outlays
(Not Including Net Advances)

	(1) Nominal Terms $’million	(2) Real Terms $’million	(3) Percentage Change in (2)
1997-98	299	311	-
1998-99	237	243	-21.8
1999-2000 Budget	633	633	160.6
1999-2000 Estimated Result	475	475	95.5
2000-01	580	564	18.8
2001-02	551	523	-7.3
2002-03	514	476	-9.0
2003-04	527	476	0.0

The following chart shows the trend of capital outlays net of advances over the period of the table.



It will be seen that:

- the 1999-2000 Budget provided for a very large increase in capital expenditure but, in the event, the revised expenditure level fell well below the budget estimate. Recent data from the Department of Treasury and Finance indicates that the revised estimate was also not achieved with a slippage on capital projects that was yet to be finalised at the time of this Report;

- the 2000-01 Budget provides for an increase (nearly 19 percent in real terms), a proportion of which relates to slippage from 1999-2000 and the forward estimates allow for a decline from that high level but maintain outlays well above the 1997-98 and 1998-99 levels. It is likely that the slippage for 1999-2000 has exceeded the revised estimates and that the actual payments for 1999-2000 will be lower than reported at this time.

SUMMARY OF ANALYSIS OF OUTLAYS

For reasons that have been discussed, to enable trends in overall spending by the non-commercial sector to be analysed in a meaningful way it is most useful to exclude separation packages, other abnormal items, interest payments, and internal payments to PTEs.

If this is done, the results are as follows:

Non-Commercial Sector Outlays

	Total Outlays (a) $'million	TSPs $'million	Other Abnormals $'million	Interest and Internal Payments $'million	Adjusted Total Outlays $'million	Real Terms $'million
1997-98	4 618	41	-141	1 009	3 709	3 852
1998-99	5 134	51	27	954	4 102	4 205
1999-2000 Budget	5 548	40	2	958	4 548	4 548
1999-2000 Estimated Result	5 388	69	70	925	4 324	4 324
2000-01	5 465	20	14	766	4 665	4 540
2001-02	5 464	-	-	645	4 819	4 576
2002-03	5 601	-	-	638	4 963	4 597
2003-04	5 849	-	-	646	5 203	4 702

(a) Excludes Commonwealth Specific Purpose Payments and subsidy payments reclassified for the period 2000-01 to 2003-04.

The following table shows how total outlays, after adjustment, have changed or are forecast to change from year to year.

Total Non-Commercial Sector Outlays as Adjusted Increase Over Previous Year

	Increase Adjusted Total Outlays Percent	Increase Real Total Outlays Percent
1997-98	-	-
1998-99	10.6	9.2
1999-2000 Budget	10.9	8.2
1999-2000 Estimated Result	5.4	2.8
2000-01	7.9	5.0
2001-02	3.3	0.8
2002-03	3.0	0.5
2003-04	4.8	2.3

The tables show that on the basis of this data for the years 1997-98 to 2000-01, there are substantial increases in adjusted expenditure in both nominal and real terms. The increase in the 1999-2000 estimated result over 1998-99 is $119 million in real terms or 2.8 percent, and for 2000-01 over 1999-2000 the increase is $216 million in real terms or 5.0 percent. Small increases in real terms are projected over the remainder of the estimates period.

For the whole period of analysis, the increase in 2003-04 over 1997-98 is $850 million in real terms or 22.1 percent.

REVENUES AND GRANTS

The 2000-01 Budget shows very significant changes to the composition of the revenue side of the Budget over the forward estimate period.

Foremost in the changes are the effects of the national tax reform and revised Commonwealth-State funding arrangements.[36] Under these arrangements some State taxes will be abolished or reduced and replaced by Commonwealth funding in the form of GST revenue grants and transitional grants.

Another significant change relates to the effects of the disposal of electricity businesses either completed in 1999-2000 or to be completed in 2000-01. This has the effect of reducing revenue from commercial public trading entities.

Finally the forward estimates indicate considerable fluctuations in other State own source revenues as a result of periodic, lumpy distributions to the Budget from public financial institutions, namely SAAMC and SAFA. These distributions are called upon where required for the overall budget result.

The following table shows the trend projected for revenue and general purpose grants over the period 1997-98 to 2003-04.

Revenue and General Purpose Grants

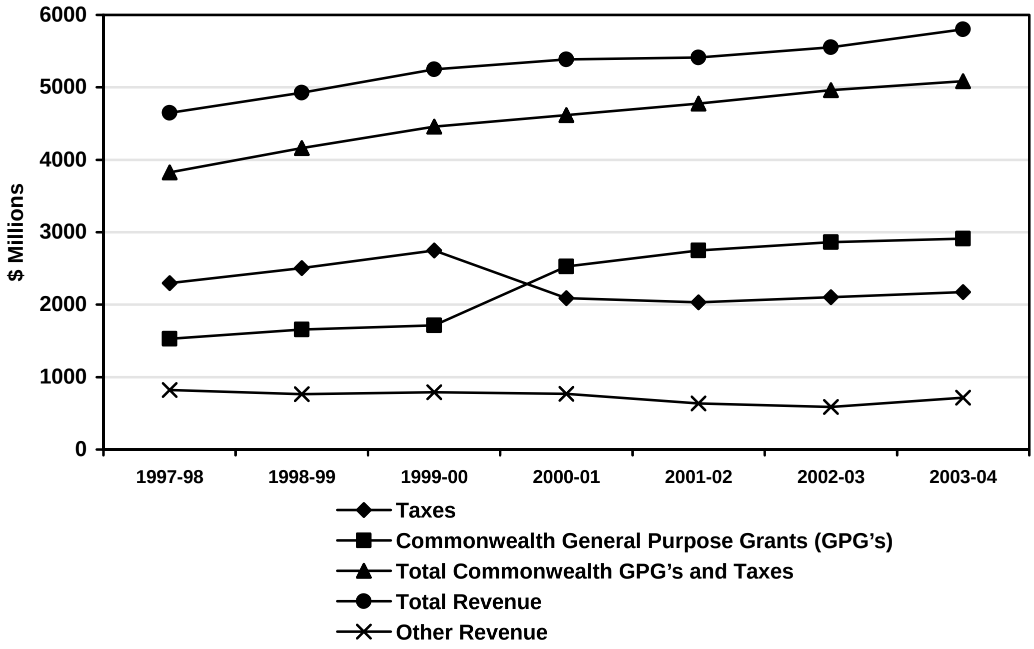
	Total Revenue and Grants (a) $'million	(b) Real Terms $'million	Increase Real Terms Percent	Increase Real Terms $'million	Cumulative Increase Real Terms $'million
1997-98	4 694	4 875	-	-	-
1998-99	4 925	5 048	3.6	173	173
1999-2000 Budget	5 425	5 425	7.5	377	550
1999-2000 Estimated Result	5 250	5 109	1.2	61	235
2000-01	5 384	5 112	0.0	3	237
2001-03	5 414	5 015	-1.9	-97	140
2002-03	5 553	5 019	0.1	3	144
2003-04	5 800	5 242	4.4	223	367

(a) General purpose grants only ie excludes Commonwealth Specific Purpose Payments (SPPs).
(b) 1999-2000 dollars.

36 Details of these arrangements are set out in the 'Budget Statement 2000-01' Budget Paper 2, section 6.5.

The following chart (nominal amounts) assists to see the significant compositional changes in revenues over the forward estimate period.

Revenues Excluding Commonwealth SPPs (Nominal) (a)



(a) SPP — specific purpose payments

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

- the table shows a real terms decrease in total revenues from 1999-2000 ($5 109 million) until 2002-03 ($5 019 million) rising again in the last year 2003-04;
- the magnitude of the changes outlined above, in particular from national tax reform. The rapid increase in Commonwealth general purpose grants and the offsetting reduction in State taxation revenue in 2000-01 are readily apparent. This decline is exaggerated by the one-off receipt of $103 million in stamp duty in 1999-2000 from the disposal of electricity assets. The chart also shows the trend of the total of Commonwealth and taxation revenues and the nominal increase across the period of the combined revenues;
- the increase in relative importance of Commonwealth funding to the State;
- the decrease in revenues due to the disposal of electricity businesses is apparent in the trend of both total revenue and other revenues. Not evident from the chart is the lumpy contributions from SAAMC and SAFA. In their absence, however, the trend for other revenues would be considerably different — showing a declining result.

The following commentary provides some additional analysis of these overall trends and other matters.

Taxes

Total taxation receipts for 1999-2000 are estimated to be $2.7 billion a real increase of $179 million or 7.0 percent over 1998-99. Taxation receipts for 2000-01 are estimated to be $2.1 billion a real reduction of $714 million or 26 percent from 1999-2000. From 1997-98 to 2003-04 estimated reduction is $421 million or 17.7 percent. This is offset by increases in Commonwealth revenues from national tax reform.

National Tax Reform

The national tax reform process has resulted in the Commonwealth ceasing to provide franchise fee replacement revenue from 2000-01. This was previously reported under State taxation revenue and is the prime reason for the decrease in taxation revenue over the estimates period. Actual receipts in 1999-2000 were $574.2 million. Estimated receipts for 2000-01 are $29.8 million. The other major effect is the abolition of financial institutions duty from 1 July 2001. This tax is estimated to provide $93.3 million in revenue in 2000-01. These reductions will be made up by Commonwealth grants so that the State is no worse off under the revised arrangements.

Department of Treasury and Finance have estimated that national tax reform changes will amount to $602.2 million in 2000-01 rising to $831.3 million in 2003-04.

Gaming Machines

As reported for a number of years that the largest single influence on taxation income has been the introduction of gaming machines into licensed hotels and clubs, such machines having previously been confined to the Adelaide Casino.

Taxation from gaming machines is estimated at $211.3 million[37] in 1999-2000 an increase of $23.3 million or 12.4 percent over 1998-99. This figure undoubtedly overstates the net effect of the introduction of the machines on the State's tax collections, as there has been a negative impact on revenue from other forms of gambling.

Gaming machine revenues are estimated to reduce to $183.4 million in 2000-01 as a result of national tax reform arrangements. This was explained in the Budget Papers:

> *… GST will be imposed on gambling … (this) will necessitate a change in State gambling tax arrangement to avoid an increase in the overall tax burden on gambling.*[38]

---

[37] Budget Statement 2000-01, Budget Paper 2, Table 5.7.

[38] Budget Statement 2000-01, Budget Paper 2, p. 6.15.

The Department of Treasury and Finance estimate that in the absence of GST gambling revenues would be in the order of $226.6 million in 2000-01. The revenue impact from gaming machines is therefore estimated to increase by $15.3 million in 2000-01, the smallest annual increase since the tax began in 1994-95.

Other Changes in Taxation Legislation

Estimates provided by the Department of Treasury and Finance show that the net effect of other changes in taxation legislation made since December 1993 was to add to the anticipated 1999-2000 revenue a net amount of $143.4 million and $129.7 million in 2000-01. Following a reduction in the emergency services levy in the 2000-01 Budget, estimated to be worth $24.6 million in net effect in 2000-01, projections for tax increases indicated in my last Report, and announced in the 1998-99 and 1999-2000 Budgets, have been revised downward with receipts from changes in taxation contributing $147.8 million in 2003-04 only $4.4 million more than in 1999-2000, in real terms a reduction of $10 million.

A major component of this relates to stamp duty changes introduced in the 1998-99 Budget, which have added about $68 million to revenue in 1999-2000 and stamp duty changes in the 1999-2000 Budget, which are estimated to add about a further $8.6 million to revenue in 1999-2000.

Emergency Services Levy

An Emergency Services Levy amounting to $129.8 million (net of government contributions) was announced in the 1999-2000 Budget. The Department of Treasury and Finance identified an amount of $23.8 million as the net impact of the levy on the budget.

In the 1999-2000 Budget a range of amendments were made to the operation of the levy which were expected to cost $24 million per annum. Details are set out in the Budget Papers.

Summary of Taxation Revenue Changes

The foregoing is summarised in the following table which adjusts for the effects of national tax reforms to enable a comparison over the period back to 1993-94.

Taxation Revenue

		Actual 1993-94 $'million	Actual 1994-95 $'million	Actual 1995-96 $'million	Actual 1996-97 $'million	Actual 1997-98 $'million	Actual 1998-99 $'million	Estimated Result 1999-2000 $'million	Estimate 2000-01 $'million	Estimate 2001-02 $'million	Estimate 2002-03 $'million	Estimate 2003-04 $'million
1.	Total	1 811.0	1 879.0	2 024.0	2 133.0	2 296.4	2 493.0	2 746.0	2 088.7	2 032.5	2 102.2	2 172.7
2.	Contribution of gaming machine tax receipts (pre GST)	-	54.6	108.3	133.0	158.0	188.0	211.3	226.6	238.1	243.7	252.3
3.	Amount attributable to national tax reform changes	-	-	-	-	-	-	-	(602.2)	(762.1)	(800.3)	(831.3)
4.	Amount attributable to other changes in taxation legislation (a)	-	11.2	25.4	22.4	14.9	103.9	143.4	129.7	135.3	143.5	147.8
5.	Total amount attributable to legislative changes (b)	-	65.8	133.7	155.5	172.9	291.9	354.7	(245.9)	(388.7)	(413.1)	(431.2)
6.	Classification change (c)	-	-	-	17.7	18.3	16.6	16.8	18.4	18.8	19.5	20.3
7.	'Internal' changes (d)	-	-	2.8	5.5	38.8	17.8	19.7	17.3	16.8	16.3	15.7
8.	Abnormal stamp duty receipts associated with the sale of government assets	-	13.1	12.8 -	-	3.1	-	110.6	-	-	-	-
9.	Residual amount	1 811.0	1 800.1	1 874.7	1 954.2	2 063.4	2 166.7	2 244.3	2 298.9	2 385.7	2 479.5	2 567.9

Note: Totals may not add due to rounding.

(a) Based on data provided by Department of Treasury and Finance. Item (4) excludes changes referred to in item (7). Includes the net budgetary impact of the emergency services levy. Note that increased tax on gaming machines in the Casino is included in item (4) as is revenue raised from Water Catchment levies.

(b) Equals total of (2), (3) and (4).

(c) Figures from 1996-97 to 1999-2000 relate to TAB funds paid to racing clubs via RIDA. Figures from 2000-2001 onwards relate to ongoing liquor and fuel subsidies less TAB funds distributed to the harness and greyhound racing codes and fractions and unclaimed dividends paid to the racing industry.

(d) Reflects the net impact on the introduction of land tax TER payments by State Authorities and the abolition of the electricity levy neither of which affect the overall non-commercial sector result.

Leaving aside items (6), (7) in the above table — neither of which affect the overall non-commercial sector result and (8) which is regarded as abnormal receipts — the projected increase in total tax revenue (adjusted to add back the effects of national tax reforms) over the ten years from 1993-94 to 2003-04 may be represented as follows:

Attributable To	**Nominal Terms**		**Real Terms***	
	$'million	**Percent**	**$'million**	**Percent**
— taxation on gaming machines	252	13.9	228	11.3
— other changes in taxation legislation	148	8.2	134	6.6
— 'natural growth' (residual amount)	757	41.8	684	33.9
Total	1 157	63.9	1 046	51.8

* 1999-2000 dollars.

On the basis of this data, the projected real terms increase would be 51.8 percent, comprising a 33.9 percent increase attributable to 'natural growth' and the remainder to the introduction of gaming machines and increases in tax rates.

Net Operating Surplus of Non-Commercial Public Trading Enterprises

This item consists of the net surpluses (before interest) of bodies which are classified as public trading enterprises by the Australian Bureau of Statistics but are regarded by the State Government as part of the non-commercial sector. The larger authorities included in the category are the South Australian Housing Trust, the Forestry component of the Department of Primary Industries, the SA TAB, the Lotteries Commission, the Passenger Transport Board and TransAdelaide.

This item rose from $87 million in 1997-98 to an estimated $99 million in 1999-2000 and is forecast to fall to $59 million in 2000-01. Data provided by the Department of Treasury and Finance suggests that the South Australian Housing Trust has been, and remains, the principal source of deterioration in revenue from this source.

Other Own Source Revenues

In past years generally, by far the largest component of this item has been returns from the electricity sector as dividends and income tax equivalents. As a result of the disposals this item reduces markedly in the future. While projections are provided for the forward estimates period, the remaining electricity assets are to be disposed of in 2000-01. Effectively the only distributions of any consequence are obtained from SA Water Corporation.

SA Water provided $213.6 million in 1999-2000 rising to $219.4 million in 2000-01 but falling to $217.4 million in 2003-04 a real reduction of $17.1 million or 8 percent. Comments on SA Water's contributions to the Budget are provided in Part B of this Report under the section for SA Water.

Other Revenue

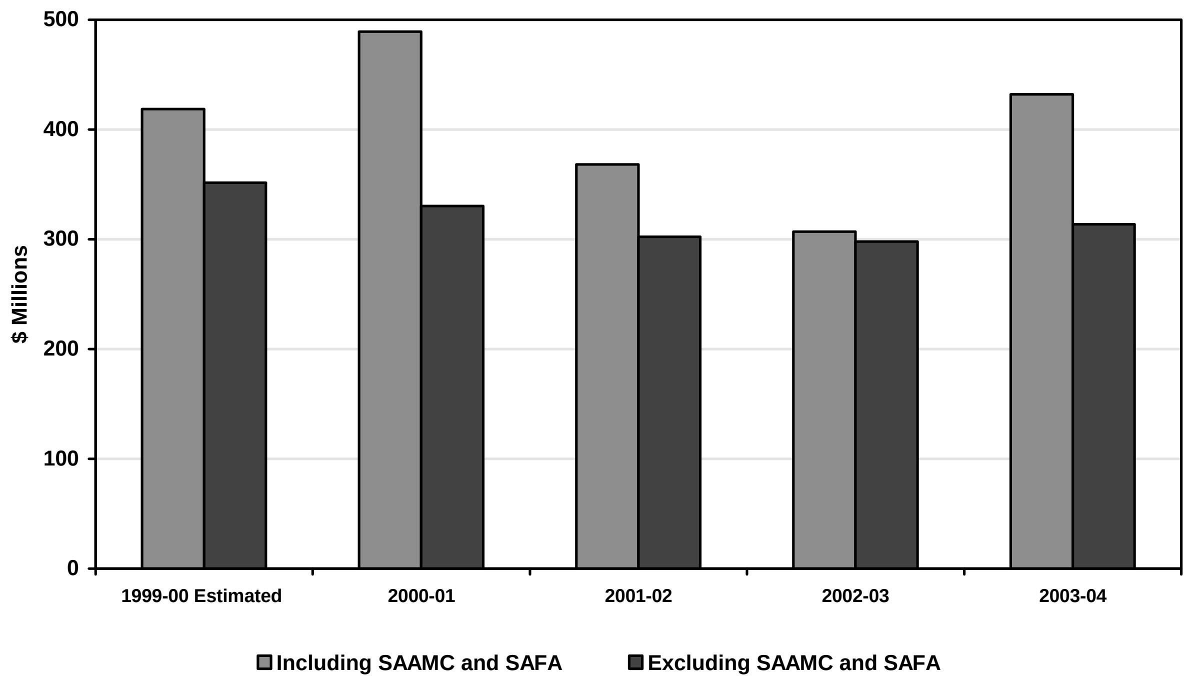
As mentioned, other revenues fluctuate over the forward estimates period due to the lumpy distributions projected from SAAMC and SAFA.

Distributions from these entities have in recent years been estimated to provide large amounts to the Budget but have generally not been required. This is illustrated by the 1999-2000 Budget where $200.6 million was estimated to be received from SAAMC. This entire amount was deferred to 2000-01 and beyond. Over the three years to and including 1999-2000, the actual result has been that $64.2 million has been returned to the Budget from SAFA tax equivalent payments.

In 2000-01 there is a one off benefit of tax equivalents revenue from Funds SA amounting to $18 million and arising from the sale of the Adelaide Casino.

The following chart shows other revenue including and excluding SAAMC and SAFA receipts for the period from 1997-98.

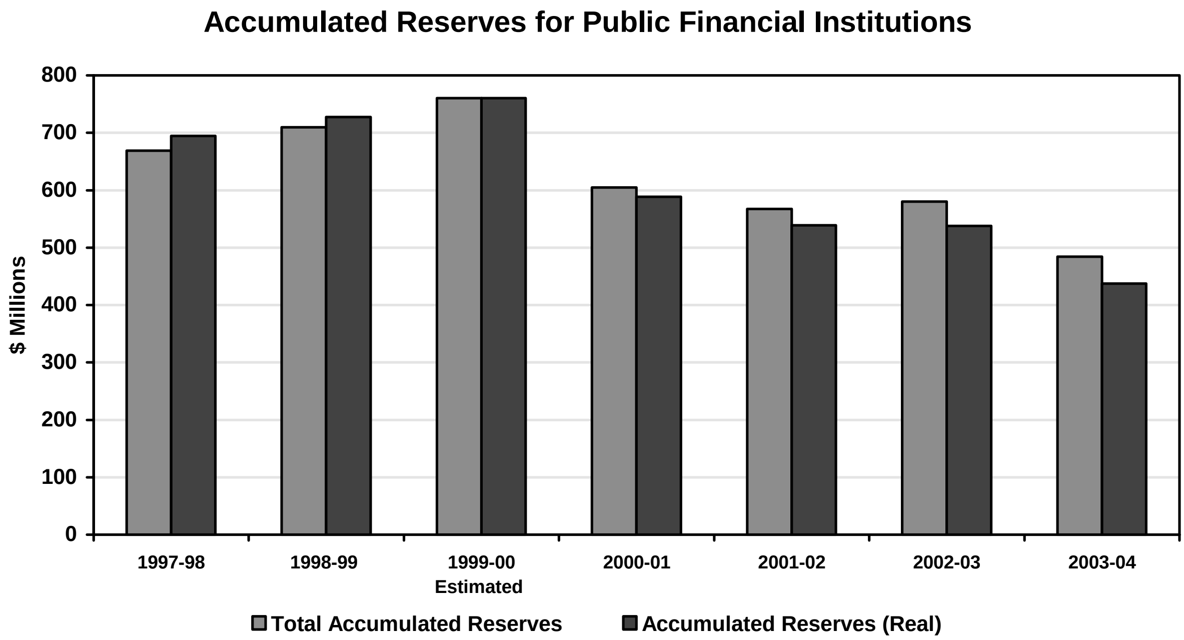
Other Revenue Including And Excluding SAAMC And SAFA Receipts.



The lumpiness of the SAAMC and SAFA contributions are evident. Details of these contributions are clearly shown in the Budget Papers.[39]

Accumulated Reserves for Public Financial Institutions

The following chart, based on data provided by the Department of Treasury and Finance, shows projected accumulated reserves for all of the public financial institutions over the forward estimates period.



The chart indicates that in nominal and real terms, accumulated reserves increased up until 1999-2000, as distributions were continuously deferred, reduce in 2000-01 and are reasonably stable up to 2002-03. The distributions projected in 2003-04 have another substantial negative impact on the total accumulated reserves. They remain, however, in the order of $480 million in nominal terms at that time, down from $604 million in 2000-01.

Commonwealth General Purpose Grants

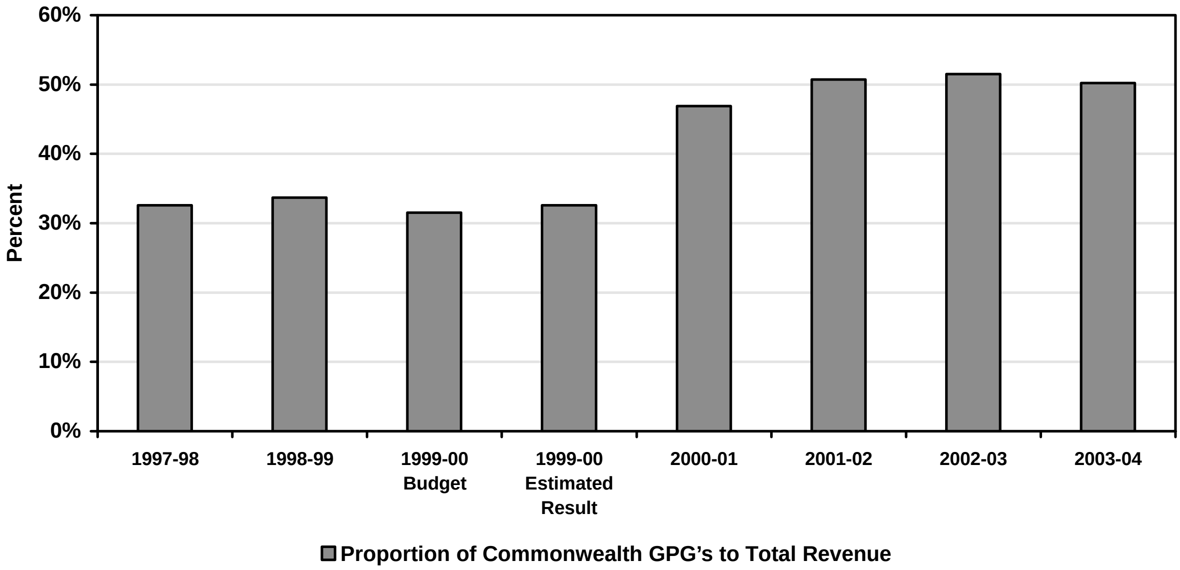
As already mentioned, Commonwealth general purpose grants increase significantly over the forward estimate period, predominantly in 2000-01, as a result of national tax reform arrangements. The increase in nominal terms between 1998-99 and 1999-2000 was 3.4 percent equivalent to a real terms increase of 0.9 percent or $14.5 million. From 1999-2000 to 2000-01 general purpose grants are forecast to grow in real terms by $745 million or 43.5 percent.

[39] Budget Statement 2000-01, Budget Paper 2, Table 5.10.

For the period of the trend analysis from 1997-98 to 2003-04 the increase is estimated to be $1 385 million or 90.6 percent in nominal terms or $1 046 million or 65.8 percent in real terms.

The impact of national tax reform in respect to the State's dependence on the Commonwealth for revenue is demonstrated in the following chart.

Proportion of Commonwealth General Purpose Grants to Total Revenue (excluding SPPs)



Over the period the proportion of Commonwealth general purpose grants to total revenue excluding SPPs increases from 32.6 percent to 50.2 percent. The reliance of the State on Commonwealth funding is apparent. The change can also be influenced by the disposal of electricity asset income, which reduces total revenue. Given the completion of the disposal process in 2000-01 the proportion is likely to marginally increase again after that time.

ELECTRICITY ASSETS DISPOSALS AND THE STATE'S FINANCES

INTRODUCTION

In June 1999 the Parliament passed the *Electricity Corporations (Restructuring and Disposal) Act 1999*[40] (the Act) which provided for the disposal of the State's electricity assets.

That Act also provided that the Auditor-General must, within the period of six months after the prescribed date, prepare a report on:

- the proportion of the proceeds of the sales/leases used to retire State debt;
- the amount of interest on State debt saved as a result of the application of those proceeds.[41]

Pursuant to the Act, the prescribed date is the earlier of the date of the last sale/lease agreement for all prescribed assets or the second anniversary of the date of the first relevant long-term lease. At the time of this Report that specific reporting requirement is some months in the future.

Notwithstanding, the disposal process has been completed for the majority of the electricity assets and the results of those disposals have been enunciated and form part of the 2000-01 Budget.

This section of the Report summarises matters relevant to managing the receipt of the disposal proceeds and the financial effects of the disposal process to date. The commentary covers, an overview of the proceeds received, the use of the proceeds and the net effects, to the extent they are measurable, on the State's finances to the date of this Report. Probity matters in relation to the electricity asset disposals will be dealt with in a separate series of Reports to Parliament.

The commentary seeks to provide relevant details of the results of the disposals to 30 June 2000 and put them in the context of the various financial reports produced within government, ie the Budget, Treasurer's Financial Statements and other financial statements.

Importantly, the legislative reporting requirements are narrow and reflect matters that are measurable. In contrast, an assessment of the overall net outcome for the State is highly subjective given the range of variables involved in projecting the future profits of the entities. The Government has cited a premium figure for the 2000-01 year. This projection has the benefit of relating to the first year that the assets are out of government ownership, that is,

---

40 Assented to 1 July 1999.

41 Section 22 (2) *Electricity Corporations (Restructuring and Disposal) Act 1999*.

the Government could be reasonably confident with its projections. It is perhaps the longer term that will determine the net position of the State and therein, of course, lies the uncertainty.

Clearly, Parliament expects the information on the receipt and application of the disposal proceeds and interest savings to be based on a robust and transparent system of records and calculations that take into account analysis of relevant cash flows and interest rates supported by appropriate systems and/or records. Audit has found that the Department of Treasury and Finance and SAFA maintain appropriate records to produce such information. That information has been used for this Report.

SCOPE OF THIS SECTION

The scope of this section covers the following:

- Progress of Disposals to September 2000
- Net Value of Proceeds from the Disposal of Electricity Assets
- Application of Proceeds — legislative provisions
- Administrative Arrangements
- Application of Disposal Proceeds Received to 30 June 2000
- Estimated Interest Savings
- Effect of the Disposals on the Public Finances
- Conclusions

PROGRESS OF DISPOSALS TO SEPTEMBER 2000

Settlement of the first sale/lease, for ETSA Utilities and ETSA Power, occurred on 28 January 2000. To the date of this Report the following disposals have taken place and the gross proceeds, including stamp duty, received were:

Entity	Date Announced	Date Proceeds Received	Announced Disposal Value $'million	Composition of Value Cash $'million	Super (a) $'million
Disposals in 1999-2000					
ETSA Utilities/ETSA Power	11 Dec 1999	28 Jan 2000	3 500	3 406.0	94.0
ETSA Power (b)	14 Jan 2000	28 Jan 2000	25	25.0	0
Optima Energy	4 May 2000	6 June 2000	315	295.0	20.0
Synergen	11 May 2000	6 June 2000	39	35.6	3.4
Total for 1999-2000			3 879	3 761.6	117.4
Disposals in 2000-01					
Flinders Power (c)	3 August 2000	8 September 2000	465	313	31
ElectraNet	20 September 2000		938	926	12
Terra Gas Trader (d)			n/a	n/a	n/a
			1 423	1 239	43

(a) Represents unfunded superannuation liabilities transferred to private operators.
(b) Onsold with disposal proceeds greater than $150 million reverting to the State.
(c) Total value includes $121 million projected liabilities taken over by lessee.
(d) Final bids received and assessed with no decision at the time of this Report on disposal.

NET VALUE OF PROCEEDS FROM THE DISPOSAL OF ELECTRICITY ASSETS

Before disposal, the net value of the electricity assets to the State was represented by the difference between the value of assets and liabilities as reflected in the accounts of the entities. In the disposal process certain assets and liabilities were retained by the State and the balance exchanged for the disposal proceeds. In the Whole-of-Government Financial Statements, discussed later, the net result of the disposals will be reflected as the difference between the net value of physical and other assets previously owned by the State and the cash proceeds received for those assets.

Readers will be more familiar with the announced proceeds than the accounting result. It is in relation to the proceeds that there is an expectation of debt reduction. The following table sets out, in relation to the disposals completed in 1999-2000, the detail of any of assets and liabilities retained by the State before disposal and the disposal proceeds. This aims to assist readers with the determination of the net value to the State of all the assets and liabilities held in relation to the electricity entities after the disposals were completed.

Estimation of Net Value of the Proceeds from Electricity Asset Disposals
As at 30 June 2000

	$'million	$'million
Announced value of proceeds from disposals		3 879.0
Less: Retained electricity entity liabilities		
Debt (a)	681	
Unfunded superannuation	67	
		748.0
Net Value (b)		3 131.0
Less: Value of unfunded superannuation liabilities transferred to private operators		117.4
Net Value available to cover other State liabilities		3 013.6

(a) This is the estimated market value of debt retained. The carrying or book value was $620 million.
(b) Includes unfunded superannuation liabilities to be transferred to private operators.

The table shows that the net value of the electricity asset disposals to 30 June 2000, that is, the change in financial assets after the disposals, is estimated to be $3 013.6 million. To this extent the State has covered the market value of any retained net liabilities prior to the disposal of the electricity entities. That is, this is the amount available to cover State liabilities other than for disposed of electricity entities. It should be noted that this amount is derived after allowing for the amount of $117.4 million being the value of unfunded superannuation liabilities transferred to private operators. That amount was not cash proceeds but has the effect of reducing the State's unfunded superannuation liabilities.

The amount of $3013.6 million is not, however, the amount that will be referred to in relation to debt retirement. A higher amount based on cash proceeds ($3761.1 million at 30 June 2000) net of allowable costs is used for that purpose. There are two reasons for this. Firstly, the debt retained (except for notional amount as explained below) was included in net debt calculations in past years — the gross proceeds are applied to that debt. Secondly, the cash proceeds were not used to fund the retained unfunded liabilities.

Retained Debt

As can be seen from the table, prior to disposal, debt with an estimated market value of $681 million was transferred to the Treasurer. The book value of this debt was $620 million. This debt was included in the calculation of net debt in past years (in the net debt of public non-financial corporations). An amount of $61 million was notionally added to the debt for the purposes of this presentation and for determining net interest savings.[42] The additional amount reflects the fact that interest rates for the debt exceeded market values at the time of transfer. This debt, will now be serviced by the non-commercial sector. If retired early, then as with any debt, to the extent that the interest rates on that debt exceed market rates, accounting losses will be incurred.

Retained Unfunded Superannuation Liabilities

The table also shows that the State retained unfunded superannuation liabilities to the value of $67 million. This liability represents superannuation obligations to former employees of the electricity entities who had ceased employment before the disposals occurred. These unfunded liabilities were previously included in the calculation of unfunded liabilities and consequently, the balance of unfunded liabilities is not increased. However, because this liability would have been previously met by the electricity entities, it was not included in the Government's program for funding past superannuation liabilities. The funding program has accordingly been increased.

Assessing the Net Financial Position

The relevance of the table is to indicate that proceeds are to a degree offset by retained liabilities in assessing the net position from the disposal of the electricity assets. The position is not that the State has exchanged its electricity businesses for $3.9 billion but has retained some liabilities of those businesses for a net position after covering all electricity entity liabilities of $3.01 billion. If the State had transferred the liabilities to the private operators, the price received would have been reduced by the amount of the liabilities — that is, the result would have been the same. As mentioned, later in this section a comparison of the reported whole-of-government financial position is discussed.

APPLICATION OF PROCEEDS — LEGISLATIVE PROVISIONS

The Treasurer must apply the proceeds from the disposal of electricity assets according to the provisions of the Act. Key provisions of the Act are as follows:

> *(1) The Treasurer may only apply proceeds of a sale/lease agreement under this Act as follows:*

---

[42] The Department of Treasury and Finance incorporated this adjustment, and Audit considers correctly so, in the figuring to estimate interest savings.

(a) in payment of an amount equal to any payment made by an electricity corporation, or a body by which assets or liabilities have been acquired under a transfer order, on the termination or surrender of a lease entered into before 17 November 1998;

(b) in payment of the costs of restructuring and disposal of assets of electricity corporations and preparatory action taken for that purpose;

(c) in payment to an account at the Treasury to be used for the purposes of a scheme to limit differences between electricity prices charged to classes of consumers in non-metropolitan areas and those charged to corresponding consumers in metropolitan areas.

(d) in payment to an account at the Treasury to be used for the purposes of retiring State debt.

(2) Any income from investment of money paid into an account at the Treasury under subsection (1) must be applied for the purposes of retiring State debt.

(3) An amount paid by way of security will not be regarded as proceeds of a sale/lease agreement for the purposes of this section.[43]

Details of application of the proceeds follow in this section of the Report.

ADMINISTRATIVE ARRANGEMENTS

To assist with the administration of the application of proceeds in accordance with the requirements of the Act, the Department of Treasury and Finance established special deposit accounts as follows:

- ***Electricity Reform and Sales Operating Account*** — an existing account, the purposes of which were amended, to allow proceeds from disposals to be credited to the account and applied to any of the legislated applications including transferring proceeds to the Electricity Sale/Lease Proceeds Account.

---

[43] Section 21 *Electricity Corporations (Restructuring and Disposal) Act 1999*. The remaining provisions of that section are:

(4) An electricity corporation must, if the Treasurer so directs, make a specified payment to the Treasurer.

(5) A State-owned company must, if the Treasurer so directs, make a specified payment to the Treasurer.

(6) The Minister must establish, maintain and operate a scheme (funded initially by the account referred to in subsection (1) (c) and subsequently by money appropriated for the purpose) for the purposes of ensuring that the electricity price charged to any small customer who is supplied electricity through the transmission network in South Australia, but not generally through a metropolitan transmission network connection point, will not exceed 101.7% of the electricity price charged to a corresponding small customer, with the same levels and patterns of consumption, who is generally supplied through a metropolitan transmission network connection point.

- ***Electricity Sale/Lease Proceeds Account*** — an account established to receive disposal proceeds and interest earned on those proceeds and to apply those monies toward the retirement of debt.

Both accounts may be credited with disposal proceeds but credits in the Electricity Sale/Lease Proceeds Account may only be used for debt retirement. Both accounts are interest bearing to comply with section 21(2) of the Act.

The separate purposes of the accounts assist in recording and reporting the use of proceeds for authorised purposes. This will assist in meeting the information requirements of the Act from the time of receipt of any proceeds to their application.

APPLICATION OF DISPOSAL PROCEEDS RECEIVED TO 30 JUNE 2000

Proceeds from disposals were first received on 28 January 2000, the date the first lease took effect. Accordingly, Audit reviewed the application of the proceeds to ensure:

- the application of proceeds is in compliance with the provisions of the Act;
- the reporting provisions of the Act for the Auditor-General are able to be met.

In summary, the application of proceeds to 30 June 2000 was as follows:

	$'million
Gross cash proceeds	3 761.6
Less: Adjustments (a)	0.5
Gross cash proceeds actual	3 761.1
Less: Application for purposes other than debt retirement	191.8
Available for application to debt retirement	3 569.2
Add: Return of Stamp Duty	103.9
Total available for debt retirement before interest income	3 673.2

(a) Adjustment for motor vehicles and onsold costs of ETSA Power.

The following provides details on the application of the proceeds.

Application of Gross Proceeds to Purposes Other Than Debt Retirement

As indicated in the preceding table, the gross cash proceeds from asset disposals to 30 June 2000 amounted to $3761.1 million. None of the proceeds represented security deposits for the purposes of section 21(3) of the Act. The following table sets out details of applications of proceeds to purposes other than debt retirement.

Entity Disposals in 1999-2000	Stamp Duty $'million	Retained for Operating Costs (a) $'million	Disposal Costs — Entity Specific $'million	Total $'million
ETSA Utilities/ETSA Power	103.9	67	11.7	182.6
Optima Energy	6.0	-	0.7	6.7
Synergen	2.0	-	0.5	2.5
Total for 1999-2000	111.9	67	12.9	191.8

(a) Includes estimated operating costs of Electricity Reform and Sales Unit of $65.7 million.

Stamp Duty

Gross proceeds for each of the disposal transactions to 30 June 2000 included amounts to provide for stamp duty. Stamp duty is a State tax rather than disposal proceeds and the law requires the receipts to be credited to the Consolidated Account. Of the three disposal transactions only the first, ETSA Utilities/ETSA Power, had been assessed for stamp duty before 30 June 2000. In 1999-2000 the Government subsequently made a payment of $103.9 million, equal to the assessed stamp duty, from the Consolidated Account to the Electricity Sale/Lease Proceeds Account for the purpose of debt retirement. The Department of Treasury and Finance has advised that the same approach is to be adopted for the other asset disposals as and when they are assessed. The amounts in the table were amounts set aside in the Electricity Reform and Sales Operating Account as a provision for stamp duty.

Operating and Disposal Costs

Funds have been provided from the cash proceeds to cover the operating costs of the Electricity Reform and Sales Unit (ERSU) and other disposal costs. Detailed commentary on ERSU's activities and expenses is provided in Part B of this Report. The following briefly summarises the operating and disposal costs.

Operating Costs

ERSU was established to administer the reform and disposal of the State's electricity assets. Its principal costs are payments of consultant's fees for those consultants involved in this process over the three years to 1999-2000. Total costs over the two years to 30 June 2000 were $90.8 million.

In relation to the disposal of ETSA Utilities/ETSA Power, the Treasurer authorised $65.7 million be retained by ERSU to finance its operating costs.

Disposal Costs

Total disposal costs incurred by ERSU in 1999-2000 amounted to $22.2 million. Of this $12.9 million related directly to the three entities in the preceding table. The principal disposal cost related to the purchase of leased vehicles, which for all three entities amounted to $12.4 million. This related to the cost of acquiring vehicles from a lessor to allow transfer of the vehicles to the new operators. Other disposal costs were for director's completion fees and for retention fees.

Monies Retained by ERSU

Monies have been retained in the Electricity Reform and Sales Operating Account to meet these payments and any balance not so used will be used for debt retirement. As mentioned, details of the preceding are set out in Part B of this Report in the section for the Electricity Sales and Reform Unit.

No funds had been set aside as at 30 June 2000 for the purposes of sections 21(a) and (c) of the Act, that is, for the termination or surrender of a lease entered into before 17 November 1998 or for the purposes of a scheme to limit differences between electricity prices charged to classes of consumers in non-metropolitan areas and those charged to corresponding consumers in metropolitan areas.

Net Proceeds Applied to Debt Retirement

It is first necessary to observe that as net debt simply represents the difference between various financial assets and liabilities, as soon as proceeds from electricity assets are received the State's net debt position is changed. This does not however imply that proceeds are immediately applied to the retirement of particular debts. To understand the overall process of debt retirement it is necessary to briefly address the management process for applying proceeds to debt retirement.

Preparation for Debt Retirement

Following the original announcement of proposed asset sales in February 1998, there was the expectation of receiving some billions of dollars of proceeds from asset disposals. The Department of Treasury and Finance, together with the Government's primary debt management agency, the South Australian Government Financing Authority (SAFA), planned for the orderly and managed retirement of debt.

In relation to planning for the receipt and application of proceeds actions including the following were undertaken.

Foremost was the clear establishment of the meaning of State debt as referred to in section 21(1)(d) of the Act. While it might at first appear that this would be unnecessary, as debt has a normally accepted meaning, there are generally accepted practices within governments and financial markets that warranted such clarification. For example, there are debts between agencies of government, there are statistically based definitions of debt that exclude certain sectors and there is the use of derivatives in managing debt in a variety of ways which may or may not have been regarded as being debts for the purposes of the Act.

The Crown Solicitor provided advice on this matter in September 1999. A number of observations from that advice were:

> *… a termination payment (of derivative transactions) is within the purposes of section 21 (1) (d)*
>
> *Internal transactions between State agencies do not create or retire State debt.*
>
> *There is no requirement in section 21 … that the proceeds must be immediately used to retire debt. … The inference is that funds will be kept in the account for a period and will accrue interest. … It will be possible to adopt an orderly and managed strategy for the retirement of State debt.*
>
> *… that the strategy must be directed towards the end result of retirement of debt. It cannot simply be an investment strategy which will achieve the best financial result for the State.*
>
> *The concept of retirement of debt involves particular debts being repaid …*

On the basis of this advice, debt is defined as the Government's indebtedness to external third parties and includes derivative transactions relating to that debt.

Given that the proceeds need not be immediately used to retire debt, it was also appropriate for an orderly debt retirement strategy to be adopted. SAFA adopted a strategy that included:

- hedging the disposal proceeds by appropriate derivative transactions to ensure compliance with the State's existing debt policy benchmark duration. While adopting the existing policy duration, work also continued in relation to identifying a duration target relevant to the State's changed circumstances, that is, the receipt of very large disposal proceeds. This had commenced in 1998-99 and progress on that matter was summarised in my last Report.[44] This is also discussed in the section of this Part titled 'State Debt';
- a physical debt retirement program principally of maturing debt, some targeted early redemption and the balance of proceeds invested to meet future liability maturities.

Prior to the assets disposal process, SAFA had a maturity profile that would see a large amount of debt maturing subsequent to the estimated timing of receipt of proceeds. This would enable debt retirement to occur easily with the predominant strategy being for

44 Auditor-General's Report 1999, Part A.2, pp. 63-65.

maturing debt simply to be repaid. To the extent that proceeds are not needed to retire debt they remain invested according to set guidelines.

Debt Retirement

The total amount deposited to the Electricity Sale/Lease Proceeds Account for debt retirement as at 30 June 2000 was $3.7 billion. The composition of this amount is set out in the following table.

Description	$'million
Net proceeds after applications for other purposes	3 673.2
Interest earned	31.9
Total available for debt retirement	3 705.1

As can be seen interest earned on proceeds invested to 30 June 2000 and deposited in the account, as required under section 21(2) of the Act, amounted to $31.9 million. This represents the cash transfers to the account to that date and further amounts are accrued as at 30 June 2000.

The application of net proceeds to debt retirement and balance of proceeds to 30 June 2000 was:

	Number of Deals	Principal $'million	Total $'million
Total available for debt retirement			3 705.1
Debt retirement — natural maturity	113	1 993.3	
Debt retirement — early retirement	129	426.9	
Total debt retirement			2 410.2
Balance of proceeds at 30 June 2000			1 294.9

As indicated, total physical debt retirement amounted to $2 410 million. Some early retirement of debt ($427 million) took place as was determined by SAFA to be to the advantage of the State. The difference between the carrying (book) value and market value on early retirement shows as gains or losses on debt retirement. The early retirements incurred book losses of $17.3 million. This amount is included in the total value of early retirement. Generally, debt will be repurchased prior to maturity where yields are higher or equivalent to those derived by reference to SAFA's domestic funding cost. That is, higher than market interest rate debt may be retired to reduce the ongoing average interest cost of remaining debt.

As at 30 June 2000 an amount of $1 295 million had not yet been applied to debt retirement and remained invested. Audit understands that the remaining proceeds are expected to be fully utilised by the end of calendar year 2000.

ESTIMATED INTEREST SAVINGS

There are two time frames for calculations of interest savings that are of interest at the time of this Report namely:

- estimated savings achieved on proceeds for the 1999-2000 financial year — based on estimated net proceeds from asset disposals in the year and market interest rates applying for the relevant period;
- estimated savings for the 2000-01 Budget — based on projections of both total proceeds available for debt retirement and interest rates relevant to the budget period.

These are discussed in turn in this section. It should be noted that all estimates will be reviewed once the asset disposals are finalised and all actual data can be concluded.

It is also important to emphasise that interest saving calculations will be reflected in the whole-of-government interest payments to the private sector and in the Budget Papers. These two sets of data may show some variation because they are based on different factors.

Net interest payments to the private sector reflect the current interest costs on external borrowings less earnings on external investments.

Interest payments in the Budget reflect net payments from the non-commercial sector to SAFA on borrowings from SAFA. This is discussed later under the heading 'Indebtedness of the Treasurer'.

The following table gives an indication of the changes to estimated net interest payments from the non-commercial sector over the four years to 2001-02 as presented in various Budget Papers.

It is important to note that all of the following analysis excludes any effect from asset disposals after 30 June 2000 consistent with the 2000-01 Budget approach.

Changes to Estimated Net Interest Payments

	Net Interest Payments $'million	Change $'million
1998-99 actual	539	
1999-2000 budget (no asset disposals) (a)	544	
1999-2000 estimated result (b) (c)	460	(79)
2000-01 budget (b)	347	(113)
2001-02 estimate (b)	251	(96)

(a) In 1999-2000 Budget.
(b) In 2000-01 Budget.
(c) Change for 1999-2000 estimated result is from 1998-99 actual.

As is evident, interest payments are expected to reduce significantly each year to 2001-02. As indicated on the table, net interest payments for 1999-2000 were $84 million lower compared to the 1999-2000 Budget amount of $544 million. This was due mainly to an allowance for savings arising from asset disposals.

The reasons for the decreases are as follows:

- 1999-2000 reflects the part year effect of the receipt of proceeds offset by the effect of internal transfers of debt from the electricity businesses to the Government before disposal as described under the earlier heading 'Progress of Disposals to September 2000';

- 2000-01 reflects the full year effect of the receipt of proceeds and their application to debt retirement offset by a projected 2.3 percent increase in the average non-commercial sector net interest rate cost to the Government. The Government is charged the Common Public Sector Interest Rate (CPSIR), which is the average net cost of borrowings[45] to finance the Government's loans from SAFA. The Government also receives interest income based on rates relevant to the deposits. The net of these is the average net interest rate cost and is projected to increase in 2000-01 because of an increase in interest rates[46] and because the majority of borrowings retired in 1999-2000 approximated current market rates leaving a larger proportion of higher yield debt than in the past thereby increasing the average rate;

- the reduction in 2001-02 primarily reflects a projected 3 percent decrease in the non-commercial sector net interest rate cost (as explained above), the balance of debt is not projected to be significantly different from the previous year. This decrease in the average interest cost is due partly to additional debt retirements of high yield debt in 2000-01.

The reduction in net interest payments over the four years from 1998-99 is estimated to be $288 million or 53.4 percent.

Estimated Interest Savings 1999-2000

The interest saving for 1999-2000 is estimated to be $77.2 million. This amount is determined by the following calculation.

---

[45] The CPSIR is essentially the net interest cost, ie the difference between interest expense and interest income, divided by the average principal outstanding. It also includes a margin for SAFA's costs.

[46] Budget Statement 2000-01, Budget Paper 2, p. 2.9.

Disposals in 1999-2000 Entity	Date of Proceeds	Net Cash Proceeds (a) $'million	Interest Rate (b) Percent	Interest Saving (c) $'million
ETSA Utilities/ETSA Power	28 Jan 2000	2 671	6.725	75.8
Optima Energy	6 June 2000	294	6.420	1.2
Synergen	6 June 2000	36	6.420	0.2
Total for 1999-2000		3 001		77.2

(a) Proceeds net of costs and assumed debt. See discussion later.
(b) Average interest rate for the 1999-2000 year.
(c) Interest saving for the part year.

The interest rate used for ETSA Utilities/ETSA Power is determined as the month end average market interest rates applying to debt of SAFA's average maturity and credit rating, ie SAFA's estimated average prevailing borrowing cost for its 2.8 year benchmark modified duration portfolio.

Due to the short time frame for the other entities a daily average was used.

The monthly average will be used for future reporting on estimated actual interest savings. While this approach does not provide absolute precision in the calculation of interest savings, it is not considered to lead to materially inaccurate information and is administratively efficient. For example, information as to particular debt maturing or being repurchased is not required. The approach is supported by the fact that any transaction with the financial markets will be based on prevailing market rates. As such, renewal of a maturing debt or early redemption of debt will be based on current market rates.[47] By having the proceeds from asset sales available to repay debt, the State is avoiding paying those prevailing rates.

Estimated Interest Savings for the 2000-01 Budget

Interest savings in relation to the proceeds have been estimated in the Budget as $210 million.

This saving requires an estimation of a projected interest rate for the 2000-01 financial year and applying that rate to the net proceeds from disposals.

[47] Examples are (1) If the State had debt with an interest rate of 10 percent maturing on 30 June 2000 and prevailing rates were 6 percent, the interest avoided is 6 percent. (2) If $1 million of debt with an interest rate of 10 percent and two years to maturity was repurchased at 30 June 2000 ie before maturity, with prevailing rates of 6 percent, it would cost $1.07 million to repurchase that debt, a loss of $70 000. The saving is therefore not the 10 percent interest cost but an amount reduced by the loss on repurchase — the net saving will equate to the current market interest rate of 6 percent.

Net Proceeds

Net proceeds is determined as the following:

	$'million
Gross cash proceeds	3 761.6
Less: Application for purposes other than debt retirement	191.8
Available for application to debt retirement	3 569.8
Add: Return of stamp duty	111.9
Total available for debt retirement	3 681.7
Less: Market value of retained debt	681
Total available for debt retirement before interest income	3 000.7

As discussed earlier, debt retained by the Government is at book values. To determine the net saving, however, it is necessary to adjust for the market value, as savings are determined on a market value basis. On the assumption that stamp duties will be used for debt reduction the amount includes all stamp duties rather than just the amount in relation to ETSA Utilities/ETSA Power. All data will be reviewed again after all disposals are complete.

Projected Interest Rate

The projected interest rate for the 2000-01 financial year is 7 percent and was determined by the Department of Treasury and Finance's interpretation of market information.

With the passage of time it will be possible to assess the actual savings based on actual interest rates as indicated previously.

EFFECT OF THE DISPOSALS ON THE PUBLIC FINANCES

The disposal of the electricity assets affects the State's finances and financial position in a number of ways. These may be categorised as:

- Change in operating results
- Structural change in financial position
- Presentational change in financial position.

These are considered in turn.

Change in the State Public Sector Operating Result

Net Benefit from Electricity Asset Disposals

The net benefit from completed electricity assets disposals is estimated in the 2000-01 Budget as $109 million for 2000-01.[48] This net benefit is determined as the difference

[48] Budget Statement 2000-01, Budget Paper 2, p. 2.10.

between estimated interest savings of $210 million as discussed previously and dividends, taxes, other distributions etc foregone in that year estimated to be $101 million.

Comments on the estimated interest savings were made above.

In relation to the estimation of revenues forgone, in past Reports I have indicated that in assessing a premium on asset disposals there can be a difference between an assessment based on the non-commercial sector Budget position and the whole-of-government position.

The former is interested only in whether the data included in the Budget projections vary to generate a net improvement. Revenue estimates are discretionary distributions of the profits of entities and amounts due under tax equivalent arrangements. To the extent that interest savings outweigh foregone revenue estimates, there is an improvement.

On a whole-of-government basis the interest savings would need to exceed the annual operating results before interest and tax equivalents of the entities. If Budget distributions were 100 percent of that amount the premium calculation is unaffected by the calculation method. If less than 100 percent of profits were distributed, a premium calculation on Budget distributions would be overstated.

The premium calculation for the electricity assets disposals is based on Budget distributions ie tax equivalents and dividends as projected in the 1999-2000 Budget. Information for 2000-01 on the profits of the electricity assets is not and will not be available and cannot be used for the estimation of the premium.

The estimates were as follows:

Distribution Foregone in 2000-01

Entity	**Estimated Distributions $'million**
ETSA Power	96.6
ETSA Utilities	109.1
Synergen	1.2
ElectraNet	6.0
Total distributions	212.9
Less Power Bill Levy (a)	112.0
Distributions foregone	100.9

(a) Proposed in the 1999-2000 Budget.

The Department of Treasury and Finance has indicated that since ElectraNet was not disposed of in 1999-2000, that revenues foregone were overstated for the ElectraNet payment of $6 million. The effect of this is to understate the premium by that amount.

The Department of Treasury and Finance now estimate distributions foregone at $94.9 million and the premium for 2000-01 to be $115 million.

Change in Contributions from Electricity Businesses

It is of interest to note the change in contributions received from the electricity businesses since 1995-96 as credited to the Consolidated Account or otherwise met by those businesses. The following summarises the position. Data for 1999-2000 has been omitted as it is influenced by actual assets disposals.

Receipts to the Consolidated Account comprise dividends, taxation equivalents and the Statutory Sales Levy that was in place until 1997-98. Other amounts include interest and restructuring costs. At the time the Statutory Sales Levy ceased, debt restructuring resulted in additional debt servicing costs being met by the electricity businesses to offset the loss of the levy revenue to the Budget that is, the change was Budget neutral.

Change in Contributions from Electricity Businesses

Year	Consolidated Account Amounts $'million	Other Amounts $'million	Total Amount $'million
1995-96	235.8	36.3	272.1
1996-97	212.2	71.9	284.1
1997-98	273.3	83.9	357.2
1998-99	172.0	112.9	284.9
2000-01 estimate (a)	150.6	n/a	150.6

(a) Excludes Power Bill Levy and other amounts. Of this amount $94.9 million related to entities disposed of in 1999-2000.

The actual receipts varied from year to year with a peak in 1997-98. The amount estimated for 2000-01 was the lowest over the period noting that no 'other amounts' value has been included for that year. The electricity businesses certainly would have met interest payments if owned by the Government. Based on loans in 1998-99 from the South Australian Government Financing Authority this would have been in excess of $50 million suggesting that a total contribution for 2000-01 would have exceeded $200 million when comparing to the other amounts in the table. This also excludes any restructuring costs. The projected reduction in receipts is consistent with expectations of reduced contributions because of the assumed industry changes following the introduction of the National Electricity Market. Contributions are also discussed in Part B of this Report on the Electricity Supply Industry.

It should be noted that in relation to the estimated premium from electricity assets disposals discussed earlier, that estimation allows for the effect of retained debt as discussed under the heading 'Net Proceeds'.

Earlier Commitment of Premium

It is important to note that as stated in the past two Auditor-General's Reports, a premium from electricity assets disposals of $100 million was built into the forward estimates in the 1998-99 Budget.

The revised estimated premium of $115 million would realise the $100 million premium anticipated in the 1998-99 Budget (1998-99 Budget Paper 2 page 1-4) for 2000-01. As noted at page 2.10 it also 'compares favourably' with the abandoned power bill levy. Audit observes that prima facie, to the time of the 2000-01 Budget there is a small benefit, ie $15 million, not previously built into the forward estimates. As the estimated premium is a projection it is yet to be tested by actual outcomes that can be determined after 2000-01. Further, the revenues foregone can of course never be ascertained.

Should future premiums arise from other disposals, these would provide a new funding source for future Budgets.

Structure of the State's Financial Position

The disposals substantially change the structure of the State's financial position by allowing risk avoidance in the followings key ways.

The former assets were primarily plant and equipment, earning revenues from sales of electricity. Those assets were subject to uncertainties in regard to factors such as capital maintenance and replacement requirements, technological change etc. Those assets were exchanged for cash.

The businesses were entering a new market environment. The risks of competing in that environment with the subsequent risks to revenues and profits, are avoided but the offset is that the opportunity to earn revenues and profits is also eliminated and the State has a limited own source revenue raising base.

Public sector net debt has been reduced by about 45 percent and the State has a far reduced debt management risk in particular outright interest rate risk. This fact is clearly shown in the various debt burden indicators for the State. These are discussed in detail in the section of this Part of the Report titled 'State Debt'. Following the announcement of the first electricity assets disposals in December 1999, the State achieved an improved credit rating to AA+.

Ownership of assets operating in a competitive environment ultimately requires an assessment and management of risks and returns. The State has avoided this risk through the disposal process.

Presentational Change in Financial Position

The Whole-of-Government Statement of Financial position as at 30 June 1999 showed total net assets for the State of $10.5 billion. This included the net value of the electricity businesses. The position for the year ended 30 June 2000 had yet to be determined at the time of this Report.

Notwithstanding, the following table estimates the changes arising for the electricity assets disposals to 30 June 2000.

Entity (a)	**Proceeds $'million**	**Book Value of Net Assets $'million**	**Book Profit on Disposal $'million**
RESI Utilities Pty Ltd	184.4	148.1	36.3
Distribution Lessor Corporation	2 704.3	2 069.6	634.7
RESI Power Pty Ltd	161.7	(5.7)	167.4
RESI OE Pty Ltd	7.5	(2.2)	9.7
RESI SYN Pty Ltd	(0.2)	(2.0)	1.8
Generation Lessor Corporation	315.1	116.9	198.2
Total	3 372.8	2 324.7	1 048.1

(a) Entity names as at 30 June 2000

In addition, proceeds of $276.2 million were received with respect to future operating lease rentals relating to land with a book value of $30.8 million. The lease revenue will be brought to account over the life of the lease.

As can be seen from the table, the change in the recorded net asset position of the State was a gain of $1 048.1 million to 30 June 2000. It is expected that a gain on disposal of non-current assets of this order will be reflected in the Whole-of-Government Financial Statements for the period ending 30 June 2000. The amounts previously referred to in relation to retained liabilities will not affect the Statement of Financial Position as they are internal transfers between government entities.

Treasurer's Indebtedness

The commentary has identified the amounts available for and applied to debt retirement. In the section in this Part of the Report titled 'State Debt' commentary is provided on changes in the State's reported net debt figure including the major reduction resulting from the receipt of proceeds from the electricity asset disposals.

Within the public sector, indebtedness of the Treasurer to SAFA is reported in the Treasurer's Financial Statements in Statements I and J.

Statement J sets out changes in the Treasurer's indebtedness for the 1999-2000 year as follows:

	$'million	$'million
Balance at 30 June 1999		7 248
Add: Consolidated Account borrowing in 1999-2000	218	
Add: Assumption of electricity entity debt	620	
Add: SAFA book gains/losses (net)	187	
Less: Repayment of borrowings	2 410	
Less: Other minor adjustments (net)	10	
Net Decrease		(1 395)
Balance at 30 June 2000		5 853

The repayment of borrowings and the retained electricity entity debt already discussed herein are evident in the table.

The other addition to the Treasurer's Indebtedness of relevance in this commentary is the amount of $187 million (rounded)[49] SAFA book gains/losses. As disclosed in SAFA's annual financial statements and Statement J, book gains/losses incurred by SAFA from debt management transactions are recovered through an adjustment to the Treasurer's debt level. Commentary in Part B of this Report in the section for the SA Government Financing Authority addresses this result. In summary, the book losses are associated with the unwinding of existing debt and derivatives as a consequence of the receipt of proceeds from the disposal of the electricity assets. The book losses reflect the realisation of differences between the historical cost of borrowings and derivatives and current market values.

The receipt of the very large proceeds would have caused an increase in the age duration of State debt in contravention of the Treasurer's approved existing policy. To comply with the policy requirements, SAFA entered into financial transactions to hedge the proceeds. As debt matured or was retired early, and the debt portfolio restructured, SAFA progressively unwound this and other deals to remain within the approved policy. The restructuring process required the realisation of existing book losses of $186.9 million reflecting differences between book values and market values.

Did the State Receive a Fair Price?

With the uncertainty that goes with disposing of assets in a newly operating competitive market, I have observed that it is difficult to conclude with accuracy on the net effect on the State's finances.

In the disposal process, procedures are aimed to achieve the best price by restructuring agencies to enhance their value to a purchaser and maximising competition in the bidding process. The State also determines a range of values that it considers a fair value for the

[49] Actually $186.9 million.

assets. The principal objectives of the disposal process, as outlined in the Bidding Rules, were to maximise the proceeds available to reduce State debt and minimise the State's exposure to the risks of participating in the electricity supply industry following the introduction of the National Electricity Market.

Business Valuations

In each of the electricity assets disposals to 30 June 2000 ranges of values were established prior to the receipt of final bids based on discounted cash flow analysis. The analysis estimated the value of the businesses. As with any such valuation, they were derived using a range of discount rates reflecting the risks of operating the assets in the private sector and making relevant assumptions underlying revenues. These valuations were advised to Cabinet at the time of seeking approval to enter into lease/sale agreements.

The proceeds achieved were within or exceeded those ranges for the two largest disposals. In relation to the remaining disposal, the final bid was below the minimum in the valuation range. In that case the Evaluation Committee examined whether the State was justified in disposing of the business. Ultimately the bid was accepted by the Treasurer on advice that it was the best available price offered in a competitive process and in accordance with the State's benchmark risk position.

Overall, because of the results for the two major disposals, the State had virtually achieved the upper limit of the estimated total valuations of the assets.

The probity process is critical to the competitive bidding process. As mentioned, audit review of the probity process is subject to separate reporting.

CONCLUSIONS

The Proceeds of Disposals and the Application of those Proceeds

Electricity asset disposals to 30 June 2000 have achieved announced disposals values totalling $3 879 million. After adjustment to take account of retained liabilities from the electricity entities and non-cash transfers to the private sector of unfunded superannuation liabilities, $3 014 million was available to meet State liabilities other than those relating to disposed of electricity entities. However, as the retained liabilities are already included in the State's net debt figures, the gross proceeds less the cost of disposal will therefore reduce net State debt.

Gross cash proceeds (that is not adjusted for retained liabilities) were $3 761 million.

Appropriate records and systems are in place to facilitate final reporting as required by Parliament of:

- the proportion of the proceeds of the sales/leases used to retire State debt;
- the amount of interest on State debt saved as a result of the application of those proceeds.

To 30 June 2000 the application of the gross cash proceeds included $191.8 million for stamp duty, operating and disposal costs. The Government has determined to use the stamp duty receipts for retirement of debt and to 30 June 2000 had appropriated $103.9 million for this purpose.

Proceeds including interest set aside in a special deposit account to 30 June 2000 specifically for debt retirement amounted to $3 705 million. Physical debt retirement to 30 June 2000 was $2 410 million. The balance of the account at 30 June 2000 was $1 295 million.

Estimated Interest Savings and the Estimated Premium

Estimated interest savings to 30 June 2000 arising from electricity asset disposals amounted to $77.2 million. It is estimated that savings in 2000-01 will be $210 million excluding the effects of any further completed disposals in 2000-01.

The estimated net benefit or premium on disposal of electricity assets to 30 June 2000 was $115 million of which $100 million had been built into the forward estimates in the 1998-99 Budget. Again this excludes the effects of any further completed disposals in 2000-01.

All estimates will be reviewed once the asset disposals are finalised and all actual data can be concluded.

Reduction of Risk Exposure

Apart from the estimated premium, the State has reduced its risk exposure to operating in the National Electricity Market by the disposal of the electricity businesses. This is offset by eliminating the opportunity to earn revenues and profits in that market and reducing the State's limited own source revenue base. The State has also, by reducing debt, reduced debt management related risks and in particular outright interest rate risk. Following the announcement of the first electricity asset disposals in December 1999, the State achieved an improved credit rating to AA+.

The Accounting Gain

The accounting gain from the disposal using the book value of assets disposed of from the disposal was $1 048 million reflecting the receipt of proceeds of $3 373 million for assets with a net book value of $2 325 million. In addition, proceeds of $276.2 million were received with respect to future operating lease rentals relating to land with a book value of $30.8 million.

Net Reduction in the Treasurer's Indebtedness

For the non-commercial sector, the net reduction in indebtedness of the Treasurer, which is the base for net interest payments in the Budget, for 1999-2000 was $1 395 million. Related net interest payments in 2000-01 are expected to decrease due to the reduction in indebtedness offset by a rise in the average interest rate paid in that year. Interest payments are projected to fall further in 2001-02 due to a decrease in the average interest rate paid in that year as high yield debt matures or is retired.

The Matter of whether a Fair Price was Received

In relation to whether the State received a fair price for the assets disposed of in 1999-2000, information provided to Cabinet on the valuation of assets before each disposal, indicated that, overall, because of the results for the two major disposals, the State had virtually achieved the upper limit of the estimated total valuations of the assets.

THE TREASURER'S FINANCIAL STATEMENTS FOR THE YEAR ENDING 30 JUNE 2000

INTRODUCTION

For several years I have commented that the more relevant data for an overall analysis of public finances are that prepared by the Australian Bureau of Statistics method and presented as the non-commercial and commercial sectors. Bearing in mind that observation, this section of the Report considers the results and the financial position reported in the Treasurer's Financial Statements for the year ending 30 June 2000 that have been audited and are reported on in the Letter of Transmittal to this Report.

I have, as in past years, reported on the principal accounts of the State Government, that is, the Consolidated Account, the Special Deposit Accounts and Deposit Accounts, through which specific operations of government are conducted. This is consistent with the requirements of the *Public Finance and Audit Act 1987*. The Treasurer's Financial Statements are reported, in full, as an Appendix to this Report Part B Volume III.

APPROPRIATION AUTHORITY

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*, a high proportion of public monies are received and expended. The main receipts to this 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.

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[50] and specific appropriation authorised under various acts. Also set out are the purpose and amount of payments from the Consolidated Account, ie the use of that appropriation.[51]

Total appropriation authority for 1999-2000 was $6 078 million. Actual payments were $5 837 million, well within appropriation authority.

---

[50] Section 12 of the *Public Finance and Audit Act 1987* provides that the Governor may appropriate from the Consolidated Account in any financial year, an amount not exceeding three percent of the total of the amounts set out in the annual Appropriation Acts in respect of the previous financial year.

[51] Statement K — Statement of Appropriation Authorities, Appendix to Part B Volume 3 of this Report.

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.

THE CONSOLIDATED ACCOUNT OUTCOME

The result on Consolidated Account for 1999-2000 was a deficit of $217.5 million ($400.5 million). The deficit was determined after receipts of $5.6 billion (budget $5.8 billion) and payments of $5.8 billion (budget $5.9 billion).

The deficit was financed by borrowings from SAFA.

The key differences between budgeted and actual figures were:

- an increase in taxation receipts of $192.5 million due mainly to an increase in stamp duty receipts of $174.5 million over budget. This includes $118 million from the disposal of electricity assets;[52]

- an increase in Commonwealth grant receipts of $26.6 million;

- a decrease in RESI electricity entity distributions of $118.5 million due mainly to the abandonment of the anticipated electricity levy following the passing of legislation enabling the disposal of the State's electricity assets;

- additional payments amounting to $100 million ($265.3 million) towards funding past service superannuation liabilities;

- deferral of receipts from the South Australian Asset Management Corporation and the South Australian Government Financing Authority with a net effect totalling approximately $232 million. These receipts were not required by the Government for the 1999-2000 year and have been held over to the 2000-01 Budget and beyond.

Other minor but notable variations included Court fees and fines being $14.8 million below budget and infringement notice schemes $6.1 million below budget while royalties exceeded budget by $12.2 million.

Full details of the budget and actual data is presented in Statement A 'Comparative Statement of the Estimated and Actual Receipts and Payments to the Consolidated Account'.

---

52 Comprising $103.9 million in respect to ETSA Utilities and ETSA Power and $14.4 million ***ex gratia*** payments for subsequent refinancing documents.

THE CONSOLIDATED ACCOUNT DEFICIT

The cash deficit of $217.5 million exceeded budget by $103.4 million. The size of the deficit, however, overstates its significance to the extent that it represents only a section of the overall budget result as described in the earlier sections in this Part of the Report.

It is important to emphasise the cash deficit here is offset by cash surpluses in the rest of the non-commercial sector with the net result being that the non-commercial sector cash deficit for 1999-2000 was in the order of a very much smaller $17 million. The cash surpluses are reflected in the cash position of the Treasurer's Financial Statements explained later in this section.

APPROPRIATION FLEXIBILITY

While there is specific appropriation authority established under various legislation there is in fact very broad 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. The next section on the cash position of the Treasurer's Financial Statements provides further comments.

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;
- contingency provisions for employee entitlements and supplies and services in the total of the appropriation purpose 'Administered items for Department of Treasury and Finance'.[53] These amounts are included within the total appropriation but are generally not committed to a specific purpose at the time of the budget.

---

53 *Appropriation Act 1999* Schedule. Details in 'Portfolio Statements 1999-2000 Budget Paper 4 Volume 1' pp. 3.32 and 3.33.

Prior to 1998-99 only the GAF was available. The 1999-2000 Budget included contingency funds totalling $144.3 million, which when added to the $165.8 million available from the GAF provided uncommitted flexibility within the budget of $310.1 million or 5.2 percent of the total of the *Appropriation Act 1999* and the GAF.

Use of the contingency provisions is on a similar basis to the GAF with the Treasurer approving the expenditure of funds.

The following table sets out the availability and use of these funds in 1999-2000.

	Authority $'million	**Actual Payments $'million**
Governor's appropriation fund	165.8	70.1
Total contingency provisions	144.3	110.8
Total flexibility	310.1	180.9

Details of the purpose of the actual payments from the GAF are provided in Statement K.

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.

SUMMARY OF THE CASH POSITION OF THE TREASURER'S FINANCIAL STATEMENTS

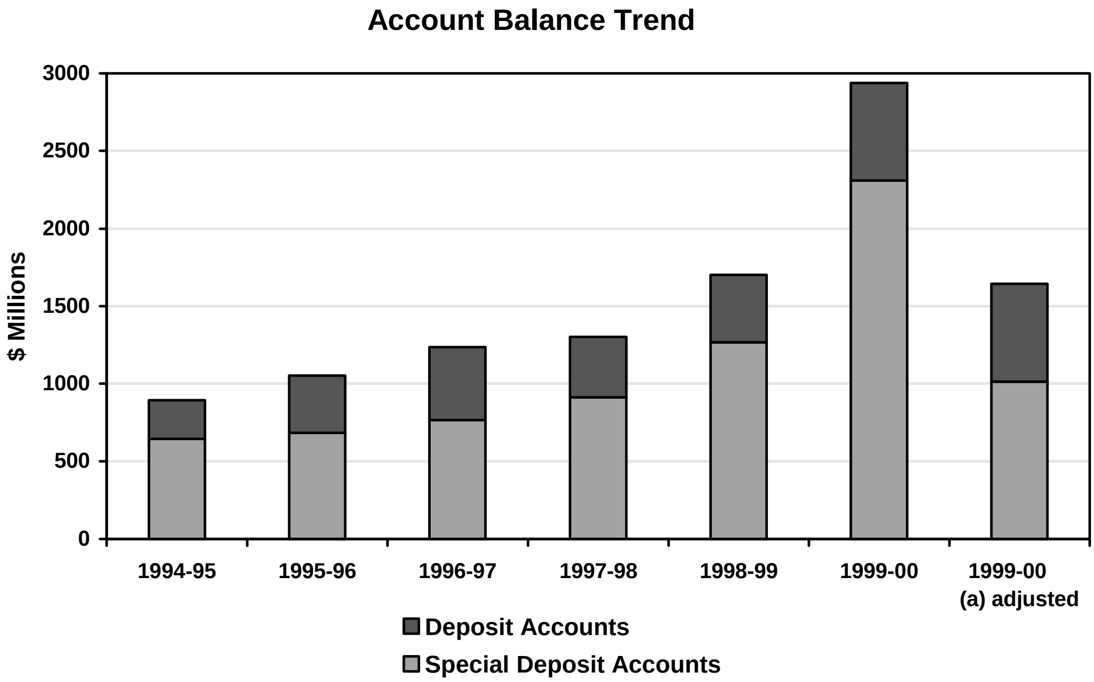
The Treasurer's Financial Statements report the cash position of the various accounts that the Treasurer is empowered to operate pursuant to the *Public Finance and Audit Act 1987*.

These balances do not purport to represent the total cash position of the public sector. The following table does, however, indicate the cash position of agencies included in the Treasurer's ledgers and these are the majority of government agencies.

The following table shows the balances of the Accounts (Statements F and G) of the Treasurer over the past six years.

Year	**Deposit Accounts $'million**	**Special Deposit Accounts $'million**	**Total Cash $'million**
1994-95	249	644	893
1995-96	371	682	1 053
1996-97	469	766	1 253
1997-98	390	911	1 301
1998-99	436	1 266	1 702
1999-2000	**631**	**2 308**	**2 939**

The following chart highlights the trend in account balances over the period.



(a) 1999-2000 adjusted to exclude the balance of the Electricity Sale/Lease Proceeds Account.

The increase in total cash funds as at 30 June 2000 of $1 237 million from the previous year is dominated by the balance of unutilised proceeds from the disposal of electricity assets in 1999-2000. It also represents the sum effect of a number of significant increases and decreases in other balances over the year. In view of the impact of the unused electricity asset disposal proceeds, two sets of data are presented for 1999-2000 in the chart. The 1999-2000 adjusted figure excludes the balance of the Electricity Sale/lease Proceeds Account. That adjustment shows that overall there is a slight decrease in other cash balances.

The key changes were the following:

- the balance of the Electricity Sale/Lease Proceeds Account at 30 June 2000 was $1 295 million (nil) being proceeds not yet used for debt retirement;
- related to this account was the increase of $23 million in the balance of the ‘Electricity Reform and Sales Operating Account’, the account for all the transactions in relation to the Electricity Reform and Sales Unit. This is predominantly in relation to the disposal of electricity assets. The operations of this unit are discussed further in Part B of this Report;

- there were very large decreases in the cash balances of some accounts. The South Australian Superannuation Fund Account (SASF) was down $131 million resulting from a much lower final adjustment to superannuation funding this year compared to last year. Adjusting payments for superannuation are discussed in the section of this Part of the Report titled ‘An Overview of the State’s Finances’. The South Australian Government Insurance and Risk Management account (SAGIRM) was down $121 million due to the investment of cash balances during the year with external fund managers;

- the balance of the ‘Accrual Appropriation Excess Funds’ account increased by $44 million to $119 million. This account was opened in 1998-99 in relation to accrual based appropriation funding. These funds are appropriated from the Consolidated Account but not accessed until agencies need the funds for the purposes they were appropriated; that is, to meet employee long service leave or capital expenditure funded by an annual depreciation expense.

As noted, there was a reduction amounting to $252 million in the SASF and SAGIRM accounts. Further there were significant reductions to the balances for the Human Services ($61 million) and Education ($54 million) Operating Accounts. Notwithstanding the electricity proceeds account balance, it is evident that other accounts continued to accumulate large balances for the year ie the large decreases were offset by other large increases. This continues a trend for the six years represented in the table of increasing balances in these accounts.

Details of these accounts are set out in Statements F and G of the Treasurer’s Financial Statements for 1999-2000.[54] Statement C — ‘Funds of the Treasurer as at 30 June 2000’ shows the disposition of these funds as cash and investments with SAFA.[55]

INDEBTEDNESS OF THE TREASURER

The other significant change in the Treasurer’s Financial Statements in 1999-2000 is reported in Statements I and J in relation to the Indebtedness of the Treasurer and the financial relationships and transactions between the Treasurer and SAFA.

Following the disposal of electricity assets in 1999-2000 and various smaller transactions, there has been a net reduction of $1.4 billion or 19.3 percent in the balance of the Indebtedness of the Treasurer to SAFA from $7.2 billion to $5.9 billion.

---

54 Statement F — Special Deposit Accounts and Statement G — Deposits Lodged with the Treasurer, Appendix to Part B Volume III of this Report.

55 Statement C shows the balances of the two deposit accounts together with cheques drawn but not presented at 30 June 2000 and the disposition of total funds.

The items comprising the net change are set out in Statement J as follows:

	$'million	$'million
Balance at 30 June 1999		7 248
Add: Consolidated Account borrowing in 1999-2000	218	
Add: Assumption of electricity entity debt	620	
Add: SAFA book gains/losses (net)	187	
Less: Repayment of borrowings	2 410	
Less: Other minor adjustments (net)	10	
Net Decrease		(1 395)
Balance at 30 June 2000		5 853

Details in relation to the assumption of electricity entity debt, SAFA book gains/losses and repayment of borrowings are set out in the section of this Part of the Report titled 'Electricity Asset Disposals and the State's Finances'.

STATE DEBT

INTRODUCTION

In the 1998-99 Budget, the Government set out a four-year financial plan. Two key elements of the strategy outlined in that plan were continuing real reduction in net debt with the aim of achieving a AA plus rating as soon as possible and the elimination of unfunded superannuation liabilities by 2024. The Government stated that a major asset sales program announced in February 1998 and affirmed in the 1998-99 Budget, would, among other benefits, be significant to the rate of debt reduction.[56]

In the 1999-2000 Budget tabled in May 1999, the target with respect to unfunded superannuation liabilities was extended to 2034. Net debt was expected to continue to reduce in real terms notwithstanding that proceeds from possible asset disposals were not included in the forward estimates.

In June 1999 Parliament passed legislation enabling the lease or sale of publicly owned electricity assets, the largest public sector asset disposal in the State's history. As detailed in the section of this Report titled 'Electricity Disposals and the State's Finances', by 30 June 2000 a large proportion of the disposal program was complete and had resulted in a major reduction in reported net debt.

Net debt at 30 June 2000 is estimated to be $4.2 billion down $3.5 billion from the previous year. Since 30 June 2000, assets disposals have been concluded resulting in cash proceeds of $1.2 billion[57] and the last electricity disposal remains to be finalised.[58]

This section of the Report tracks trends in debt related information before and since the current asset disposal program. The influence of asset leases/sales and some related matters are integral to the commentary provided hereunder.

Included in this section are a:

- commentary of factors relevant to understanding the debt data published by government;
- range of debt measures and indicators that assist in monitoring the position in relation to debt management in past and future years and commentary on factors that have influenced, or are influencing, the amount of debt and its future reduction;
- commentary on debt management performance and future directions.

---

56 Budget Statement 1998-99, Budget Paper 2, p. 1-1.

57 Flinders Power and ElectraNet.

58 Terra Gas Trader.

As in past Reports, the commentary highlights the significance of asset disposals to debt reduction against a background of projected balanced budgets and recent operating deficits. The commentary only takes into account asset disposals completed to 30 June 2000. Nonetheless, in recognition of the major reduction in debt burden indicators achieved, a question as to ongoing strategy in the event of further asset sales also arises.

This section, in some instances, repeats commentary and explanations provided in past Reports. This is done to assist readers to understand some permanent factors associated with debt analysis.

UNDERSTANDING DEBT DATA

Definition of Net Debt

The term 'debt' means the amounts outstanding by a borrower to the persons or entities that have lent funds to the borrower. The figures that are quoted for government debt do not normally include amounts of interest accrued but not paid nor amounts outstanding to trade creditors.

The net debt figures most commonly referred to in the Budget papers and this Report and generally referred to in media and other public sector financial commentaries on the State finances are based on Australian Bureau of Statistics (ABS) definitions.[59] Data is presented both including and excluding the effects of asset sales. Further, the figure in focus relates to the net debt of what is referred to as the non-financial public sector that comprises of all public sector entities except for public financial corporations such as the South Australian Government Financing Authority (SAFA).[60]

There is also whole-of-government net debt reporting on both the ABS basis (data available at the time of this Report follows later under the heading 'Book Values and Market Values') and on the accrual accounting basis (see the section in this Part titled 'Whole-of-Government Financial Statements'), although the latter reports borrowing and financial assets separately rather than a net debt figure. The whole-of government figures have not been the focus in the past in any forum.

For consistency, this Report continues to focus on the non-financial public sector net debt.

---

59 For example, net debt as at 30 June 1999 for the non-financial sector was calculated as gross debt less cash and deposits as set out in the 'Treasurer's 1998-99 Budget Outcome' Table 5.1.

60 There are ten entities in this ABS sector including HomeStart Finance and the South Australian Asset Management Corporation. Full details are set out in Appendix C to 'Budget Statement 2000-01' Budget Paper 2. The ABS has explained that they are shown as a separate sector because entities provide financial intermediation or auxiliary financial services and these services are considered to have little in common with the operations of the non-financial sector.

How Net Debt Changes

An increase in the financial asset components of net debt (to the extent it exceeds any increase in the financial liability component) will reduce net debt simply because of the method of calculation — physical retirement of debt is not necessary. The primary factors that influence the net debt figure are:

- the annual surplus/deficit — a surplus will reduce debt and a deficit increases debt;
- asset sales — can affect net debt by exchanging physical assets for cash.

These are stated separately because of the Government's practice of presenting the annual surplus/deficit exclusive of asset sales. Audit believes this practice to be useful in understanding underlying and sustainable public sector financial operations. Details of the factors affecting net debt are presented under the heading 'Debt and Deficits' in this section of the Report.

Data Sources and Measurement Issues

In 1997-98 some changes to ABS classifications to exclude universities and SAFA from the non-financial public sector have created a break in the time series data available. The effect was to increase the net debt figure for the non-financial public sector because of the exclusion of factors such as SAFA's capital and the cash assets of universities from the calculation. The break is shown where relevant in the information that follows. Most importantly, this adjusted basis has been used consistently for data from and including 1997 thereby providing a sound basis for monitoring changes in net debt arising from the current asset disposals process.

Unfunded Employee Entitlements

It has been the practice for some time to publish data for both net debt and for the aggregate of net debt and unfunded employee entitlements of which superannuation is the main component. Audit has stated for a number of years that it is the latter measure which is by far the more significant, as the two components are not only similar in essence, but are, in a sense, interchangeable. This has been particularly true in recent years in this State where the amount of superannuation funding contributions each year has been determined, in effect, as a 'balancing' item to offset cash flow timing effects and to maintain the deficit of the non-commercial sector at or near projected levels.

The 1998-99 Budget result demonstrates this point. While the estimate of past superannuation payments for that year was $76 million, actual payments were $139 million.[61] Had this not occurred the cash based financial result for the year would have been lower than the reported deficit of $133 million. The effect was that net debt rose while past superannuation liabilities decreased.

---

61 Budget Statement 2000-01, Budget Paper 2, Table 4.2.

Notwithstanding their interchangeability, there are important differences between the retirement of debt and the funding of unfunded past superannuation liabilities. This is discussed later in this section under the heading ‘A Choice for Future Applications of Cash Proceeds From Asset Disposals Should They Arise’.

Book Values and Market Values

Net debt data is now reported at both book value (reflecting the initial yield of individual transactions), and market value or replacement cost. Differences between the two arise when fixed rate debt has been raised at interest rates different from current rates.[62]

Data provided by the Department of Treasury and Finance shows the following estimates of debt at book and market values for the two years 1998 and 1999. Data was not available for 1999-2000 at the time of this Report.

Comparison of Market and Book Values of Net Debt
30 June 1998 to 1999

	Non-Financial Sector		**Whole-of-Government** (a)	
	1998 **$’million**	**1999** **$’million**	**1998** **$’million**	**1999** **$’million**
Market value	8 343	8 222	6 718	6 828
Book value	7 589	7 729	6 089	6 339
Difference	754	493	629	489

(a) Includes financial sector

As can be seen the difference between market value and book value had reduced over the two-year period. This reflects two factors. Firstly, there has been an increase in interest rates over the period, which reduces the market value of debt. Secondly, high yield debt has matured or been repurchased over the period so that average yields of remaining debt are closer to market values.

Another notable factor from the table is the difference between non-financial sector and whole-of-government net debt. This reflects the net financial assets held by the public financial corporations consistent with their financial intermediary activities.[63]

62 Take the example of borrowing $1 million for a two-year term at an interest rate of 10 percent, ie an interest cost of $100 000 per year. Should interest rates immediately decrease to say 8 percent, the borrower would have to pay more than $1 million to repurchase the debt because a lender would want to maintain the yield (interest rate) of 10 percent or $100 000 per year originally available. At a rate of 8 percent the lender will need to reinvest more than $1 million to earn $100 000 per year. As a result, as interest rates fall the market value of the debt increases and the opposite is true for interest rate increases.

63 For example, ‘Treasurer’s 1998-99 Budget Outcome’ Table 5.2 shows net financial assets for the sector of $1.3 billion.

Other Measurement Issues

Past Reports have drawn attention to the effects on the debt data of transfers within the State public sector as a whole, in particular transfers from public financial corporations to the non-commercial sector. The key point made is that transfers between sectors can have the effect of reducing non-financial sector net debt without altering the whole-of-government position. In this regard transfers from the South Australian Asset Management Corporation (SAAMC) are a case in point. The 2000-01 year includes a return of capital receipt of $26 million from SAAMC.[64] This has the effect of reducing the assets of SAAMC but will offset certain outlays in the non-financial sector and keep published net debt figures below what they would otherwise be if the outlays were financed from borrowings. An increase of debt is avoided but there is no improvement in the State's overall financial position from this transfer.

Debt as Part of the Government's Overall Balance Sheet

It is fundamental that debt is only one part of a government's balance sheet and that a full assessment of the State's financial position should take account of physical public assets and commercial assets as well as financial liabilities and assets.

As noted in the data that follows and in past Reports, the debt reductions achieved by the State in recent years predominately 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 and economic risks that have the capacity, if they cannot be appropriately managed, to impact on future finances. For example, the electricity businesses were operating in a new competitive market. Additionally, reduction of debt reduces exposure to interest rate and other financial market risks. These can be regarded as structural improvements in the State's balance sheet to the extent that risk is avoided.

Reduction of debt in conjunction with reductions in revenue-producing assets may or may not have a significant net effect, positive or negative, on the State's 'bottom line' depending on the comparison between interest saved and revenue foregone. In the case of the electricity businesses, based on the Government's estimates of potential revenues from these assets, a premium has been achieved. This is discussed in detail in the section of this Report titled 'Electricity Assets Disposals and the State's Finances'.

The preceding must be distinguished from changes in debt levels affected through altering the balance between annual expenditures and revenues — with any improvement in that balance meaning (other things being equal) lower interest costs and an ongoing improvement in the State's 'bottom line' and balance sheet. The policy of seeking balanced budget outcomes theoretically prevents this type of change in debt levels, although a surplus was achieved in 1997-98. A small deficit is projected for 1999-2000. Details in relation to debt and deficits are provided later in this section.

---

64 Portfolio Statements 2000-01 Volume 1, Budget Paper 4, p. 3.24.

DEBT MEASURES AND TRENDS

Debt Measures and Indicators

There are a variety of measures and indicators in relation to debt burden that are generally accepted. Notably, there are some differences in information published by the Government,[65] ABS and financial markets reflecting timing (data can be improved over time) and definitional differences. The essential trends and positions are, however, consistent. As mentioned the data herein is primarily sourced from the Department of Treasury and Finance and uses ABS definitions.

The measures and indicators included in this section of the Report encompass:

- net debt — nominal and real terms;
- ratios relating to debt affordability;
- a reconciliation of debt and deficits;
- debt servicing;
- the State's position relative to other States and Territories.

This section aims to consolidate some generally accepted measures to provide a base for comparison of past performance and predicted change over the next few years and discusses reasons for and, observations from, the trends that are revealed.

Longer Term Trends in the Level of Debt

The following tables show data on a long-term basis. As indicated, from 1997 there is a break in the series resulting from the exclusion of the South Australian Government Financing Authority and universities from the series under ABS reclassifications. The overlapping years of 1997 and 1998 indicate the magnitude of the effect of the reclassification.

South Australian Public Sector Net Indebtedness 1950 to 1998

June	Nominal Prices $'million	Real Terms (a) $'million	Per Capita (Real Terms) $	Percentage of GSP Percent
1950	284	n/a	n/a	n/a
1960	752	n/a	n/a	n/a
1970	1 473	10 815	9 339	n/a
1980	2 242	6 221	4 755	n/a
1990	4 682	5 914	4 129	16.3
1991	7 155	8 512	5 885	24.4
1992	8 055	9 340	6 413	26.9
1993	8 249	9 372	6 416	26.9
1994	8 440	9 403	6 414	26.2
1995	8 468	9 152	6 228	25.4
1996	7 752	8 078	5 479	21.6
1997	7 499	7 743	5 233	20.6
1998	7 237	7 516	5 053	18.6

(a) Estimated June 2000 values

65 Budget Statement 2000-01, Budget Paper 2, Table 2.3.

South Australian Public Sector Net Indebtedness 1997 to 2004 (New Series)

	Nominal Prices $'million	Real Terms (a) $'million	Per Capita (Real Terms) $	Percentage of GSP Percent
New Series				
1997	7 946	8 204	5 545	21.8
1998	7 589	7 881	5 302	19.1
1999	7 720	7 913	5 300	19.0
2000 (b)	4 226	4 226	2 818	9.9
2001 (c)	4 302	4 187	2 779	9.5
2002 (c)	4 316	4 098	2 710	9.1
2003 (c)	4 281	3 966	2 614	8.5
2004 (c)	4 214	3 808	2 502	7.9

(a) Estimated June 2000 values
(b) Preliminary estimate
(c) Projections

It will be seen that in real terms from the 1970s the State's debt was reducing until 1990 but then rose substantially as a result of the need to fund the losses of the State Bank of South Australia in particular, reaching a peak in real terms in 1994.

The major reduction in 2000 resulting from electricity asset disposals is also clearly apparent.

Composition of Net Debt

As was stated previously, net debt changes simply if financial assets increase without repayment of debt. The following table shows how the composition of net debt was expected to change over the three years to 2001 at the time of the 2000-01 Budget.

Composition of Net Debt

Year	Gross Debt $'million	Financial Assets (a) $'million	Net Debt $'million
1999	10 037	2 317	7 720
2000 (b)	6 990	2 764	4 226
2001 (c)	6 116	1 814	4 302

(a) Comprises cash, deposits and lending
(b) Preliminary estimate
(c) Projections

As can be seen from the table:

- for 2000 it was estimated that gross borrowings reduced from the retirement of debt and financial assets increased from the retention of some proceeds pending further retirement of debt with a resultant major decrease in net debt;

- for 2001 it is projected that both borrowings and financial assets will decrease as cash proceeds are used for physical debt retirement with a small increase in net debt resulting from a projected operating deficit. These data do not take account of asset disposals after 30 June 2000.

Net Debt and Unfunded Superannuation Liabilities

As discussed, it is desirable that account is taken of unfunded employee entitlements as well as net debt.

The estimated total debt and unfunded superannuation liability as at 30 June 2000 was $8 340 million ($11 711 million in 1999) comprising debt of $4 226 million ($7 720 million) and an unfunded superannuation liability of $4 114 million ($3 991 million). The major decrease in debt was therefore marginally offset by an increase in the estimated unfunded superannuation liability.

The following table provides net debt and unfunded superannuation liability for the new series data, ie from 1997.

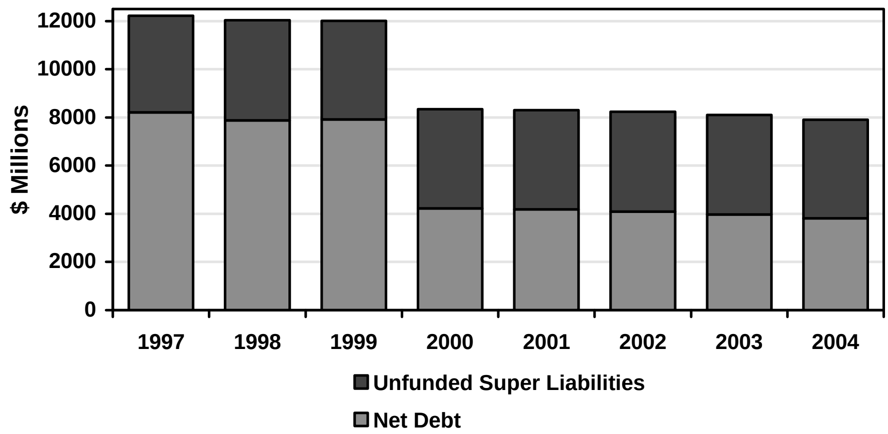
Net Debt (Excluding Asset Sales) and Unfunded Superannuation Liabilities

June	Net Debt (a) Nominal Prices $'million	Unfunded Superannuation Liabilities $'million	Total $'million	Total in Real Terms (b) $'million
1997	7 946	3 893	11 839	12 224
1998	7 589	4 001	11 590	12 037
1999	7 720	3 991	11 711	12 004
2000 (c)	4 226	4 114	8 340	8 340
2001 (d)	4 302	4 229	8 531	8 303
2002 (d)	4 316	4 359	8 675	8 237
2003 (d)	4 281	4 463	8 744	8 100
2004 (d)	4 214	4 532	8 746	7 904

(a) Including the effects of the sale of government businesses
(b) June 2000 values
(c) Preliminary estimate
(d) Projections

The following chart illustrates the dramatic effect that the disposal of electricity assets has had on the trend in net debt and unfunded superannuation liabilities in real terms over the reported period for the new series data.

Net Debt (including asset sales) — New Series Real Terms



The chart also indicates that while the effect of asset disposals on net debt is pronounced, in the absence of subsequent disposals there is minimal change. It is also apparent that unfunded superannuation liabilities are steady over the period.

Policies and the Effects Thereof Since 1997

Reduction in net debt has been a major plank in the policies of the current State Government.

The following table is based on data provided by the Department of Treasury and Finance. The table focuses on movements excluding the effects of asset disposals.

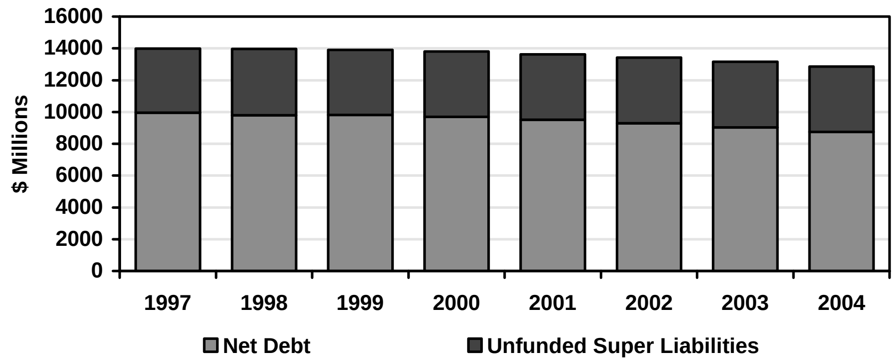
Net Debt (Excluding Asset Sales) and Unfunded Superannuation Liabilities

June	Net Debt (a) Nominal Prices $'million	Unfunded Superannuation Liabilities $'million	Total $'million	Total in Real Terms (b) $'million
1997	9 646	3 893	13 539	13 979
1998	9 439	4 001	13 440	13 958
1999	9 570	3 991	13 561	13 900
2000 (c)	9 697	4 114	13 811	13 811
2001 (d)	9 773	4 229	14 002	13 627
2002 (d)	9 787	4 359	14 146	13 428
2003 (d)	9 752	4 463	14 215	13 168
2004 (d)	9 685	4 532	14 217	12 849

(a) Excluding the effects of the sale of government businesses
(b) June 2000 values
(c) Preliminary estimate
(d) Projections

The following chart shows the trend detailed in the table in real terms.

Net Debt (excluding Asset Sales) and Unfunded Superannuation Liabilities — Real Terms



It is apparent that:

- the level of total nominal net debt (excluding the effect of the sale of Government businesses) and unfunded superannuation liabilities at June 2000 was higher than at June 1997 (by about $270 million) and is forecast to continue to grow further over the period of the forward estimates to 2003-04;
- by the end of the forecast period the total is estimated to be $680 million higher than at June 1997. This is virtually all due to projected growth in unfunded past superannuation liabilities while debt increases marginally;
- the decline over this period in real terms is primarily due to the effects of inflation, that is consistent with the policy of running a balanced, non-commercial sector budget. Surpluses are projected for the final two years in the series as indicated in under the later heading ‘Net Debt and Deficits’.

Unfunded Superannuation Liabilities

The preceding tables set out details of 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 has been the policy of most Australian states until relatively recently, to fund superannuation benefits as they arise. Now it is commonplace 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 the immediate future — thus there is the ability to seek to fund them over forty years. In estimating the liabilities, a range of variable factors are taken into account, key among them are assumptions of salary earnings, investment earnings, inflation and demographic details such as mortality rates. Also important are the scheduled past service contributions by the Government. The Commonwealth Government also funds certain of the liabilities. A detailed actuarial review of the ability of superannuation funds to meet their current and future liabilities is conducted every three years while updates to estimate the value of future payments, based on adopted assumptions, are made annually.

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.

Peak in Unfunded Superannuation Liabilities

The significance of this commentary is that the liability may change periodically as assumptions and experience change. This is an accepted fact for this type of liability. The State has a number of different schemes in operation and a number of schemes that are closed to new entrants.[66] The quoted unfunded superannuation liabilities represent all of these schemes. To the extent that contributions from members and the Government and investment earnings do not exceed the annual increase in accrued liabilities, the unfunded liability will continue to increase. On current projections, unfunded liabilities will peak around the period 2012 to 2016. Further comments in relation to funding of past superannuation liabilities are made under the later heading 'A Choice for the Application of Future Cash Proceeds From Asset Disposals Should They Arise'.

Net Debt and Deficits

The following table is designed to aid an understanding of the relationship between the net debt figures and the annual Budget results as published:

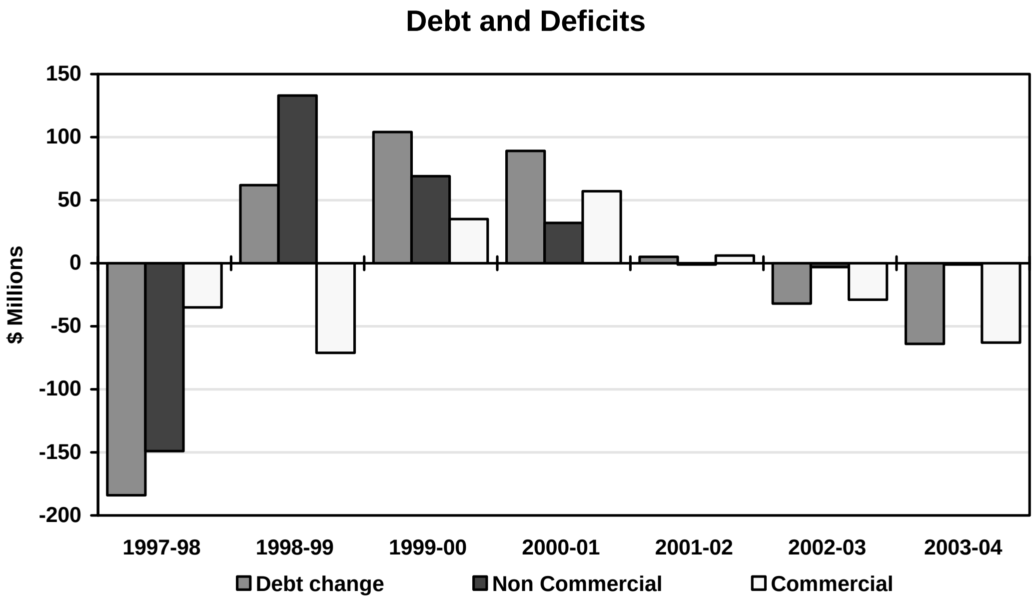
Reconciliation of Debt and Deficits (a)

	(1) Net Debt Level at End of Year (b) $'million	(2) Change in Debt in Year (a) $'million	(3) Non-Commercial Deficit $'million	(4) Commercial Sector Deficit $'million	(5) Sale of Government Businesses $'million	(6) Other Factors (c) $'million
1996-97	7 946	-	-	-	-	-
1997-98	7 589	-357	-149	-35	-147	-26
1998-99	7 720	131	133	-71	-	69
1999-2000 (d)	4 226	-3 494	69	35	-3 682	84
2000-01 (e)	4 302	76	32	57	-	-13
2001-02 (e)	4 316	14	-1	6	-	9
2002-03 (e)	4 281	-35	-3	-29	-	-3
2003-04 (e)	4 214	-67	-1	-63	-	-3

(a) Total of columns (3) to (6) equals column (2) — means a surplus
(b) Nominal prices
(c) 'Other Factors' includes items such as changes in levels of unpresented cheques, effects of differences in classification of certain advances
(d) Preliminary estimate
(e) Projections

66 Details of the majority of the State's superannuation liabilities and assets are included in Volume III of Part B of this Report under the heading 'SA Superannuation Board'.

The following chart shows the changes in debt exclusive of asset sales/disposals and other factors.



The point to be noted from the table and chart is that notwithstanding the target of balanced budgets, the operations of the non-commercial sector have or are projected to, contribute to debt reduction in only one year (1997-98) up to 2001-02. In fact that was due only to a large special transfer from the South Australian Government Financing Authority. The three years 1998-99 to 2000-01 either have or are projected to result in deficits, adding to debt. The final three years are projected to be consistent with the targeted balanced budgets for the non-commercial sector and for surpluses to be achieved in the commercial sector.

Debt Affordability and Servicing

While the preceding shows the change in the level of net debt and unfunded superannuation over a number of years, the effect on the State's finances is reflected in the State's ability to finance debt, and the cost of servicing debt to the exclusion of other purposes.

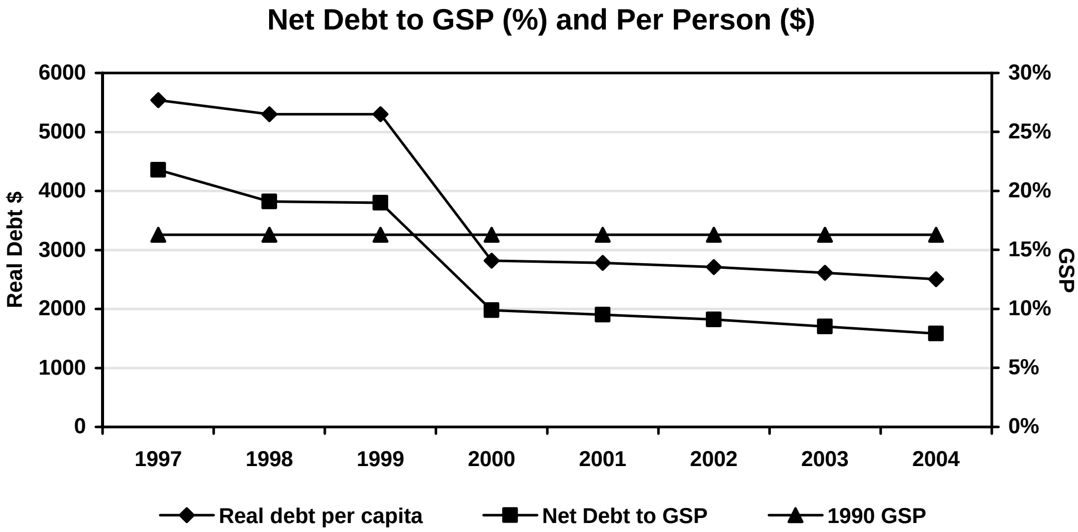
The following shows through a number of ratios how the affordability and servicing of debt has changed or is projected to change over the next few years.

It should be noted that as ratios reflect the results of more than one variable factor, the trends could alter with adjustment to any of those factors. Some comment in this regard is provided in the following commentary as relevant.

Net Debt to GSP and Per Person

An indicator widely used in financial markets is the ratio of State debt to State economic output — GSP. An indicator perhaps more meaningful to the public generally is the value of net debt per person, that is, net debt per capita.

The chart below sets out the trend for these two indicators.

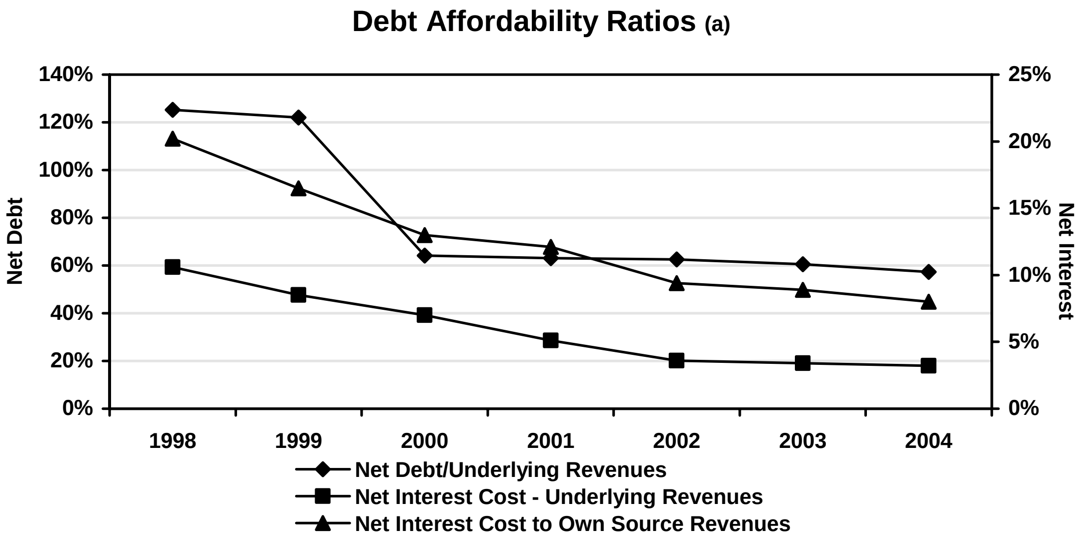


As can be seen from the chart, the electricity asset disposals in 2000 create a pronounced decrease in the ratios. Net debt to GSP is now well below that of 1990, before the effects of the State Bank collapse. The steeper decrease in the ratio of net debt to GSP than the per capita ratios reflects the higher experienced or projected growth of GSP compared to population growth over the same period.

Debt to Revenues and Net Interest Bite

The following indicators show the experienced and projected affordability of net debt by comparing debt and net interest cost to State revenue measures. Net debt to underlying revenues shows the proportion of debt to the State's revenue base.

The net interest cost to underlying and own source revenues shows the proportion of State revenues consumed in meeting net interest costs.



(a) Underlying revenues are total revenues adjusted in 1999-2000 for estimated stamp duty receipts from electricity asset sales of $110 million.

The chart again is dominated by the effect of electricity asset disposals in 2000 and shows a projected continuous improvement in all the indicators as the debt burden reduces. The chart also shows the following:

- net debt to underlying revenues shows one major decrease in 2000 for the effects of asset disposal proceeds and a steadying thereafter as both projected net debt and underlying revenues change little over the forward years (note the effects of further asset sales are excluded from the data);
- the net interest cost to revenue indicators reflect a steady decrease over the projected period but are in fact dominated by large projected decreases in net interest costs up to 2002 after which, net interest costs are projected to reduce at a much lower rate;
- the dominance of the decreasing net interest cost is such that the net interest cost to own source revenue indicator continues to trend downward even though there is a significant decrease in own source revenue in 2001 from the GST arrangements. This change would otherwise have seen an upward movement in this indicator.[67] Underlying revenues are not affected in this regard as increased Commonwealth GST related revenues offset lower own source revenues. An explanation of interest cost projections is provided in the section of this Part of the Report titled 'A Commentary on the State's Budget Over the Period 1997-98 to 2003-04'.

SOUTH AUSTRALIA'S DEBT POSITION RELATIVE TO OTHER STATES AND TERRITORIES

The following sets out a commentary on the State's debt and related financial position relative to other States and Territories.

Net Debt and Unfunded Employee Benefits

The following table, derived from data published by the ABS[68] for the General Government and Public Non-financial Corporations (formerly Trading Enterprises) sectors shows South Australia's debt and unfunded employee benefits relative to other States. Data for 2000 is not available at the time of this Report. Note that unfunded employee benefits include superannuation and other benefits such as long service leave.

---

67 That is, as the base figure, own source revenues, in the ratio reduced.

68 Government Finance Statistics 1998-99, Catalogue No 5512 and Public Sector Financial Assets and Liabilities 30 June 1998, Catalogue No 5513.0.

Net Debt and Unfunded Employee Benefits

30 June	South Australia (a) $'million	Total All States and Territories $'million	South Australia as Proportion of all States and Territories Percent	Unfunded Employee Benefits South Australia as Proportion of all States and Territories $'million
1993	16 674	137 481	12.1	8.8
1994	15 589	129 515	12.0	9.3
1995	13 986	129 621	10.8	9.0
1996	13 519	117 839	11.5	8.4
1997	13 408	108 302	12.4	8.8
1998	12 871	102 175	12.6	8.2
1999	12 591	93 462	13.5	9.3

(a) ABS data may vary from Department of Treasury and Finance data due to timing and definition differences

Although there has been a decline in absolute terms in the level of debt and unfunded superannuation liabilities in South Australia, the difference relative to other States and Territories has been minimal and in 1998 and 1999 deteriorated to a small extent compared to 1993. This is essentially due to the relative net debt changes. While it has already been shown that there is a significant reduction in this State's net debt in 2000 (ie down $3.5 billion), in the absence of comparative data for the other States and Territories it is not possible to consider the relative change that arises in 2000.

It is of interest to note that in regard to unfunded employee benefits, South Australia's position relative to the other States and Territories improved over the period until 1999. This reflects this State's policy of funding of past superannuation liabilities. The effect in 1999 is considered to be reflective of other States also adopting specific strategies for funding unfunded superannuation liabilities.

Net Debt and Net Financial Worth

As mentioned, the ABS has adopted accrual based reporting. The first year of adoption of the new basis was 1999, therefore trends data will commence from that year. Audit discussed with the Department of Treasury and Finance appropriate indicators for balance sheet and other analysis using this data to assist the assessment of the State's relative position to other jurisdictions.

Audit has determined that other than generally accepted indicators, many of which have already been referred to, it was appropriate to provide a range of indicators to cover different aspects of financial position rather than focus on a single aspect. Essentially, what was considered were forms of gearing or leverage indicators[69] and measures of relative wealth.

[69] That is, for the purpose of this analyses, the degree to which debt or liabilities are used in capital structure.

The following ratios, all of which are essentially gearing ratios, were considered relevant:

- net debt as a percentage of non-financial assets;
- net financial worth (see below) as a percentage of non-financial assets;
- net interest cost as a percentage of total revenue.

Data necessary for relative wealth measures for 1999-2000 was not collated at the time of finalising this Report but some observations can be made using data from the 2000-01 Budget.

Net debt has been defined previously. It has also been noted 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.

Net financial worth (NFW)[70] is a measure included in the uniform reporting by the jurisdictions that is determined by total liabilities less total financial assets. As total liabilities exceed financial assets for all States, this is a net liability measure rather than a measure of wealth, as the title might otherwise convey. It is, however, a broader measure than net debt and captures changes in other liabilities when observing trends and comparing between jurisdictions.

Some Qualifying Observations Concerning the Ratios

Before considering the ratios, a number of observations might be made as to their usefulness. The purpose of the ratios is to draw attention to relative differences between jurisdictions. No suggestions are made as to what is regarded as optimal.

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 are also often 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.[71]

It should be noted that having regard to some of the observations that follow, further consideration will be given to relevant ratios for the future.

The following information was presented by States in their 2000-01 Budgets using the ABS accrual based method. Audit has not attempted to include all States and Territories. The net debt data is consistent with past presentations and is provided as a memo item in financial reports for the States.

---

70 The New South Wales (NSW) Budget Papers note that NFW is a useful indicator for examining the soundness of a government's fiscal position, particularly as a benchmark against itself over the medium-to-long term. 'NSW Budget Statement 2000-01' p. 9-5.

71 A discussion of issues on comparing asset positions between States is provided in 'Budget Statement 2000-01' Budget Paper 2, p. 7.2 to 7.4.

Net Debt as a Proportion of Non-Financial Assets

The following chart plots the ratio of non-financial public sector net debt to non-financial assets[72] for the selected States. The data is the estimated result for 1999-2000 in each State as presented in their respective 2000-01 Budget Papers. The use of 1999-2000 estimated results allows a comparison after the effect of electricity asset disposals in this State in 1999-2000.

Non-Financial Public Sector Net Debt to Non-Financial Assets for 1999-2000

The chart shows that after the asset disposals program in 1999-2000 South Australia's ratio is estimated to exceed the other selected States, but is relatively close to New South Wales and Western Australia. As mentioned there are two key aspects to this type of comparison, namely that net debt is only one liability of the States and that differences in asset valuations can affect the ratios. It is notable from this chart that Victoria has a very low ratio reflecting the use of its very high infrastructure asset disposals proceeds for debt reduction. Queensland is the only State with negative net debt.

Net Debt as a Proportion of Non-Financial Assets (Excluding General Government)

The following chart plots the ratio of non-financial public sector net debt to non-financial assets excluding the general government sector non-financial assets for the selected States. General government non-financial assets represent assets such as schools and hospitals that are subject to a high degree of variability in valuation approaches across jurisdictions[73] and tend not to be subject to disposals to the same degree as infrastructure assets. Removing them provides a measure of the coverage of net debt by other non-financial assets.

---

72 Non-financial assets are essentially physical assets (eg infrastructure — water, roads, hospitals etc) owned by government.

73 It is relevant to note that some non-financial corporation infrastructure assets are also subject to high variability in asset valuations across jurisdictions.

Non-Financial Public Sector Net Debt to Non-Financial Assets (Excluding General Government) for 1999-2000

On this basis, South Australia is in a slightly better position than New South Wales and closer to Western Australia and Victoria. The change from the preceding chart reflects the higher proportion of general government non-financial assets to total non-financial assets in the other States. South Australia's ratio benefits from the inclusion of housing and water assets valued on a deprival basis.

Net Financial Worth as a Proportion of Non-Financial Assets

The following chart plots the ratio of non-financial public sector net financial worth (NFW) to non-financial assets for the selected States for 1999-2000. As mentioned this is a net liability ratio, representing the cover of net liabilities by non-financial assets. For example for South Australia the estimated result for 1999-2000 is that NFW is $10.3 billion and non-financial assets are $21.5 billion. This equates to a ratio of 48 percent.

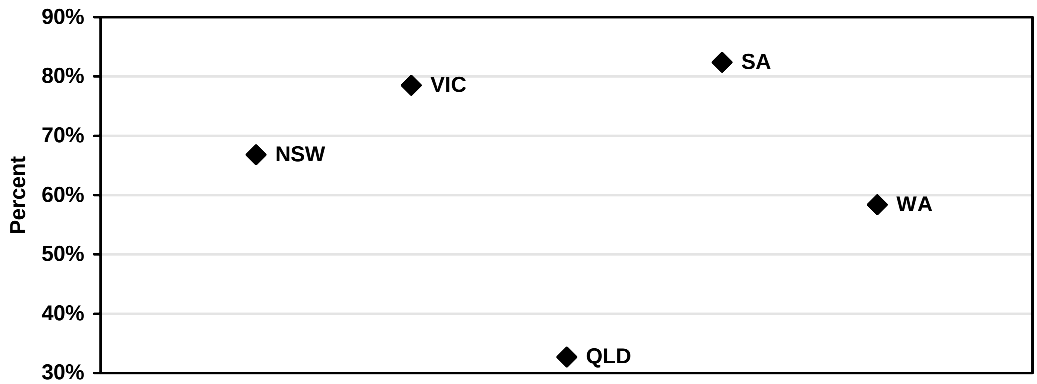
Non-Financial Public Sector Net Financial Worth to Non-Financial Assets for 1999-2000

This chart shows South Australia has a higher proportion of net financial worth to non-financial assets, than the other selected States. The chart also demonstrates the effect of including other liabilities. The difference between South Australia and New South Wales indicates New South Wales' very substantial recent funding of past superannuation liabilities. Victoria's position relative to New South Wales and Western Australia reflects a high proportion of unfunded superannuation/employee liabilities.

Net Financial Worth as a Proportion of Non-Financial Assets (Excluding General Government)

To complete these charts, the following chart plots the ratio of non-financial public sector net financial worth to non-financial assets excluding general government sector non-financial assets for the selected States.

Non-Financial Public Sector Net Financial Worth to Non-Financial Assets (Excluding General Government) for 1999-2000



Again, the removal of the high proportion of general government assets in all States changes the position substantially. On this basis South Australia compares favourably with Victoria and New South Wales notwithstanding Victoria's substantial asset disposals program and debt reduction. The chart also shows the relative strength of Western Australia.

Net Assets Per Capita

As mentioned, measures of relative wealth are necessary to give a context to the preceding ratios. At the time of finalising this Report all the necessary data was not collated for 1999-2000. Data has, however, been presented in the Budget Papers[74] on net assets per capita as at 30 June 1999. While this is before this State's asset disposals, the data is of interest. The following chart plots the Budget data — Queensland was not included.

---

[74] Budget Statement 2000-01, Budget Paper 2, Table 7.4.

Net Assets Per Capita at 30 June 1999

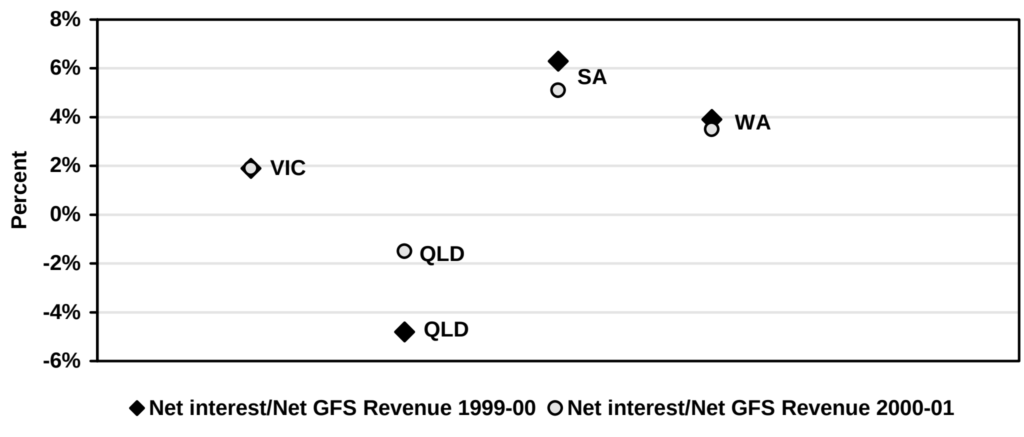
The data presented is consistent with that in the preceding chart of the ratio of non-financial public sector net financial worth to non-financial assets excluding the general government sector non-financial assets, noting that net assets per capita is a ratio of relative wealth and therefore the State's positions are reversed from the earlier chart.

Again, the position of Victoria is of interest having regard to its asset disposal program.

Net Interest Costs

A comparison of net interest costs as a proportion of total State revenue[75] (excluding interest income) shows the relative 'net interest bite[76]' of net debt. The following chart shows the estimated results for 1999-2000 for the selected States and budgeted results for 2000-01. This enables the full impact of asset disposals in 1999-2000 in South Australia to be shown as it takes until 2000-01 for this to occur. All data necessary for New South Wales was not available so it is not charted.

Net Interest Costs as a Percentage of Total GFS Revenue 1999-2000 and 2000-01



---

[75] Total non-financial public sector Government Finance Statistics (GFS) revenue as published in respective 2000-01 Budget Papers.

[76] As opposed to interest coverage, another possible gearing indicator.

The chart shows the change in this ratio for South Australia from 1999-2000 to 2000-01. As would be expected from the application of asset disposal proceeds to debt reduction, the proportion of net interest cost to total revenue fell. Such a change in this type of ratio is not necessarily an indication of improved financial position. There is also a reduction in revenue when income earning assets are disposed of and this indicator does not reveal whether a premium or loss is derived from asset disposals due to the magnitude of total income from other sources. That is, the relative change in revenue will be smaller than the relative change in net interest cost and thus the ratio improves.

The chart also indicates the State continues to exceed the other States in this ratio. While there is estimated to be a substantial worsening in the ratio for Queensland (due to exceptional investment income performance in the previous year), there is virtually no change for Victoria and Western Australia from 1999-2000 to 2000-01.

Summary of the State's Relative Position

The comparisons of the State's position to other States and Territories shows that this State is likely to substantially improve its relative position, if not ranking, following the asset disposals in 1999-2000. In relation to the balance sheet ratios, the analysis indicates that in some respects the State is reasonably placed compared to the other States shown. In this regard the close comparison for the ratios of non-financial public sector NFW to non-financial assets (excluding the general government sector) and net assets per capita, between South Australia and Victoria were of interest noting Victoria's past asset disposals program.

In interpreting ratios over the longer term, the nature of some of the ratios is such that they can show an improvement in the ratio but not necessarily indicate an improved financial position. As mentioned at the outset, the balance sheet ratios used are subject to the variability of the methodology applied to value assets. The analysis also confirms that focus on net debt alone is inappropriate and that net financial worth under the ABS accrual method is a better indicator.

With respect to the interest bite, broad calculations by Audit indicate that in order to close the gaps that exist in the ratio of net interest cost to GFS revenue, if this was considered desirable, it is likely that further very large decreases in net debt would be necessary. In this regard there are electricity asset disposals to be concluded in 2000-01 that will cover a large proportion of that requirement but probably not all, all other things being equal. There are other assets nominated for sale.

Before the 1999-2000 asset disposals, the State was quite poorly placed and the debt levels and associated burdens were generally considered to be too high. A major reduction to net debt has occurred and the State's exposure to debt burdens been reduced. This was achieved by capitalising the value of the electricity businesses and retiring debt.

The preceding commentary suggests that, having regard to the improvements now achieved from the electricity asset disposals, where further asset disposals are contemplated they should be carefully considered to ensure they are in the best long term interest of the State.

Further, in order to maintain the existing position, it will be necessary to maintain appropriate risk management processes in regard to the State's ongoing financial operations to protect against the incurrence of future major liabilities.

DETERMINING AN APPROPRIATE LEVEL OF DEBT

The commentary in this section so far indicates that South Australian public sector net debt has reduced markedly since the post State Bank peak in 1994 in both absolute (total debt) and relative (ratios) terms. In fact the data show the ratio of net debt to GSP is now below the 1990 level, that is, before the effects of the State Bank collapse. The Government also had a specific target of achieving a AA+ rating — this was achieved in December 1999.[77] The effects of the finalisation of the electricity asset disposals or future asset sales are yet to be taken into account.

The preceding also indicates the potentially difficult task of achieving some of the debt burden ratios of the other states. Data presented by various financial market rating agencies and commentators also indicate the State's improvement in debt burden indicators and that, after changes in rankings arising from electricity asset disposals, the ranking to other states and territories are projected to be virtually unchanged over the forward estimate period. ABS data indicate that only Queensland does not have net debt in the non-financial public sector. Other commentators project that, in the next five years, the only other jurisdiction that will not have net debt is the Australian Capital Territory, although all States and Territories show improvement in debt burden ratios over that period.

In view of the success in reducing debt and the magnitude of future debt reduction probably needed to further improve the State's relative position to other States and Territories, questions arise as to what is an appropriate level of debt for the State and what strategies are relevant for the future. The following scenarios might arise.

- The Government is pursuing other asset disposals. As indicated in this Report, the Government's rationale for future asset disposals is motivated by a desire to reduce exposure to perceived operational and market risks ie in the gambling industry. In this case debt reduction may, to a degree, be a by-product of other aims.
- In the event that the State proceeds with further asset disposals and this generates a premium (net improvement between interest savings and revenue foregone), the Government will have a choice in the use of such premiums — debt reduction through a cash operating surplus is an option. It must be acknowledged that such a

[77] Budget Statement 2000-01, Budget Paper 2, p. 2.2.

position seems mere postulation at this time — the data suggest that in terms of maintaining the State's relative position in relation to debt burden indicators it must continue to closely manage the factors that influence debt levels, that is the budget surplus/deficit. There is also mounting pressure to have accrual based budget targets in the future.

- In the future debt may be appropriately incurred in furthering other non-commercial sector service provision aims — for example, increasing public infrastructure. Under current government policy of meeting infrastructure from recurrent revenues this would not occur — the question is whether this policy is necessary — at least in such a strict sense. Clearly, in its own right debt is not a bad thing[78] — only excessive debt may be so regarded.

Audit is not aware of any public debate on what an appropriate debt level for a State is — this is also perhaps not to be unexpected given the recency of change and the focus necessary to achieve that change. Nonetheless, the matter is perhaps worthy of consideration given the recent major changes in the debt burden.

A CHOICE FOR FUTURE APPLICATIONS OF CASH PROCEEDS FROM ASSET DISPOSALS SHOULD THEY ARISE

It has already been demonstrated that virtually the only reduction in nominal net debt arises from asset disposals.

By comparison, funding of past superannuation liabilities is met from the budget.

While the application of electricity asset disposal proceeds to debt is a legislative requirement and, was appropriate in view of the previous net debt position, at least for the 1999-2000 disposals, this is not necessarily the position for future asset disposals.

There is a case for considering augmentation of funding for past superannuation liabilities given that such funding may generate equal if not better value for the use of proceeds in respect to the State's overall financial position.

The case for further funding of superannuation is that such funding adds to an asset base that is invested in a diverse range of assets. To the extent that that asset base earns a better return than the State's cost of funds (being the saving from debt retirement) for an appropriately accepted level of risk, the State is better off.

It is significant to note that in the past six years the returns on State superannuation assets have been as follows:

---

78 Indeed, reasonable debt servicing costs on borrowings raised to provide public infrastructure has, in the past, been regarded as an equitable way of spreading the costs over the generations of citizens that benefit from the infrastructure.

Returns on State Superannuation Assets

Year	Investment Earnings Percent
1994	3.2
1995	5.0
1996	-3.7
1997	21.0
1998	12.8
1999	11.1

In relation to the preceding table, 1997 represented the first year the then newly established Superannuation Funds Management Corporation (Funds SA) of South Australia adopted a strategic asset allocation model with an identified risk/return profile. Exceptional performance was also achieved in 1999-2000 with actual returns ranging from 12.7 percent to 17.4 percent[79] in the asset portfolio. Details in this regard are included in Part B Volume III of this Report in the section for the Superannuation Funds Management Corporation.

Three critical questions come to mind and there may well be others of equal importance.

Firstly, is the State in a position to put such funding as a priority above other demands? — this is clearly a policy decision.

Secondly, in the long term, can diverse assets earn a return greater than the State's cost of funds at a satisfactory level of risk? — this can be viewed in an historic sense. However, the past is not necessarily a good predictor of the future and the quantum of funds to risk is very large — this is, however, already the case, Funds SA has funds under management in excess of $5 billion.[80] The Department of Treasury and Finance has advised in relation to this matter that it has had a review undertaken that noted the possibility of higher returns but only at the expense of significantly higher risk.

Thirdly, is it appropriate to put further assets into superannuation beyond the current funding plan? — this is an intergenerational equity issue — such funding may produce a long term financial benefit above that of alternative courses — this benefit would however, be enjoyed to a large degree by another generation at the expense of the current generation.

A further point of interest in relation to the current funding program for superannuation is that on the current estimations, by about 2020, admittedly a long time hence, benefit payments

79 Excluding profit from the sale of the Adelaide Casino.

80 In the 'Budget Statement 2000-01' Budget Paper 2 it is noted at p. 7.14 that Funds SA aims to achieve the highest possible return on investment funds while having proper regard to manage risks at an acceptable level. It also notes the emphasis on the importance of diversification as a strategy for risk management and return enhancement.

under closed schemes begin to peak. At this time the total assets of these schemes are projected to fall over a number of years such that total available assets are in the order of one years benefits payable. (Currently, total assets are approximately equal to double one year's benefits payable). While this is well into the future, should that position arise, and estimations can be under as well as overstated, there may be a higher than normal risk of demands on the budget to meet benefit payments at the same time as meeting past service contributions (which at that time are currently estimated to be in around $350 million per annum — about double the benefit payments made at this time). Again, this is a long way off and subject to many variables, it is however, the projected position.

DEBT MANAGEMENT — GENERAL

My past Reports have discussed debt management issues in considerable detail with a focus on matters relevant to the determination of policy and on performance.

As is evident from the preceding commentary and analysis the effects of the electricity asset disposals have been widespread and it is the case that both debt management policy and performance are also influenced. The following sets out the current status of policy related matters and performance in the light of the asset disposals.

Debt Management Policy

In past Reports I have stated that borrowers have a range of choices including selecting between short-term or floating rate borrowings on the one hand and long-term, fixed rate borrowings on the other.

Decisions on these matters can have major implications for the cost of debt because of:

- differences, at any point in time, between short and long-term interest rates;
- changes in the level of interest rates;
- changes in the relationships between short and long-term rates.

Short-term interest rates are normally lower than long-term rates (though there are occasional exceptions and this has recently occurred).

It does not follow, however, that it is always the right decision for governments (or, again, other borrowers) to borrow on the basis of short-term or floating interest rates, for a number of reasons including that:

- borrowers with fixed interest obligations at the time of interest rate rises will, to that extent, be protected from those rises and may thus save in interest as compared with having borrowed short-term; another way of making this point is that, in these circumstances, the borrower will make a capital gain;

- the use of long-term, fixed interest rate debt will lead to greater stability in interest costs over time and would be appropriate for a borrower who, for whatever reason, places a premium on such stability.

Of course, the obverse of these points applies — that borrowers more interested in lower interest costs on average over the longer-term will (other things being equal) tend to prefer shorter-term borrowings and that long-term fixed interest borrowers will also make capital losses when interest rates fall.

In my 1995-96 Report (Part A, pages 38 and 39) and since then, I have discussed the 'trade off' between low interest rates on average over a period and the degree of stability in interest costs during that period.

Debt Management Review

A previous Report noted that in 1998-99 the Department of Treasury and Finance appointed an external consultant to review debt management and in particular to determine the most appropriate borrowing profile for the long-term management of the State's non-commercial sector debt portfolio.

The task involved an assessment of:

- the risks and costs associated with alternative borrowing profiles;
- the Treasurer's objective for long-term debt management;
- the outlook for future patterns in rates of interest and inflation;
- the most appropriate borrowing profile to achieve the Treasurer's objective.

Review Findings

As stated last year, a range of viable benchmarks was identified. Lower modified duration[81] benchmarks of 1.01 and 1.56 years offered lower average costs but higher budget volatility. Higher duration benchmarks of 2.09 and 2.6 years offered reduced volatility but higher average costs. The average interest cost per annum for the 2.6 year duration was estimated to be higher[82] than for the 1.01 year duration. The budget volatility of the longer duration was estimated to be less than the shorter duration benchmark.[83]

---

[81] The duration measure currently used by the Department of Treasury and Finance is known as modified duration and is a measure of the sensitivity of the value of a portfolio of interest bearing securities to changing interest rates.

[82] Average interest cost was estimated to be $19 million higher per year based on a portfolio debt in excess of $5 billion. The actual portfolio will now be much lower after the effect of asset disposal proceeds.

[83] $14 million per annum again based on a debt portfolio exceeding $5 billion.

The findings reaffirmed the fact that there is a trade-off between costs and volatility in selecting a borrowing profile and that it was a matter of judgment to determine the balance between these two factors.

Status of the Review

Following the conclusion of the review, the Department of Treasury and Finance provided the report to the Treasurer for consideration. Relevant to the consideration of the report was the fact that the Government was successful in obtaining Parliament's approval for the leases/sales of electricity assets. In the absence of projections as to how this event influenced the outcome of the review, the policy benchmarks then in operation were retained and further work on the debt management policy commissioned.

In the course of 1999-2000 it has been determined that the so-called 'post sale era' provides a range of opportunities for revision of debt management policy and related procedures.

The general conclusions of the consultancy review have been confirmed as being unaffected by the disposals outcomes ie the significant reduction in debt and, at the time of this Report, matters relevant to finalising a revised debt management policy and related practices were being resolved.

Audit's understanding is that a shorter duration range in the order of the lower duration benchmarks identified in the consultant's review will be introduced as practical in the near term. Additionally, practical and simplified operating guidelines will be adopted, assisting in reducing the administrative and transactional effort required by past practices.

The changes envisaged are also consistent with the existing overarching policy of minimising interest costs in the medium term while protecting the budget from significant variations in interest costs. To a degree the latter aim is assisted by the substantially lower stock of debt following the asset disposal program — ie the reduced level of debt naturally reduces the State's exposure to fluctuating interest rates.

Audit considers these changes to be potentially quite significant to ongoing net interest costs, with the prospect of generating direct benefits corresponding to the differences between shorter and longer interest rates over the medium term. Such differences could reasonably be expected to be greater in an immediate interest cost sense than, for example, the interest cost benefits of a credit rating improvement which may have more benefit in an economic confidence sense than a direct cost saving sense.

Debt Management Performance in Recent Years

As indicated in the Budget Papers,[84] the debt management task for 1999-2000 was dominated by the need to ensure the orderly and efficient retirement of State debt. Receipt of proceeds of the magnitude of the disposals process exposed the State to movements in

---

84 Budget Statement 2000-01, Budget Paper 2, pp. 7.10-11.

interest rates. Accordingly, the electricity proceeds were hedged to the Government's 2.8 year modified duration benchmark to manage this exposure. Hedges were entered into in December 1999 when the details of the initial transactions were reasonably known. At this time the financial markets were illiquid reflecting factors such as the then unknown effects of Y2K. Nonetheless, hedging arrangements were able to be achieved. Hedging of transactions is undertaken to manage key exposures and may occur in a number of ways each of which introduce factors of cost.

The preceding is relevant to the following table, which, as in past Reports, sets out data on debt management performance over a number of years.

Market Value Cost of State Debt (a)

Time Period	Actual Portfolio Percent	Benchmark Portfolio (c) Percent	Floating Benchmark Portfolio Percent	Long Term (10 Year Bond) Benchmark Portfolio Percent
1992-93	11.1	14.4	n/a	n/a
1993-94	3.6	0.5	n/a	n/a
1994-95	11.4	12.4	n/a	n/a
1995-96	9.4	9.1	7.7	11.9
1996-97	13.5	13.5	6.9	23.5
1997-98	8.4	8.7	5.0	18.1
1998-99	4.2	4.3	5.1	0.8
1999-2000	6.2	5.9	5.4	7.4
Three years 1997-98 to 1999-2000 (b)	6.3	6.3	5.2	8.5
Four years 1996-97 to 1999-2000 (b)	8.0	8.0	5.6	12.1

(a) Data provided by Department of Treasury and Finance and represents debt managed by SAFA on an active basis and does not include debt managed on a passive basis (eg CPI indexed debt and Commonwealth Housing Agreement Debt). It also does not include all government entities. Actual portfolio reflects the performance in respect of the actual debt portfolio. All other portfolios are hypothetical scenarios, eg Benchmark portfolio reflects the performance of a hypothetical benchmark of debt.

(b) Figures for the cost of funds shown here reflect annual rates.

(c) Duration of 3.2 years to December 1995, 2.75 years to June 1996, and 2.8 years thereafter.

(d) The debt management task is currently considered by the Department of Treasury and Finance to be in transition as debt management policy and procedures to apply in the post debt retirement era are being finalised.

The table shows the full 1999-2000 year effects of hedging of the electricity asset disposal proceeds. The cumulative market value cost of funds for the Treasurer's portfolio was 6.2 percent compared with 5.9 percent for the benchmark. For the part year before hedging commenced, the performance was 3.1 percent per annum compared with 3.2 percent per annum for the benchmark.

Hedging managed the key outright level of interest rates, however, other factors affected the performance against benchmark. These factors were that the yield curve flattened (ie the difference between short and long term interest rates reduced) and that interest differentials between different yield curves change introducing some costs associated with the long dated debt maturities and hedge instruments in the portfolio.

Ultimately, it was necessary to manage the State's exposures associated with the disposals process. While the preceding shows some of the effects associated with actions taken, it does not show the benefits of entering into the hedge transactions nor does it show the costs of alternative courses of action both of which are relevant in considering the actual results.

The table also continues to show the cost differential between shorter (in the table floating) benchmarks and longer (10 year bond) benchmarks demonstrating the cost trade-off aspect discussed in relation to the proposed change in debt management policy.

CONCLUSION

The Reduction in Net Debt

There has been a major reduction in the order of $3.5 billion in net debt in 1999-2000 and this has been effected both through physical retirement of debt and a temporary increase in financial assets pending debt retirement in 2000-01.

Even with the addition of unfunded superannuation liabilities, which were projected to rise by some $120 million, the overall decrease of net debt and unfunded superannuation liabilities remains in the order of $3.4 billion.

This is a major change in the State's financial position in as much as exposure to the burdens of net debt is reduced — following the exchange of income earning assets, that were themselves subject to a variety of operational risks, for cash.

The Debt Position Relative to Other States and Territories

The reduction in net debt has enabled the State to improve its relative position to the other States and Territories, matching some debt burden indicators and continuing to lag in relation to some others. In regard to those where this State lags the position of the main states, the ability to match their position in a number of indicators, if there is such a requirement, seems limited or at least difficult, needing further large asset disposal proceeds, and it seems appropriate to consider other possible priorities.

Also the data suggests that having achieved an improvement in debt burden indicators, this emphasises the need for strict risk management processes in protecting against the incurrence of large liabilities in the future.

Considerations Concerning the Future Application of Proceeds from Asset Disposals

In view of the improved position now existing, it is considered appropriate to consider or review current strategies in relation to the use of future disposal proceeds and/or premiums should they arise to ensure the best advantage is gained from those assets. In this regard, augmented funding of past superannuation liabilities is worthy of consideration against other priorities

Debt Management

Following the significant change to the State's financial position the Department of Treasury and Finance is well down the track to implementing a revised debt management policy tending to a lower policy benchmark duration than in the immediate past. While continuing to meet the Treasurer's policy requirements, the revisions to policy being considered provide the opportunity for lower ongoing interest and administrative costs in the future, notwithstanding the reduced level of net debt.

ASSET DISPOSALS

INTRODUCTION

1999-2000 saw the disposal of the main part of the State's electricity assets and announcements on progress with other asset disposals that are most significant to the Government's overall budget and debt reduction strategy.

This section of the Report provides an update on the program of asset disposals commenced by the Government other than the electricity assets, including:

- an overview of the principal parties responsible for the current asset reform and disposals program;
- a commentary on the current asset disposals process and summaries of specific assets.

Details on electricity asset disposals are included in the section of this Part of the Report titled 'Electricity Asset Disposals and the State's Finances'.

RESPONSIBILITY FOR ASSET REFORM AND DISPOSALS

In February 1998, the Government announced its asset sales agenda, stating that ETSA Corporation and SA Generation Corporation (trading as Optima Energy) were to be sold and that the Government was also considering a number of other sales including: the Lotteries Commission of South Australia (Lotteries Commission); the South Australian Totalizator Agency Board (SA TAB); the South Australian Ports Corporation (SA Ports Corporation); HomeStart Finance; WorkCover Corporation of South Australia (WorkCover); and the Motor Accident Commission (MAC). SAGRIC International Pty Limited (SAGRIC) was also added to the list of assets being subjected to a detailed scoping study to assess commercial risks of ownership against benefits provided.

Given the number, complexity and size of the asset disposals that are either under implementation or consideration, the majority of these disposals are being coordinated through a detailed series of procedures involving a Cabinet committee, departmental committees and specific groups within government.

The following provides an overview of the reporting relationships.

CABINET

↑

Asset Sales Cabinet Committee

↑

Asset Sales Advisory Panel and Asset Sales Steering Committee

↑

Departments

↑

Asset Reform/Sale Oversight Groups

Two departments have been allocated primary responsibility for distinct parts of the reform, sale/lease process, namely:

- ***Treasury and Finance: The Electricity Reform and Sales Unit*** was established by Cabinet to manage the reform, restructure and sale/lease process for the electricity entities and to advise the Treasurer of the appropriate policies, objectives and procedures with respect to the management of those assets. The Department is also responsible for oversight of the review and possible sale of the MAC and HomeStart Finance;

- ***Administrative and Information Services: The Government Businesses Group*** was established within the Department for Administrative and Information Services and its responsibilities include the Department's assets sales program. Review/Project teams were established by Cabinet in a previous year and are located within the Government Businesses Group. The group is responsible for the oversight of the review and possible sale of the Lotteries Commission, SA TAB, SA Ports Corporation, WorkCover and SAGRIC.

Although these parties have the responsibility for the scoping studies to determine whether a disposal is the best option for the State, the nature of their operations normally results in others being involved in the process, including the Department of Treasury and Finance, and the Crown Solicitor's Office.

In addition to the above departments being involved in asset disposals, the South Australian Asset Management Corporation (SAAMC) continues to operate. SAAMC is a statutory authority created to manage and realise the non-core business and low quality assets of the former State Bank of South Australia, which were not vested with Bank SA.

In prior years, the Government's asset sales program was undertaken principally by the Asset Management Task Force (AMTF). That program has come to an end and since the cessation of the AMTF, ongoing management of the seven remaining sale projects, and the assets and liabilities of the AMTF were in a previous year, transferred to a section within the Department of Treasury and Finance.

In addition, asset sales of a more minor nature continue to be undertaken by individual agencies as part of their ongoing operations.

The following provides a commentary on specific reform, asset sale/lease programs for the entities covered by the Government announcement.

COMMENTARY ON ASSET DISPOSALS

Department of Treasury and Finance — Electricity Reform and Sales Unit (ERSU)

The Disposal Process

In conducting asset sales/leases for which it is responsible, ERSU follows a process involving three stages, namely:

- ***Scoping Review*** — identifying all issues to be addressed to facilitate a sale/lease including the value of selling/leasing the asset compared with retention of the asset; determining whether the asset should be offered as a whole or in parts; and determining whether the disposal should be by trade sale or public float.

- ***Sale/Lease Preparation*** — addressing all issues identified in the scoping review, including legal, financial and technical due diligence; preparing an information memorandum (or prospectus); identifying the target selling market and pre-marketing; and preparing instructions for any necessary legislation.

- ***Sale/Lease Implementation*** — the sale/lease of South Australia's electricity entities is to be conducted via a competitive bidding and contracting process encompassing an expression of interest/indicative bid screening process followed by a final round competitive bidding process for each entity.

The overall sale/lease process requires Cabinet decisions at the end of each stage, before progressing to the next stage.

As mentioned, commentary on the progress of electricity asset disposals is provided in the section in this Part of the Report titled, 'Electricity Asset Disposals and the State's Finances'.

Department of Treasury and Finance — Other Possible Sales

The Department of Treasury and Finance is also responsible for the scoping reviews and possible sale of the MAC and HomeStart Finance.

Motor Accident Commission (MAC)

Macquarie Bank Corporate Finance and Tasman Asia Pacific were appointed as scoping consultants to commence a review of the compulsory third party bodily insurance market in South Australia. The review assessed the public benefits and costs of the current arrangements and any associated restrictions on competition. The review was to identify possible market structures that could achieve similar outcomes for South Australia. The implications of the proposed market structures for MAC and the Government as owner was to be assessed.

A report on the scoping review has been prepared for consideration by the Treasurer. The Premier publicly announced that there was no intention to sell government-owned enterprises, except for a limited list which did not include MAC.

HomeStart Finance

Bankers Trust Corporate Finance was appointed as scoping consultants to assist with the review of HomeStart Finance from a commercial perspective and assess options for the long-term future of HomeStart Finance.

A report on the scoping review has been prepared and submitted to Cabinet. The proposal involving the possible sale of the investment grade part of the portfolio was also considered and the sale will not proceed.

Department of Treasury and Finance — Asset Sales

As mentioned, the Department of Treasury and Finance was assigned responsibility for the completion of the sale of the seven remaining assets of the former Asset Management Task Force. Activities are conducted through the Special Deposit Account entitled, Asset Sales Operating Account. The purpose of the account provides for net proceeds from asset sales to be applied to repay the Government’s indebtedness or for other approved purposes.

Asset Sales Operating Account

During 1999-2000, the Asset Sales Operating Account received no appropriation from the Consolidated Account. Operating revenues totalled $10.8 million and comprised the net revenue transferred by the Department for Administrative and Information Services, for the sale of Central Linen, State Print and SAGRIC. Operating expenses were negligible. The balance of the Special Deposit Account was $36.8 million reflecting the proceeds of assets sales made in the current and previous financial years.

The sale of the seven remaining assets of the former AMTF has either been completed or responsibility transferred to other departments. (Refer to comments later in this section under the heading, Department for Administrative and Information Services, — 'Other Possible Sales'). During 1999-2000, no funds were applied to repay debt. However, from the net revenue transferred by the Department for Administrative and Information Services, certain sale proceeds were identified for debt and equity repayments for Central Linen and State Print. This is to be processed in 2000-01.

Department for Administrative and Information Services

The Disposal Process

As mentioned the Department for Administrative and Information Services is responsible for the scoping reviews of the Lotteries Commission, SA TAB, SA Ports Corporation, WorkCover and SAGRIC. The Government Businesses Group (GBG) of the Department has prime responsible for the management of the review, reform and possible sale of those assets. It is assisted by Review/Project Teams which have been established and located within the GBG.

The Review/Project Teams established within the Department to manage the review and possible sale of the Lotteries Commission and SA TAB were combined to form the Asset Sales Unit (Gaming) with the Unit reporting to an oversight group. Work related to other assets is managed through Review/Project Teams established specifically for the purpose.

In conducting asset sales for which it is responsible, the Department follows the same disposal process as ERSU. This process involves three stages, namely Scoping Review, Sale Preparation and Sale Implementation.

The overall sales process requires Cabinet decisions at the end of each stage, before progressing to the next stage.

Work undertaken by Audit in 1999-2000 confirmed the operation of the three stages of the sale process. In particular, Audit reviewed Cabinet submissions on the scoping reviews completed to date and on Cabinet approval of sales to date.

A summary of those possible asset sales reviewed by Audit follows.

Possible Asset Sales — Gaming

Lotteries Commission of South Australia

Bankers Trust Corporate Finance was appointed as consultant for the scoping review in conjunction with the GBG. The primary objective of the scoping review was to:

> *Identify an appropriate commercial outcome for the Government which will determine its relationship with the Lotteries Commission of South Australia and which will maximise financial returns while minimising the commercial risks (current and emergent).*

The review was to include an assessment of business and commercial risks and the impact on Lotteries Commission business of increasingly competitive alternative forms of gambling and technological changes such as interactive and electronic gambling.

SA TAB

Macquarie Corporate Finance was appointed as consultant for the scoping review in conjunction with the GBG. The primary objective of the scoping review was to:

> *Identify an appropriate commercial outcome for the Government which will determine its relationship with the SA TAB and will maximise financial returns while minimising the commercial risks.*

The review was to include an assessment of the impact of business and commercial risks facing the SA TAB.

Status

Lotteries Commission of South Australia

In last year's Report, comment was made that an initial report on the scoping review had been prepared and submitted to Cabinet. In the Cabinet submission covering the scoping review, the Government gave in principle support for a sale of the Lotteries Commission subject to further detailed analysis and resolution of a range of issues.

Last year, further work was carried out, firstly by principal consultant Bankers Trust Wolfensohn (and a number of minor consultants) and then added to by Credit Suisse First Boston. In September 1999, Cabinet in a submission reaffirmed its decision to sell the Lotteries Commission in parallel with a sale of SA TAB. In February 2000, the Government announced its intention to offer for sale the operations of the Lotteries Commission. In June 2000, the Minister for Government Enterprises introduced into Parliament two bills to provide for the sale. At the time of preparation of this Report, the bills were still before Parliament.

SA TAB

In last year's Report, comment was made that an initial report on the scoping review had been prepared and submitted to Cabinet. While there were many important issues remaining to be worked through in detail, Cabinet had, after assessing a range of commercial options, decided to investigate further the possible privatisation of the SA TAB. An important element of this decision included the requirement to consult with key stakeholders concerning a possible sale, including the South Australian Racing Industry.

Further work was carried out last year, firstly by principal consultant Bankers Trust Wolfensohn (and a number of minor consultants) and then added to by Credit Suisse First Boston. In September 1999, Cabinet in a submission reaffirmed its decision to sell the SA

TAB. In February 2000, the Government announced the sale of the SA TAB and in June 2000, a bill for the disposal of the SA TAB was introduced into Parliament. At the date of preparation of this Report, the bill was still before Parliament.

Other Possible Sales

In a previous year, the Government announced its intention to have scoping reviews completed for a number of other organisations to assess the risks of continued Government ownership and consider privatisation. The Department is responsible for progressing the reform/possible sale of a number of other government assets including:

- SA Ports Corporation
- WorkCover
- SAGRIC.

In addition to the above, the Central Linen Service and State Print are part of the previous sales agenda and are also the subject of review and sales consideration.

South Australian Ports Corporation

The scoping study has been completed and a submission containing the consultant's findings on the scoping review was prepared and presented to Cabinet. In March 1999, Cabinet approved a number of recommendations which included the following: 'in principle, that South Australian Ports Corporation be sold as a whole by way of a trade sale...'

In April 1999, the Government announced its intention to proceed in principle with the sale of the SA Ports Corporation and established the Ports Corp Sale Project Team within the Department for Administrative and Information Services. Since that time a private sector corporate advisory firm has been appointed to '...assist the Government to achieve a vibrant, competitive transport sector for South Australia and maximise the value of the SA Ports Corporation trade sale'.

In November 1999, the Government announced that the Kangaroo Island ports, including Kingscote, Penneshaw and Cape Jervis would be separated from the sale, as these ports '... are community ferry ports and quite different from the larger commercial wharves that operate elsewhere in the State'. Navigation aids, channels and breakwaters have also been excluded from the proposed divestment of South Australian Ports Corporation.

Three bills were introduced into Parliament in May 2000 to provide for the disposal of the assets of the South Australian Ports Corporation. At the time of preparation of this Report, the bills were still before Parliament.

WorkCover Corporation of South Australia

In a previous year, a scoping study review was completed and Cabinet approved the recommendation to: 'retain the Corporation in Government ownership and withdraw it from the assets sales process'.

SAGRIC International Pty Limited

The scoping study has been completed and a scoping report on the future of SAGRIC was prepared and submitted to Cabinet. In March 1999 Cabinet approved a number of recommendations which included the following:

> *SAGRIC International Pty Ltd (SAGRIC), other than the Government Services Export Unit (GSEU), be offered for sale by a relatively short process of public Registrations of interest followed by Requests for Proposals from shortlisted parties interested in purchasing SAGRIC ...*

In December 1999, Cabinet approved the sale of SAGRIC and in particular approved negotiations for the sale of the shares of SAGRIC. The Department for Administrative and Information Services (DAIS) is responsible for the residual receivables and contracts of SAGRIC retained by the Government and not transferred to the purchaser. The residual receivables and contracts are under the control of the GBG which is responsible for their completion and collection. To 30 June 2000, DAIS has collected $3.6 million for the receivables and sale of shares which has been transferred to the Department of Treasury and Finance controlled — Assets Sales Operating Account. Further amounts are due to be received post 30 June 2000, from the receivables retained by Government upon the sale of SAGRIC.

Central Linen Service

In October 1999, Cabinet in a submission approved the sale of the Central Linen Service to Ensign Services (Aust) Pty Ltd trading as SSL Spotless Linen.

Sale proceeds amounted to $11.3 million with proceeds being recorded in DAIS's accounts and the net proceeds transferred to the Department of Treasury and Finance controlled — Asset Sales Operating Account.

In that Cabinet submission, it noted that there are strong strategic reasons (in particular the avoidance of industrial, business and employee risks) for proceeding with the sale of Central Linen despite an estimated cost to Government of $5.8 million in net present value terms over ten years. A significant ongoing cost to Government relates to the redeployees previously working within the Central Linen business unit. These redeployees continue to be the responsibility of DAIS and are managed by it's Placement Services Unit.

State Print

In August 1999, Cabinet in a submission approved the Minister for Administrative Services entering into contracts for a sale of State Print to Endeavour Print Pty Ltd. After further negotiation, only the assets required by the purchaser were transferred with the printing and related services being outsourced to the purchaser. The part of State Print that publishes the Government Gazette and provides printing and publishing services to the Parliament was not included in the sale.

In that Cabinet submission, it indicated that the sale of assets and recovery of debtors was $1.2 million and that this amount was to be offset against the book value of the assets. However, the Cabinet submission also detailed that there is a net cost to government in the first five years of $5.2 million for the disposal of State Print and included in that cost is the cost of redeployees.

Accounting

In a previous year, the Treasurer approved the creation of a non-interest bearing Special Deposit Account entitled, Office for Government Enterprises, Asset Sales Operating Account through which the Asset Sales Unit will conduct its activities. In effect, the activities of the Unit are the activities of the Asset Sales Unit (Gaming) and Review/Project Teams established to oversight the review and possible sale of assets for which the Department has responsibility. The purpose of the account is consistent with other sales accounts.

For the 1999-2000 financial year, funding provided from the Department of Treasury and Finance Controlled — Asset Sales Operating Account to the DAIS — Asset Sales Operating Account amounted to $2 million, expenditure was $4.7 million which included $3.1 million for consultants, with the majority of the cash balance of the DAIS — Asset Sales Operating Account being used to fund the balance of expenditure.

Post-sale Responsibilities

Following the completion of a sale there is often the need to manage not only those assets that did not form part of the sale but also other post-sale contract responsibilities. These responsibilities may be undertaken by establishing entities or processes to specifically manage them, or by utilising existing administrative arrangements. Examples of specific post-sale responsibilities undertaken by various parties include:

- SAAMC, which was established with responsibility for the non-performing assets of the State Bank of South Australia;
- MAC, which is responsible for Compulsory Third Party insurance and certain residual activities of SGIC not forming part of the sale (eg credit risk and similar type insurances).

Audit review of post-sale responsibilities is normally considered as part of the sale process and the monitoring of post-sale responsibilities will often form part of the ongoing audit of the agency or entity responsible.

South Australian Asset Management Corporation (SAAMC)

As previously mentioned, SAAMC was established in July 1994 to manage and realise non-core business and low quality assets of the former State Bank of South Australia. On commencement, the Corporation had assets of $8.4 billion and approximately $8.1 billion of short-term and long-term government guaranteed borrowings.

Sales of assets by the Corporation have been used to reduce the size of its balance sheet, and this is reflected in the Corporation's assets (and corresponding liabilities and capital) which have been reduced as follows:

	$'billion
1 July 1994	8.4
30 June 1995	4.0
30 June 1996	2.9
30 June 1997	2.4
30 June 1998	2.5
30 June 1999	2.2
30 June 2000	2.1

Assets on hand at 30 June 2000 principally relate to liquid and trading securities set aside for repayment of borrowings as they become due for payment.

During 1999-2000 SAAMC had no major asset divestments and settlements. The decrease in SAAMC assets, liabilities and capital to $2.1 billion reflects the loan repayments that occurred. SAAMC is due to repay $314 million of capital markets borrowings in 2000-01 and this will result in a further reduction in the Corporation's balance sheet, ie the assets and corresponding liabilities/capital. SAAMC's long term debt profile is such that the majority matures in the period ranging from year 2001 to 2005.

For 1999-2000, the Corporation made an operating profit after income tax of $30.2 million ($50.9 million) and had retained profits at 30 June 2000 of $243.3 million. The reduction in operating profit after income tax was due principally to a reduction, from the previous year of $20 million in recoveries of bad and doubtful debts.

Under its governing legislation, any surplus of funds of SAAMC must be paid into the Consolidated Account or otherwise be dealt with as the Treasurer of South Australia may determine. As in the previous year, the Treasurer has determined that, SAAMC's surplus in retained profits and capital remain in SAAMC's accounts as at 30 June 2000.

As a consequence there was no distribution of SAAMC's profits in the 1999-2000 financial year. The 2000-01 budget papers show that the distribution of SAAMC's profits has been deferred to the 2000-01 financial year.[85]

CONCLUSION

With the progress achieved in the sale/lease of the electricity entities; the preparation of bills which are before the Parliament for the sale of the Lotteries Commission, SA TAB and SA Ports Corporation, asset disposals are a major feature of the Government's budget and debt reduction strategy to reduce the impact of interest expense on the Budget. There is a need for the disposals to be underpinned by sound processes that exhibit transparency and reflect appropriate accountability mechanisms. It is essential that, in the event of disposal, maximum benefit is achieved by the disposal process not only in terms of disposal proceeds but also the broader effect on the South Australian community.

Audit will continue to monitor the progress of asset disposals, review procedures and financial analysis justifying the decisions taken to accept final bids and ensure that proceeds are used for the purpose for which they are intended.

Under the provisions of the *Electricity Corporations (Restructuring and Disposal) Act 1999*, I have commenced an examination of each long-term lease completed and will report separately; on the proportion of proceeds used to retire State debt; on the amount of interest on State debt saved as a result of application of those proceeds; and on the probity of the processes leading up to the making of each long-term lease.

---

85 Estimates Statement, 2000-01 Budget Paper 3, p. 58.

WHOLE-OF-GOVERNMENT FINANCIAL STATEMENTS

INTRODUCTION

The progress achieved with preparing whole-of-government statements, although currently not required to be audited, means that South Australia is presenting similar information to that used by most other Australian jurisdictions.

For a number of years now my Reports have commented on the need for continuing enhancement of the various data presented on the State's financial position. I have commented that I consider whole-of-government financial statements, together with other information such as the Budget, Budget Outcome, and agency financial statements, provide users with both an overview and a detailed understanding of public sector operations, achievements and financial position.

This section of the Report provides an overview of issues relevant to the presentation of whole-of-government financial statements and provides some brief analysis and commentary on data currently available.

Because the timing of the tabling of this Report in Parliament is before the annual whole-of-government financial statements can be finalised for the immediate past year, ie 1999-2000, data referred to herein is in relation to the 1998-99 year. Accordingly, such commentary is brief.

PREPARATION AND AUDIT OF WHOLE-OF-GOVERNMENT FINANCIAL STATEMENTS

Consolidated financial reports for the South Australian public sector have been prepared since 1996-97, however, there has never been a legislative requirement for their preparation, audit or presentation to Parliament. Neither is there a legal framework detailing requirements as to the form and content of the whole-of-government financial statements.

The *Public Finance and Audit Act, 1987* (the Act) does not require that the whole-of-government financial statements be audited by the Auditor-General and be tabled in the Parliament for consideration of the members.

I commented last year, that the Department of Treasury and Finance would commence a detailed review of the Act in order to establish an appropriate financial reporting and auditing regime to formally adopt accrual based whole-of-government financial information as a fundamental element of the financial accountability framework in the State. At the time of this Report, that review had yet to be completed.

EXISTING REPORTING FRAMEWORK

The current basis for preparation of the whole-of-government financial statement is the Australian Accounting Standard AAS 31 'Financial Reporting by Governments' which became mandatory for the reporting period ending on or after 30 June 1999.

The Standard notes the following as its purpose:

> *3.1 The purpose of this Standard is to set out standards for general purpose financial reporting by the Commonwealth Government, the governments of New South Wales, Queensland, South Australia, Tasmania, Victoria, Western Australia, the Australian Capital Territory and the Northern Territory.*
>
> *3.2 Commonwealth, State and Territory Governments are reporting entities, and should prepare general purpose financial reports, because there are users who depend on the financial information contained in them for making and evaluating decisions about the allocation of resources. Users of the general purpose financial reports of governments include parliamentarians, the public, providers of finance, the media and other analysts. General purpose financial reports will also assist governments to discharge their financial accountability*

Further, the standard notes that the accrual based whole-of-government statements offer additional information to users compared to cash based information. It states:

> *3.2.1 This Standard requires governments to prepare accrual-based general purpose financial reports which include the assets they control, the liabilities they have incurred, and their revenues and expenses so that their financial reports provide users with a comprehensive summary of their financial performance, financial position, and financing and investing activities. Users are not able to obtain this overview by analysing all of the individual financial reports of the many entities which a government controls.*
>
> *3.2.2 Accrual accounting is where assets, liabilities, equity, revenues and expenses are recognised in the reporting periods to which they relate, regardless of when cash is received or paid. In contrast, the cash basis of accounting records the effect of financial activity only when cash is received or paid. Accrual accounting provides better information about financial performance, financial position and financing and investing activities because it records assets and liabilities (as well as amounts received or paid during the current period). As a consequence, accrual-based financial reports prepared*

by governments for a given period will differ significantly from cash-based financial reports covering the same period. For example, the following information is evident in accrual-based financial reports but not cash-based financial reports:

- *(a) non-cash assets such as land, buildings, motor vehicles and plant and equipment and their depreciation;*
- *(b) the value of 'receivables' (such as the amount owing to governments from others but not yet received) and the value of 'payables' (such as amounts owed by governments for goods that have been purchased but not yet paid for);*
- *(c) liabilities, including those relating to employee entitlements which have not yet been paid and long-term contractual obligations;*
- *(d) the changing value of a government's financial assets and liabilities, such as changes to amounts owed to overseas lenders resulting from exchange-rate movements; and*
- *(e) the full cost of government activities for the period, the revenues generated for the period, and any differences therein.*

Currently, the Treasurer and Under Treasurer are responsible for preparation of the whole-of-government financial statements. During the year, on their behalf, the Department of Treasury and Finance formally prepared and presented a complete set of whole-of-government financial statements in accordance with the Accounting Standard. These financial statements were for the period ending 30 June 1999.

As stated, I consider the whole-of-government financial statements as an essential component of the various information presented on the State's finances and financial position and are useful to management, governing bodies and other users for making and evaluating decisions about the allocation of scare resources.

However, until such time as relevant legislative provisions are passed that will provide for the audit of these statements, I am unable to issue a formal Independent Audit Report containing an audit opinion.

Notwithstanding the absence of a mandate to issue a formal audit report in respect of such information, I considered it both valuable and within the ambit of wider public expectation that such financial information should be required to carry some form of independent commentary regarding its credibility and validity. Consequently, having regard to audit work performed in relation to the whole-of-government financial statements for 1998-99, a management letter was forwarded the Department of Treasury and Finance with a view to providing an indication of the important financial reporting considerations that would need to be addressed in order to receive an unqualified independent audit report; should prospective legislative changes require the need to provide such an audit opinion. These considerations included:

- the whole-of-government financial statements have excluded certain entities that Audit consider should have been included;
- limitations on the scope of our audit process as a consequence of unaudited health data being used to form part of the consolidation process;
- uncertainty as to the carrying values ascribed to plantation forests;
- uncertainty in provisions brought to account for contract losses.

The Audit management letter was reproduced in full with the whole-of-government financial statements published by the Department of Treasury and Finance.

Departmental Response

The Department responded positively to the issues raised. In regard to the particular issue concerning mandated authority to both prepare and audit whole-of-government financial statements, it was suggested that this issue was to be addressed as part of planned amendments to the Act.

Other aspects, concerning potential qualification reporting areas, were either being progressed or addressed in terms of a consultative process with responsible agencies for practical solutions over a reasonable time horizon.

AUDIT REVIEW OF THE CURRENT REPORTING PROCESS

Scope of Review

The scope of Audit's review spanned some 80 consolidated government agencies. The basis for this consolidation was Australian Accounting Standard AAS 24 'Consolidated Financial Reports' which sets out the principles for determining the economic entity. This standard uses the concept of control[86] to determine which entities will be included.

The coverage represented all sectors of State Government activity namely:

- the general government sector which comprises all agencies that are not public trading enterprises or public financial enterprises;
- public trading enterprises that provide goods and services which are mainly market, non-regulatory and non-financial, and financed mainly through sales to the consumers of these goods and services;

---

86 Control is defined as the capacity to dominate the financial and operating policies of another entity so as to enable that other entity to operate with it pursuing its own objectives.

- public financial enterprises that have one or more of the following characteristics: they perform central bank functions; accept demand, time or saving deposits; or have the authority to incur liabilities and acquire financial assets in the market on their own account.

However, because of the concept of control used to prepare these statements, 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.

Timely Reporting

The usefulness of the whole-of-government statements is contingent on their reliability as well as timeliness. In view of the enormity of the consolidating task, it is only currently possible, within any one reporting year, for this Report to present the financial statement outcomes of the whole-of-government for the preceding financial year. Provided below is a summary of the past three years financial results to 1998-99.

It is Audit's preference for the Department of Treasury and Finance to be able to report at the earliest opportunity so that information is available to users on the most timely basis. It should be noted, however, that the consolidation exercise is contingent upon the Department of Treasury and Finance receiving in a timely manner the audited data provided from all public sector agencies, which presents inherent limitations on the timeliness of this exercise.

In relation to the 1999-2000 financial year, the Department has advised it has received an improved response from agencies which should assist in the preparation of the statements.[87]

Financial Results of Past Years and an Analysis

	1999 $'million	1998 $'million	1997 $'million
Revenues			
Taxation	1 749	1 656	2 411
Grants	3 697	3 574	2 933
Sale of goods and services	3 964	3 437	2 911
Investment revenues	1 048	1 161	1 277
Other	570	777	725
	11 028	10 605	10 257
Expenses			
Employee expenses	3 660	3 109	3 716
Supplies and services	2 814	2 493	2 232
Grants and subsidies	1 554	1 144	753
Interest and other finance expenses	1 387	1 690	1 974
Other	1 953	1 880	1 920
	11 368	10 316	10 595
Operating Surplus (Deficit)	(340)	289	(348)

87 While this is the case for the whole-of-government financial statements, the Department also prepares the annual Budget Outcomes document — a whole-of-government report but with a different focus. With regard to this report, the Department is continuing to experience difficulties in receiving the relevant information on a timely basis.

	1999 $'million	1998 $'million	1997 $'million
Assets			
Cash and investments	7 708	7 607	6 248
Superannuation assets	996	3 542	3 055
Physical assets	22 825	22 814	21 524
Other	2 555	2 456	2 471
	37 084	36 419	33 298
Liabilities			
Unfunded superannuation	3 909	3 839	4 399
Borrowings	14 999	14 771	13 872
Employee entitlements	1 028	1 055	893
Superannuation liabilities	3 945	3 555	3 055
Other	2 720	2 413	2 761
	26 601	25 633	24 980
Net Assets	10 483	10 786	8 318

Data for 1997 is presented primarily for reference purposes. Improvements since that data was prepared mean that the 1999 year is the most reliable year. The data highlights some interesting aspects over the past three years, namely:

- an operating deficit for the period, between 1998 and 1999, of $340 million; a turnaround of $629 million from the previous year's surplus. This can principally be reflected by the increase in Employee Expenses and Supplies and Services;
- Employee Expenses, in particular, includes superannuation expenses comprising new service expense plus the gain or expense arising from any decrease or increase in the past service liability. During 1998-99, this expense item amounted to approximately $655 million. Within any financial year, the magnitude of changes made to the unfunded past superannuation service liabilities significantly contribute to the operating result for the period. Changes are due mainly to investment returns on superannuation assets and reassessments of assumptions in superannuation liability estimations;
- Net Assets have fallen marginally and primarily as a result of the deficit from operations during the year;
- as mentioned, the variability in data since 1997 to present reflects, inter-alia, the incremental improvements to the consolidation process and the reliability and uniformity of data presented between years. In analysing financial statement data, readers need to be cognisant of the inherent limitations of historical data; namely:
  - — seasonal and economic policy factors, both at a State and Federal level;
  - — any ratios used to evaluate the data are ex-post; meaning they reflect past decisions and are only predictive of the future;

— ratios used to analyse the data require significant interpretation and subjective assessment;

— accounting policies and methods used to present data by individual agencies can affect certain ratios — particularly if there is a mix of historical cost and revalued information within the accounts, which is certainly the case in comparing information between jurisdictions;

— inflation may mean an increase in profit in nominal dollar terms but not ‘real’ terms.

Notwithstanding the caution discussed above, it is equally important for me to repeat a comment I made several years ago that while the data maybe unavoidably imperfect in detail, it is correct as to order of magnitude, and is meaningful, highly relevant, and useful in understanding the broad structure of the State’s financial position and the overall relationship between the State’s assets and liabilities.

CONCLUSION

Significant progress has been made in whole-of-government financial reporting in this State, to the point where data is now formally prepared and presented in accordance with Australian Accounting Standard AAS 31 ‘Financial Reporting by Governments’ subject to Audit’s observations.

The issue regarding a proper legal framework that will address matters concerning the format and content of presentation as well as the ability to audit those statements continues, but is being addressed by the Department of Treasury and Finance.

Notwithstanding their usefulness and general importance to public governance, like all general purpose financial reports, there are inherent limitations in analysing such data and users need to be cognisant of a range of factors in evaluating the general financial health of any reporting entity.

PUBLIC SECTOR WIDE ISSUES:

SPECIFIC AUDIT ISSUES AND

MATTERS OF IMPORTANCE AND INTEREST

PUBLIC GOVERNANCE: THE GOVERNMENT MANAGEMENT FRAMEWORK AND BUDGETARY REFORM

INTRODUCTION

Previous Audit Commentary

My last two Reports have provided an overview and my observations on the objectives, concepts and recent developments concerning the reform agendas associated with the Government Management Framework (GMF) and its application since being introduced in late 1996. In essence, this year's Report draws together those past reviews and work performed in 2000 and reflects the issues that have been formally raised by Audit with the Under Treasurer and Chief Executive of the Department of the Premier and Cabinet regarding directions and actions proposed to progress managerial and cultural transformation in the public sector.

It is important to acknowledge from the outset that I have based this and previous audit reviews of this matter on the premise that government agencies and their constituents, generally would benefit from the implementation of the reform agendas given their objectives. Consequently, I have considered it important, as in the past, to report on the progress with those agendas and highlighted where I saw risks to the achievement of the targeted benefits. Importantly, my Report highlights what I consider to be a high degree of interdependence between critical elements of the reform agenda such that a breakdown in one area could have important ramifications for the approach as a whole. In this regard, identifying and completing the accountability chain has consistently been a particular focus of Audit's review.

The Objective of the Reform Process

To recap, the GMF represented a package of management and administrative initiatives designed to further improve the public sector's delivery of policy and services to Cabinet, individual Ministers and the community,[88] and to move agencies to a more competitive and business-like approach to serving the community. Budget Reform picked up these elements and has been the principal major reform initiative of the GMF. The aim of Budget Reform was stated as:

> *The ultimate objective of budget reform in South Australia is to help the government deliver:*
>
> - *Improved services*
> - *Value for money*
> - *Sound State Finances*
>
> *through better information for decision-making and clearer managerial authority and accountability.*

---

[88] An Introduction to the Government Management Framework, November 1996.

Two key outcomes from Budget Reform to date are changes in the budget preparation process and the content of the Budget Papers presented to Parliament.

Cessation of the GMF Project Board and Changed Responsibility Arrangements

The GMF Project Board was essentially vested with primary responsibility for progressing the aims of the GMF. A key outcome during 1999-2000 was the cessation of the GMF Board and upon its demise, de facto ownership passed onto the Senior Management Council and central agencies (Department of the Premier and Cabinet (DPC) and Department of Treasury and Finance (DTF).

The GMF concepts encompassed the activities of Ministers and their agencies and had the potential for improved accountability of Executive Government to the Parliament and between Ministers and their agencies. Success in achieving the GMF aims is dependent on the roles and approaches of all these participants. In this regard, I consider that DPC, as well as DTF, in their current role as the primary administrators of public sector policy and financial management, have a most important role in leading and inspiring the adoption of various aspects of the reform agendas. Their individual success will in turn depend on their own actions, but also, and most importantly, the response of the other key participants. Audit’s review highlighted a range of areas which need to be addressed to facilitate that success.

Responses to Issues Raised by Audit

The responses received in relation to issues raised by Audit indicate the considerations that I have just mentioned are shared by the central agencies. It is also apparent that experience to date is moulding a response to the key areas of the reform agendas that need further work. The advice received suggest that the practical application of the original principles is being pursued rather than attempting to replicate models for their own sake. Audit endorse this approach. There are areas, however, where it is not yet clear how this will be achieved. To this extent Audit has referred to certain ‘models’ of approach, such as change management, that may assist in the achievement of future objectives. The following sets out the matters considered by Audit in 1999-2000 and raised with central agencies. Also set out is the current position as advised by the agencies

BACKGROUND

GMF and Leadership

The GMF Project Board comprised of senior public servants from various portfolios. The Board was responsible for providing broad leadership, direction and coordination of the change processes associated with GMF, to the Senior Management Council (SMC), but was not a decision making board in the traditional sense. As already explained, however, the Board was a driver to the aims, concepts and outcomes of GMF. It had, however, ceased to operate during the year and Audit sought to understand which agencies/officers were now driving change and the principles espoused by the project.

Key Aims, Concepts and Outcomes

The key aims of the GMF were to:

- improve the focus, competitiveness, responsiveness and accountability of public sector operations, using benchmarking and contestability;
- ensure that the Government's strategic priorities drive planning, operations, budgeting and monitoring across and within agencies;
- improve the strategic management of government and agencies;
- ensure that the public sector plans, allocates, monitors, and accounts for resources in terms of what it intends to achieve for the community (outcomes) and the services (outputs) it will provide.

To achieve this, it was intended that the following key strategic outcomes would be required:

- ***An outcomes/outputs policy framework:*** whereby Ministers and Cabinet focus more on outcomes and Chief Executives and agencies are responsible for outputs;
- ***A revised accountability framework:*** where a clear and formal distinction of roles exists between Ministers as funders and purchasers of outputs which are directed at achieving specified outcomes and Chief Executives as providers of outputs in terms of quantity, quality, price and timeliness. This approach should result in output based agreements and enhances the scope for the competitive and/or contestable provision of government services;
- ***Development of an integrated management cycle:*** defining a predictable and stable annual process that would serve to bind together government strategic decision-making with decisions on resource allocation, the delivery of quality public services and whole-of-government reporting;
- ***Design and implementation of improved performance measurement and reporting:*** incorporating regular benchmarking and peer review processes, the adoption of consistent and comprehensive accounting and budgetary standards, and the provision of data which is widely accepted, credible and auditable.

Following progress of the previous two years, the main themes by which the GMF Board were to progress these outcomes in 1999-2000 were included in Stage 3 of their strategies. As advised to Audit, at the time of my Report last year, these initiatives were in the process of being developed and involved:

- consolidation of the GMF to date, particularly budget reform;
- alignment of Cabinet priorities, policies and planning and resource allocation;
- communication of the GMF as an integrated approach across all levels of government;

- support for change in management behaviour and leadership;
- creation of mechanisms to address cross portfolio issues;
- further exploration of the mechanisms for accountability.

AUDIT FINDINGS AND COMMENTS

Leadership

At its introduction in late 1996, the GMF represented the face of major change in the financial management reforms in the South Australian public sector. As with any reform or change agenda of this magnitude, whether it be by a private corporation or government, strong, clear and capable leadership was imperative.

The GMF Board was founded upon clear goals and timeframes; that is, seeking improvement in accountability, strategic management and focussing state resources towards the production of outputs and outcomes[89] and whilst some progress was being made towards these goals, the GMF Board has recently ceased to exist. Prior to its cessation, Audit considered that the GMF Board, as the driver of change, had not set out a complete, strategic vision of what the GMF comprised and, in effect, never really established a specific framework which captured its aims.

I raised the issues of authority, leadership and accountability as discernable risks in 1998-99, yet it was not apparent how, with the cessation of the GMF Board, these risks would be mitigated so that the significant resources already committed to the GMF and Budget Reform would achieve their aims. Certainly, if the original principles and aims of the GMF were valid, and I consider they were, the question remained as to who will now take up the reigns and will they be afforded the necessary authority, accountability and incentives to ensure their 'follow-through'.

During any change management process, the importance of time and timing cannot be discounted. Both scepticism and resistance are two significant factors which need proper planning so that every time momentum is lost, outcomes fail or aims are compromised, the ability to continue to achieve the outcomes and aims is not further undermined.

Change Management

The support for change in management behaviour, leadership and communication was also recognised as a key aim for Stage 3 of GMF. I commented last year that, while recognising this as an aim, the GMF Board had not developed a detailed plan on how these risk elements would be addressed. Surveys over past years by my officers and DTF have clearly highlighted the importance of these issues.

---

[89] Refer 'An Introduction to the Government Management Framework', Government Management Review Unit, November 1996.

An important element for change management is focus on the ultimate outcome. In Audit's view, as discussed later, this aspect of the change management process is currently not clear to all participants. In this regard, certain principles embodied within the GMF are also exclaimed within the Financial Management Framework (FMF).[90] Specifically, central to both frameworks are the reinforcement of devolution and decentralisation approaches to management, administration and control. Any reform agenda which seeks to devolve decision-making authority and empower agencies requires a sound framework of accountability, supported by development (training, etc), and communication. Cultural transformation is a bi-product of this process. Structured change management implementation plans, are considered to enhance the prospect of success for such a reform agenda and to assist the achievement of its aims in the most effective and efficient manner. Such a 'roll-out' would ensure detailed consideration and an action plan addressing issues concerning:

- the ability to generate a felt need/pressure for change;
- ensuring the vision for change is shared and that there is commitment to it;
- the capacity to deliver change (via resources and skills) is feasible;
- a plan detailing priorities and actionable steps needed is presented and continually reinforced;
- ensuring that there is strong leadership afforded to the project (in DTF and agencies) so there is a 'modelling of the way' via behaviour and attitude.

There is evidence that, at least within the first two years of implementation of the Budget Reform aspect of the GMF, that some of these attributes were exhibited and changes to budget process and presentation were achieved.

Two Matters Arising from this Year's Audit Review

Overall, in Audit's view two matters arise from this year's review. They are clarification of what the target for change is and who will provide the focus for change. Clarity, of what is ultimately desired to be achieved by all relevant participants from Parliament, Ministers and agencies so that the potential value of change can be emphasised. In this regard, in the absence of the GMF Board, or at present any other authoritative body to ensure the original principles and aims of the GMF Board continue to be pursued, there is a risk that the desired change is not achieved. There appears to remain a need for a specific authoritative body to engender change. Focused responsibility could assist in the process of identifying where risks lie to success managerial change, whether it be at Parliamentary level down through to agency level and in mitigating those risks.

---

90 The Financial Management Framework has been issued by the Treasurer as a contribution towards financial management improvement across the public sector. It is designed to ensure government objectives are achieved through improved financial management.

The FMF is discussed further in this section of the Report in the section titled 'Financial Management Framework: Audit Observations'.

It is evident that to date all intended participants (ie; Parliament, Ministers, agencies) in the reform program have yet to be convinced of its value in a variety of respects. Equally, all have adopted some elements.

Audit considers that perhaps the GMF and FMF could be packaged as one integrated reform tool. If Audit's observation's are not considered palatable, the question remains as to what agenda and change plan has been platformed so that these matters can be addressed?

Role of Central Agencies

Audit's review suggested that DTF remained a key participant in the ongoing reform process but, have yet to more clearly define their role. There is much evidence that suggests DTF have and want to move away from detailed, direct responsibility where relevant, but exactly what that level should be and their role in the overall accountability process remained unclear and not formally communicated to the wider public sector.

As was said in my 1998-99 Audit Report to Parliament, devolvement of responsibility tends:

> *… to obscure the fact that government is a single enterprise, which should be unified around commonalities of purpose, behaviour, management standards and reputation … [there was a need to re-build] the commitment to the collective interests of government.*

The DTF spearheaded the Budget Reform project and effectively have carriage of its outcomes, as manager of the State's finances. In positioning itself for life after Budget Reform, the DTF has undergone significant internal change, in particular:

- committing significant resources to the amalgamation of three key branches (Financial Management Branch, Budget Branch and State Enterprises) into a single Finance Branch;
- the redesign of business processes within the new Finance Branch;
- progressing the budget reform agenda and the implementation of a new Budgetary Finance Management System (BFMS).

DPC has a central leadership role for the whole-of-government and in government policy development. The nature of the GMF implies an important role for DPC. While the audit review did not focus on DPC processes in this regard, the audit findings were forwarded to DPC to ascertain their current role.

Departmental Responses

In responding to issues regarding leadership and organisational role, the DPC advised it considered it had an educative role for agencies and an advisory role for the Premier and Ministers.

On the other hand, the DTF considered its core responsibility was to ensure agencies are accountable for their performance against the responsibilities allocated to them by government. This accountability is to be achieved through the budget processes and monitoring of both financial and non-financial performance. DTF acknowledged, however, that both financial and non-financial monitoring required further development, to build on the reform process. In this regard, it was indicated that DTF were currently developing proposals for the Treasurer's consideration to improve both the timeliness and scope of financial reporting.

The DTF confirmed, that it should take a central leadership role in budget reform. Equally, the focus of these reforms should be ensuring agency accountability against government objectives. Subject to approval of the Treasurer and Cabinet, DTF will be setting out some short term plans aimed at achieving greater accountability and better information flows. DTF will consult with agencies on particular proposals but did not consider it necessary or desirable to set out detailed plans or timelines too far into the future.

Post-script

It is important to reiterate that the issues regarding leadership, change management and agency roles should be viewed as elements of one focus: cultural transformation. The key aims, objectives and outcomes of the GMF all had views of achieving a fundamental shift in both attitude, behaviour and process. In order to achieve this, in such a large and diverse sector of operations, takes considerable time, but imperative to the process is strong and collaborative leadership from key stakeholders with the will and power to achieve such change. Education and communication go part of the way, but in a bureaucratic system where agencies are driven by short planning horizons, increasing education may well be too long a time-line to achieve the desired results and therefore, what is needed, in my opinion, is an in-built incentive mechanism to ensure stronger cohesion by all participants.

Later in this section, I will discuss that these in-built mechanisms are perhaps most practically derived from existing frameworks and enhancements to past methodologies.

A Reassessment of GMF: Cabinet Priorities and Experiences to Date

The audit review highlighted a range of matters that suggested a need for review of the original concepts and a restatement of current concepts and aims to provide a context for the future. The following sets out the audit findings and departmental responses.

GMF/FMF Overlap

As referred to earlier, certain principles embodied within the GMF are also exclaimed within the FMF. Central to both frameworks are the reinforcement of devolution and decentralisation approaches to management, administration and control.

There appears to be a large degree of overlap in the principles promulgated by both frameworks. Consequently, in the absence of the GMF Board, or at present any other authoritative body to ensure the original principles and aims of the GMF Board continue to be pursued, Audit suggested that perhaps the GMF and FMF could be packaged as one integrated reform tool.

Departmental Response

The DTF outlined that they are currently in the process of developing a range of alternative measures that would be able to restate the expectations, aims, tools/methods relating to GMF matters. These have yet to be forwarded for the Treasurer's approval.

Deferral of Measurement of Outcomes

In last year's Report I referred to the Priorities Statement which first became a feature of the 1999-2000 Budget Papers and continued for this year. The Priorities Statement refers to a set of 'priorities', it does not attempt any priorities as such; rather, the priorities are broad and all encompassing. Priorities typically have a propensity to drive strategies and deliberate policies, where they are sufficiently articulated; ultimately, they should assist in determining wider resource allocation decisions.

A Directions Statement has since been established and was used as a basis to chart the relationships between government outcomes and agency priorities and initiatives in the 2000-01 Budget Papers.

Nonetheless, the question I raised in my Report last year as to what will achieve the Budget Reform axiom of 'planning as a driver to budgeting' remains relevant to the budgetary process this year. As I stated, the absence of such planning has the creative potential for dysfunctional behaviour towards the whole budget process as it becomes focused on:

> *… the short production of outputs rather than planning for the long haul and to accounting for what has been produced rather than to evaluating progress in achieving major policy objectives.*

The current platform for budget reform was principled on two key concepts; the Funder-Owner-Purchaser-Provider model, as well as recent academic literature on the approach to performance management utilising the Balanced Scorecard concept.

The Funder-Owner-Purchaser-Provider model has already been applied within many jurisdictions of the public sector. Most notable being the health sector, with recent experiences in regard to outsourcing of provider roles[91] being well documented; both in experience and level of success. I questioned the generic application of such a model in the public sector, highlighting experiences to date, and sought to understand the degree to which it would continue to underpin future managerial and financial frameworks within the public sector.

Central to both the Funder-Owner-Purchaser-Provider Model and the Balanced Scorecard concepts is the distinguishing between various levels in the supply chain; particularly with respect to the provision of the two levels of good/service: outputs and outcomes.

One clear aspect of the revised approach to both developing and monitoring the budget was the distinguishing between outcomes and outputs as a basis for subsequent measurement as to the extent to which certain priorities had been achieved. From the outset, there was a clear premise that much improvement from the revised budget process would be through a better aligning of government priorities with budget outcomes. In essence this is the linchpin to the model for budget reform in this State and revisions to the 2000-01 Budget pick up links between government outcomes and agency priorities for each portfolio.

However, a decision to not pursue, for the 2000-01 Budget, the measurement of outcomes, in Audit's view created uncertainty as to the validity of the overall reformed budget process. That is, the effectiveness link between outputs and outcomes would not form part of the accountability chain for measuring the extent to which agencies have satisfied community objectives as reflected in budget papers.

I have mentioned, in the past, that I consider Ministerial accountability to Parliament as a fundamental element to assessing the achievement of strategic priority outcomes. Measurement of outcomes, to the extent it could be practically and effectively achieved, could enhance the accountability of Executive Government to the Parliament and this matter needs to be monitored for progress in ensuing years. In the absence of effective, external (ie; Parliament) performance measurement, the current model for budget formulation and measurement does not, in my opinion, provide the improvement in accountability that was envisaged in the original agenda objectives. In my 1998 Report, I drew some parallels between Budget Reform and its predecessor Program Performance Budgeting (PPB) in the context that PPB never reached the expectations that were envisaged for its use as an accountability and performance monitoring mechanism, reinforcing the need for performance measurement. Therefore, three issues arise, namely:

- to what extent does the budget reform model in its current context retain its original integrity?

---

91 The outsourcing of Modbury Public Hospital to Healthscope.

- is there benefit in ‘repackaging’ processes and communicating a revised approach to budget formulation and performance management to better reflect current Cabinet priorities?
- how will the risks associated with a focus on the short-term production of outputs be mitigated in the absence of outcome measures which clearly link what has been produced to the outcomes being sought and whether or not this has been effectively achieved?

Departmental Response

Firstly, it was interesting to note that the Department had no intention to require that all outputs will be capable of objective measurement. It was argued that outputs do not have to be capable of objective measurement as this is a simple recipe for mis-specifying outputs and setting up counter productive incentive structures. Their intention, rather, is to correctly specify outputs at an appropriate level of detail. If they cannot be measured objectively the monitoring process will simply recognise this. Further adding, this is just one area where due recognition has to be given to the role of Cabinet and Ministers in ensuring accountability.

With respect to the continued relevance of FOPP type arrangements, DTF were in agreeance that such arrangements have limited applicability in the public service context. Whilst acknowledging they can be a very useful tool in the right circumstances, there are significant dangers in trying to apply them as a generic approach.

The DTF advised that Cabinet had agreed that portfolio outcome measures would not be prepared in the 2000-01 Portfolio Statements. However, DTF suggested that this decision reflected only a current inability to pursue such measures rather than a decision not to pursue the objective.

Again, with respect to the issue of the short term focus on outputs rather than outcomes, the Department had contended that such a proposition discounted the role of Ministers and Cabinet in ensuring the achievement of major policy objectives.

Post-script

On the issue regarding outputs and their objective measurement, there is a need to further consider two elements. Namely:

- the very statement of a class of output by an agency and DTF has, in itself, an inherent sense of expectation in relation to its effective and efficient achievement. Public sector outputs should not be produced only for internal management purposes (that is within Executive Government). Accordingly, in my opinion, the determination of measures outlining the degree of success in their achievement should be a key focus so that Parliament can be provided with relevant information on the achievements set out in annual Budgets;

- related to this first point, is specifying appropriate measures. A quick review of the Budget Papers reveals many measures and many outputs. What is clearly absent, however, is a specification as to what measures would be considered key. Performance measures are, and can always be found, in abundance; regardless of sector. This ready availability of measures can be referred to as performance measurement. Alone, however, such measures fail to appropriately discern exactly which are considered key; that is relating to wider government objectives/outcomes and which are considered information/contributory to key measures. This linkage, in the pursuit of Key Performance Indicators, can be described as the art of performance management.

In regard to the latter point regarding the role of Ministers and Cabinet, clearly, ultimate responsibility for achievement of major policy objectives rests with Ministers and Cabinet. They have the right to conduct assessments as they consider necessary. Agencies and their Chief Executives also have the primary role to deliver the appropriate operational initiatives and reforms, policies, processes and functions (ie outputs) to achieve such broader government objectives. There is internal accountability between agencies and their Ministers in this respect.

In Audit's view, however, there remains an unfulfilled need/opportunity to improve accountability of the Executive Government to Parliament on the achievement of the outcomes/outputs in that what is now available is incomplete in the sense that much of the information is subjective, based on broad allocations and is not subject to reporting actual results. Audit would agree that these matters need to be addressed practically rather than in trying to make it an exact science — an unrealistic goal. There is nonetheless much room for improvement.

Agency Survey — A Snapshot

As mentioned at the outset, the response of all participants, and that includes all agencies, is inherently important to the success of the GMF aims. Agency strategic planning is key to the new budget process. Here, in particular, the link to the FMF becomes most prominent.

In my 1999 Report I raised the issue that there remained challenges in improving the quality of agency strategic plans. I commented that central agencies should play a role in overseeing the strategic planning process across government. This has a number of objectives, including:

- ensuring that the critical linkages with government priorities and outcomes is maintained such that government operates and is managed akin to a single enterprise, unified around commonalities of purpose, behaviour and management standards;

- ensuring a base level of rigour is applied to the strategic planning process employed by agencies by reviewing 'supporting documents' to the strategic plan (such as details of stakeholder consultation);
- identifying opportunities for cross-portfolio coordination;
- compliance with the FMF.

Survey Results

To follow-up on the progress which had been achieved by government agencies in this area, Audit undertook a limited scope assessment of four key portfolio agencies. The four agencies forming part of the review scope comprise a significant portion of the State's overall budgetary outcomes.

It has now been more than three years since budget reform was first initiated, the length of most strategic planning horizons, and given its inherently high level of importance in public financial administration, it was considered reasonable to expect that the planning and monitoring elements of the overall process would have progressed to a substantial degree; particularly given its fundamental nature.

What became clear from Audit's review was that the current budget formulation and reporting processes are seen by the majority of sampled agencies as primarily fulfilling external processes and do not uniformly reflect internal business and strategic level planning processes deemed necessary for agencies to achieve their objectives. As such, the degree of synergy in the overall budgetary preparation and monitoring process to government objectives is diminished.

Listed below are some of the more salient features emanating from our review of sample portfolio organisations:

- there were unclear linkages between agency strategic and detailed action plans and the information reported within the Budget Papers; for stated outputs and performance measures. Ideally a logical and seamless flow between all key documents might have been expected, however, there was almost unanimous conjecture that the two documents served different purposes. It is not clear that agencies uniformly value the importance of ensuring there is strong fusion between agency objectives and government objectives and the role of the Budget Papers in this respect;
- performance indicators listed within the Budget Papers were considered attainable, rather than key, to achieving the outputs listed. More often than not, agencies perceived key measures as those reported internally. In fact, some considered Key Performance Indicators (KPIs) provided to DTF as serving different purposes, with one being for external financial purposes and readily measurable and achievable, rather than having true indications to agency performance. Presently, the Budget Papers are widely considered a distinct management reporting exercise for external purposes rather than an integral link to operational planning and management;

- notwithstanding differing outputs and performance measures within agency plans to Budget Papers, ie agencies had not generally implemented output measures internally, most agencies had not developed the systems, processes and procedures to readily facilitate timely, regular and continual monitoring of performance measures on an internal or external basis.

There is an obvious question as to the quality of the information being reported for Budget Paper presentation, its relevance to operational decision making and DTF's role in ensuring commitment and congruence to the process.

The current situation perhaps reflects the fragmented approach by agencies to budget reform; that is, in terms of their ability to understand and achieve the right cultural transformation within their organisations at all levels of operation, management, reporting and decision making.

Despite the jargon now filtering through to various levels of reporting and planning, and perhaps some organisations aligning internally their structures with FOPP principles, in essence, the budget preparation, monitoring and management process currently remains dissected between internal and external reporting.

Given the three years elapsed, there is a need for greater ownership of the entire process, by all its participants, in order to achieve both internal and external alignment and perhaps a repackaging of the approach to align with experiences to date and changes in direction.

Departmental Response

The Department was receptive to the results from our survey indicating that the disjunction between budget reporting and internal management processes was regarded as a major problem. DTF was confident, however, that proposed financial monitoring reforms, redefinition of agency outputs and more appropriate performance measures will help address this matter.

Pricing and Contestability

Audit has argued in the past that the concept of output-pricing lacks the required pragmatic robustness required to achieve the aims of contestability and benchmarking: two key aims of GMF (Budget Reform). This is particularly so as agencies still largely focus on cash in preparing their budgets, with accruals factored as final ***adjustments*** only.

Certainly, if it is accepted that most government outputs are not contestable (recognising that this is largely argumentative), then the absence of appropriate ***fluidity*** in the ability to transfer service provision both within the public sector and between the public and private sectors, undermines the ability to fully apply the concepts of output pricing in a public sector context.

Even if the argument were extended to a contestable or even outsourced arena (ie Modbury — Healthscope), it can be seen, as it has been now well documented, how the private sector has struggled to achieve the so- called 'benchmark prices' set. Yet despite the benefit of competition in the health arena, an impetus which is not as readily available in other areas of the public sector, advantages in the pricing of outputs is still not clear. In the absence of such competition in other sectors within the public sector, it is difficult to envisage how price could provide the required stimulus to service enhancement.

Therefore, whether determining an appropriate price for all outputs is actually desirable from a cost-benefit, information and/or decision making point of view, such that price is the perceived driver for service enhancement (all service dimensions, including efficiency and economy), is definitely brought into question. On the basis of this reasoning, two issues were referred to DPC and DTF, namely:

- How much value is there in pursuing price as a key stimuli to service enhancement?
- What processes will serve as the stimuli for achieving service enhancement in the absence of price?

Departmental Response

The Department endorsed the comments with respect to pricing and contestability. DTF observed that Audit had perhaps over-estimated their commitment to such an approach suggesting it was the exception rather than the rule. DTF advised that service enhancement would be pursued by greater accountability through a mixture of transparency, central agency monitoring and Ministerial and Cabinet oversight. Exactly how accountability and transparency would be increased to achieve the reform agendas was not explained.

Performance Oriented Management in the Public Sector

Performance management is a key determinant of the success of the GMF/Budget Reform aims. It answers such fundamental questions as: have we achieved what we set out to achieve within the defined parameters?

Output KPIs were first developed for the 1999-2000 budget and were in their formative stages, with a view to refining them in future years. It was anticipated that significant work would be undertaken in further refining the KPIs and making them a core management philosophy throughout agencies.

The main areas requiring further work as noted in my 1999 Report, were:

- the robustness of output KPIs and how well they address the qualitative criteria of relevance, focus, clarity, auditability (reliability) and decision-usefulness;

- to what extent the culture of performance orientation has permeated agencies' internal management practices;
- the finalisation of the performance management model, encompassing performance reporting, validation, use of performance information in the budget process, etc.

As already mentioned, it has been decided that the development of KPIs for government outcomes was not pursued for the preparation of the 2000-01 Budget. I am of the view that significant advancement in relation to the matters identified in last year's Report has not been achieved during 1999-2000 for the 2000-01 Budget. It also appears that the momentum to continue and progress such work in this area has slowed.

In addition to these matters, some other matters arose in the course of the audit review. Specifically:

- there is no basis for frequent reporting in a monitoring sense to Cabinet on a current year's budget — financial (recurrent and capital) and non-financial — the focus seems to be on updates for the next budget cycle;
- it is not apparent that formal reporting of actuals is a requirement for agencies — only budget data rather than annual reports.

The consequence of these matters is that the aim for improvement in accountability may not be achieved to the degree that might have been anticipated for both internal and external (ie Parliament) purposes.

Departmental Responses

As already noted, the DTF advised that the issues regarding more frequent reporting to Cabinet in a monitoring sense and appropriate measures for the measuring of performance is to be addressed as part of a suite of reforms yet to be put to the Treasurer.

BALANCE SHEET REFORM: INHERENT CONFLICTS AND OUTSTANDING ISSUES

Accrual Budgeting

One aspect highlighted in the audit review of the budget monitoring processes was the ongoing dominant focus on the cash bottom line and that the accrual concepts remain in transition/implementation status. This was evident from the outcomes of the audit survey with agencies of the opinion that DTF, while advocating accrual-output budgeting, continued to focus their budget monitoring process on the cash position. This is not surprising given that the Government's key budget target is the cash based operating result.

Whilst recognising that both cash and accrual measures are important in managing the State's finances, it is considered that little advancement has been made on the original accrual appropriation model implemented in the 1998-99 Budget process. That is, after three years, the accrual appropriation model remains in transition status and the related issues surrounding balance sheet reforms (ie cash management, asset management and planning et cetera) have not been progressed as might have been expected.

Evidence of developments in the 2000-01 Budget is the focus on accrual data in the detailed analysis of expenditure[92] and the identification of equity items in the schedule to the *Appropriation Act 2000*.

A recent change by the Australian Bureau of Statistics to report on an economic accruals basis creates a further matter for resolution, that is the State's future key budget targets.[93] This issue may add to existing uncertainty in this area. The impression of agencies of DTF's cash focus needs to be considered/addressed for the achievement of the original accountability and reporting aims of the GMF not to be impeded.

Capital Budgeting

In my Report to Parliament last year, I commented on the major elements of Phase 2 of the Budget Reform process which was, amongst other things, to '… integrate the Government's planning processes with its budgeting processes for the 1999-2000 Budget for both operating and capital investment activities …'.

The Minister,[94] in December 1998, received the Government commissioned Corke Report. That report discussed a number of issues and presented a number of recommendations regarding the capital works program for the whole-of-government. Ultimately, on the 27 April, 1999, Cabinet approved several key recommendations from that Report: the relevance to DTF was their allocated responsibility to monitor and report on the Capital Budgets. As a consequence of these responsibilities DTF reviewed the capital budgeting process and revised procedures for the 2000-01 Capital Budget outcome, as outlined in DTF Circular 311.

Key initiatives of the revised process (as outlined in DTF Circular 311) to providing input and monitoring of the Capital Investment Budgeting process were:

- establishing a Threshold Criteria for project inclusion;
- revisions to the basis for prioritisation of projects;

---

92 Budget Statement 2000-01, Budget Paper 2, Chapter 4.

93 Budget Statement 2000-01, Budget Paper 2, p. 3.6.

94 Minister, Government Enterprises and Information Economy.

- utilisation of agency strategic asset management information to assist in the planning and prioritisation task;
- to have a specific focus on Information and Communication Services type investments as part of the Senior Management Council (SMC) endorsed framework for assessment of such initiatives.

Despite the fundamental importance of improving this area of the budget process, there has not been sufficient momentum to significantly change the situation that existed prior to the Corke Report.

Project Prioritisation

Despite changes to the basis for determining which projects would form part of the Capital Budget for the 2000-01 budget, via the Threshold Criteria, the reality was that strict adherence to such arrangements would have meant few projects being considered for inclusion.

The inability to meet the minimum criteria set for project inclusion suggests either that the benchmarks for project inclusion within the Capital Budgeting Process were too high or that agencies did not fully understand or were unable to meet the requirements for presentation of quality assessment capital information. Regardless, the ability to properly filter such information is imperative and in the past has reflected the primary reason for slippage (underspending) in the capital budget process. Not unexpectedly therefore, it became a key area of the Corke Report which the monitoring process was required to be addressed by DTF.

Project Selection

Capital information presented by DTF to the SMC was largely in the form of portfolio submissions. DTF did not prioritise agency bids as this was seen as SMC's and Cabinet's role. The basis for presenting information to SMC by agencies was on three criteria (State-wide, Special Groups, Decision) that were in line with the 1998-99 Directions SA document.

An aspect of this process which remains unclear is the link between service delivery and capital investment. There is effectively no firm basis for prioritisation of capital investment bids which links government service delivery priorities to the methods developed by the bidding agencies to derive their own capital asset management plans. Importantly, such a link would remove the need for separate arbitrage based on simply the supply of funds available. Capital budgeting would take on a more uniform and holistic approach and be more in line with other aspects of the budgeting process as is the case for operating type expenditure. Again, DTF's role in this regard, would seem to place them in the best position to take a leadership and advisory role to Ministers and Cabinet so that the overall capital planning process is reviewed and integrated with other planning objectives and processes.

Monitoring and Reporting

As a consequence of the Corke Report, and its specific requirements for DTF in relation to monitoring and reporting on the capital budget, a revised data return for agencies for capital items was developed.

It was noted that for the 1999-2000 Budget, this information was not used nor was a summary report prepared for Cabinet, as the information was collected late in the budget year. Looking forward, I understand that there are intentions for the capital works budget to be considered as part of a total review of budget monitoring in 2000-01. However, my officers were not provided with any plans that would suggest the timing and expected outcomes from such a review.

In respect of the monitoring and reporting role, it is important to perhaps reflect on the timing, quality and relevance of the intended basis for agency reporting on capital information which is twice yearly. I am aware, from wider agency experience, that reporting on factors such as project budget performance to date and capital slippage already forms part of high level reporting by the agencies to their Chief Executives. It was suggested to DTF that it was perhaps worthwhile to receive the information already encompassed within documentation presented at these Executive level meetings with due regard to the need for some uniformity to assist collection and collation.

Departmental Responses

On the issue of Capital Budgeting, DTF acknowledged scope for improvement, and again referred to potential improvements on information and monitoring to be put to the Treasurer. However, with respect to prioritisation, the Department considered SMC do not have a significant role in this area. This acknowledged the role of Ministers and Cabinet in capital prioritisation.

Further, with respect to improving the link between government service delivery priorities and capital priorities, DTF suggested that it would be unrealistic to rely on too mechanical a link between service delivery priorities, capital asset management plans and capital priorities, particularly given the lumpy nature of capital projects. Again, emphasis was given to the important role of Ministers and Cabinet in this process.

Subsequently, DTF have advised that for the 2001-02 budget, Cabinet will consider an initial list of priorities which then will be subject to investigation before being considered for inclusion in the budget. DTF have also advised that reports on monitoring of the 2000-01 capital investment program had been scheduled for the end of November 2000 and February 2001 and will be provided to the Treasurer and Cabinet.

CONCLUSIONS

It is clear, despite the achievements to date in both the revised presentation of Budget Portfolio Statements and the energies and resources invested in the project throughout the public sector, that many, if not most, of the stated objectives and outcomes of the GMF and Budget Reform agendas still require urgent and specific attention.

Two Key Issues Requiring Attention

Despite the range of issues discussed in the aforementioned commentary, I consider there are essentially two key issues that require resolution, namely:

- What will be the framework and model for delivery of the original objectives and outcomes of the GMF and Budget Reform process?

  As I have commented, a framework has essentially never been developed, rather, the whole process has been categorised by a range of initiatives. The major, if only, of these being budget reform. The necessity to develop and articulate to the whole of the public sector what will be the framework and approach to managerial, budgetary, financial and cultural reform cannot be over-estimated.

  I have suggested that perhaps a repackaging of the initiatives and reforms to date within the existing Financial Management Framework would seem both logical and appropriate. In essence, many of the principles, processes and managerial philosophies are already imposed and articulated within the suite of prescribed and non-prescribed elements of that framework which public sector agencies are required to conform with.

  Regardless of the philosophical longer term views to pursue outcome assessments and measures, a critical aspect that remains, in Audit's view, unclear, is how improved accountability through performance assessment will be achieved. Clarity of a desired and practical model remains an important need. Given that we operate within the Westminster system, the improvements are likely to be information related. That is better, reliable, relevant and timely information would be the basis of improved accountability. This has clearly been an area of focus, as demonstrated by the Budget Papers, but remains an area in need of improvement.

- Who will be vested with primary responsibility for driving the change process and its outcomes, and what will be the mechanism(s) which will ensure there will be high levels of compliance, accountability and transparency within a mandated framework?

  Whilst the DTF has featured prominently in my discussions, their current mandate precludes much of the necessary powers required for effective implementation, ownership and control of the GMF and budget reform agendas. In many instances, DTF has a mandate to support a directive approach if necessary. Clearly though, DTF does not control all aspects of the issues raised. In such areas, further emphasis/persistence by DTF toward influencing change might be the only course.

Clearly, the role of DTF or any other authoritative body established for progression of the plans, aims and initiatives required, requires a defined mandate.

What I consider is imperative to the whole process, and somewhat differing in the opinions offered from the DTF, is a need for the application of a more robust planning and strategic approach to this exercise, particularly in identifying those areas perceived to present a risk or impediment to achieving stated plans and aims.

Risk Factors Affecting the Reform Process

Many, if not all, of the risk factors I outlined in last years Report to achieving the aims of the GMF and budget reform, have had an impact on the process thus far. This is evident in many respects but has been reinforced by the results of Audit's agency survey.

In view of this, there is benefit in restating what these key risks are so, as a minimum, a future focus can be given to an appropriate mitigation strategy:

- lack of direction and strong leadership, either from a central facilitator or from within agencies themselves;
- lack of appropriate capability (eg systems for costing and performance information, management development et cetera);
- the inherent conflicts in the current budget management process; that is, the need for focus on cash management and the new aims to manage balance sheet items;
- lack of clarity of information and the ability to demonstrate to Parliament and taxpayers that the GMF reform processes have led to some change in responsiveness and focus;
- the difficulty in implementing performance assessment and benchmarking to demonstrate improvement or otherwise in efficiency/competitiveness;
- the inherent subjectivity associated with causal factors for outcomes and outputs, making assessment difficult, if not impossible in many instances, to reliably perform;
- implications from over-focussing on outputs — a balance of focus and linkage between inputs, business processes, outputs, outcomes and strategies within a clear and fair framework of responsibility and accountability remains vital to minimising the risk of dysfunctional results.

As I have previously stated, these risks should be addressed in a pragmatic manner recognising their inherent limitations. Audit does not seek a mechanical response, there is however, considerable room for improvement in achieving a high degree of practically based, alignment through Parliament, Ministers and agencies in the areas of management reform.

THE FINANCIAL MANAGEMENT FRAMEWORK: MANAGEMENT AND ACCOUNTABILITY OF RESOURCES AND RISKS: AUDIT COMMENT ON PROGRESS STATUS

INTRODUCTION

In previous Reports, I have referred to certain policy guidance framework initiatives of government aimed at facilitating improvement in public sector agency management and accountability practice. The 1998-99 Report included specific commentary in respect of one of those frameworks, namely the Financial Management Framework (FMF). The FMF became operative from 1 July 1998.

The commentary in last year's Report provided a description and discussion of the significant principles of the FMF. It emphasised the importance of the implementation of these principles by agencies in exercising proper governance over resources under their management, and in the control of risks that can adversely impact on agencies' operations and resource use. Furthermore, the commentary indicated that implementation of the FMF was fundamental to this Department's audit mandate and auditing activities. A concluding observation was that considerable further work was necessary to complete the establishment of the prescribed principles of the FMF throughout public sector agencies.

The purpose of this section of the Report is to provide an update status on last year of the progress of implementation of the FMF in agencies of government. In so doing, reference is again made to some matters of importance concerning the FMF, that were discussed in last year's Report commentary.

BRIEF OVERVIEW OF THE FMF

As mentioned, this framework became operative in July 1998. It was released with a revised set of Treasurer's Instructions in December 1997. The previous Treasurer's Instructions were considered too prescriptive, inflexible, and outdated in the context of the modern day operation of a public sector agency.

The FMF provides agencies with broader guidance on critical processes and controls to be put in place to enable the exercise of good financial management and accountability practice. It allows the public sector agency more flexibility through the encouragement of the development of best practices that focus on cost effective controls of risks pertaining to the particular agency, and aims to improve the overall control environment of the agency and the Government overall.

The five basic components of the FMF are:

- planning and analysis;
- asset and liability management;
- reporting;
- transaction processing;
- control.

An insight into the scope and underlying importance of these components as pillars for sound financial management and accountability practice in agencies is provided by way of detailed explanation in last year's Report. Refer Part A 'Audit Overview', pages A3-85 to A3-87.

EXTERNAL AUDIT AND THE FMF

As the FMF sets out prescribed guidance for agencies on the essential processes and controls required for good financial management and accountability, it is fundamental to this Department's audit mandate and auditing activities.

An opinion on the adequacy of internal control has been an integral part of the audit mandate in South Australia for many years. It is a direct reporting responsibility of the Auditor-General and is required by the *Public Finance and Audit Act 1987*. In this sense internal control becomes a specific and separate reporting objective in its own right as distinct from being one of a number of sources of evidence used to support the basis of an opinion on the public accounts and agency financial statements.

In this regard external audit's assessment of an applicable agency's internal control structure must now consider whether the controls in operation are consistent with the prescribed principles of the FMF. The opinion issued for relevant agencies in Part B of this Report now states this requirement. The audit assessment can be performed in a more efficient and cost effective manner where agency management has implemented the FMF elements, assessed the agency's risks in a disciplined manner, and implemented and documented controls to mitigate the extent of adverse consequences arising from those risks.

STATUS OF IMPLEMENTATION OF FMF IN AGENCIES

1998-99 Recap

The 1998-99 Report presented, in overview terms, Audit observations in respect of progress being achieved by agencies regarding implementation of a number of important aspects of the integral components of the FMF. Audit observations were presented in the context of the recognition of the fact that 1998-99 was the first year of operation of the FMF.

Given the extensive scope of the FMF components, Audit considered it reasonable to expect that agencies would take more than one financial year to address all the FMF requirements. Audit observations in 1998-99 aligned with this expectation. Most agencies had only commenced work or were in developmental stages of addressing some or many of the important aspects of the integral components of the FMF.

Illustrative of this level of progress was that some agencies had not advanced their strategic and corporate and business related planning documents to finalisation (‘Planning and Analysis’ component). Further, structured risk management practice involving risk policy formulation, risk profiling, risk plan preparation and monitoring was only in stages of development in most agencies (‘Control’ component).

1999-2000 Update

Where applicable, public sector agency sectional reports in Part B of this Annual Report, provide commentary on the progress of developments of the particular agencies in meeting the requirements of the FMF. The respective agencies’ commentaries reflect Audit observations arising from agency review work undertaken in 1999-2000.

In an overall context, Audit has observed that developmental work that was commenced and proceeding within agencies in 1998-99 was progressed during 1999-2000. The level of progress, however, has not been substantive in most instances. Only a few agencies have addressed to a satisfactory level most of the integral components of the FMF. Most agencies have not completed implementation of a structured approach to risk management practice. This is evident by the absence of agency endorsed risk management policies and plans.

Audit considers that the need for most major agencies to direct management attention and specialist resources to ready their respective agencies for the Year 2000 matter and the new Goods and Services Tax, are factors that have constrained achievement of a substantive rate of progress of implementation of the FMF requirements.

Having acknowledged those limiting factors, it is equally significant to relate that those factors represent past considerations. It is now important for most agencies to adequately plan to address and resource outstanding issues associated with the implementation of critical aspects of the integral components of the FMF.

CONCLUSION

The FMF provides agencies of government with guidance on the critical processes and controls required for good financial management and accountability practice. It is also fundamental to this Department’s audit mandate and audit assessment activity.

Audit inquiry during 1999-2000 indicated that only a few agencies have addressed to an adequate level most of the integral components of the FMF. The commitment of agencies to the preparation for readiness for the Year 2000 matter and the new Goods and Services Tax have been factors that have restricted the rate of progress of implementation of the requirements of the FMF.

The restrictive factors are now past and agencies should now direct some focused attention and available resource to the implementation of outstanding aspects of the integral components of the FMF. The development of an implementation plan (where absent) with targeted time outcomes would demonstrate complete commitment to implementation.

The introduction and ongoing application of the components of the FMF as a normal part of agency operations must result in improved financial management and accountability practice. Audit will continue to monitor the status of agency developments in this regard.

CAPITAL WORKS: MONITORING AND CONTROL

INTRODUCTION

The Capital Works Program

The 1999-2000 Budget Statement (Budget Paper 2) estimated capital outlays for the non-commercial sector at $708 million.[95] The estimated result for 1999-2000 as disclosed in the 2000-01 Budget Statement (Budget Paper 2) was $537 million.[96] The anticipated under-budget result reflects project delays or slippages within the overall proposed capital works program for the non-commercial sector of government.

The sizeable nature of the abovementioned program in dollar terms and the arrears situation being experienced with the program clearly demonstrates the critical importance of ensuring that adequate monitoring and control is exercised over the planned achievements for the program and the constituent agency/project components of the program. This matter has been the subject of comment in previous Reports and is further commented on below.

The Role of the Public Works Committee

My previous Reports to Parliament have also included comment on the important role of the Public Works Committee as a control mechanism for the expenditure of public money on public works. The 1998-99 Report suggested that Parliament should give consideration to revisiting the definition of a 'public work' in the *Parliamentary Works Committees Act 1991* to remove uncertainty as to whether a project should be submitted to the Public Works Committee for examination. This matter is also subject to further comment below.

THE CAPITAL WORKS PROGRAM

Government Program — Budgeting and Monitoring

Last year's Report referred to a government initiated review of the capital works program and project processes by an independent consultant. The consultant's report ('Corke' Report) recommended actions to reduce instances of project slippage within the works program or project overruns.

In response to the consultant's report, Cabinet approved in April 1999 certain initiatives to improve procedures relating to capital works projects and the capital works program. One

95 Budget Statement 1999-2000, Budget Paper 2, Table 2.4 p 2.10

96 Budget Statement 2000-01, Budget Paper 2, Table 2.2 p 2.6

important initiative involved the Department of Treasury and Finance (DTF) being designated the responsibility for improved monitoring and reporting on the financial performance of the capital works program.

In the section of this Report titled 'Public Governance: The Government Management Framework and Budgetary Reform', Audit provides observations and comments arising from a review in 1999-2000 of aspects of DTF's capital budgeting, monitoring and reporting processes.

The Audit review identified scope for improved information and monitoring and this was acknowledged by DTF. The DTF advised of proposals being put to the Treasurer in this regard. The sizeable nature and economic impact of the capital works program demands that this improvement be effected as soon as practicable.

Human Services — Control Over Capital Outlays

As mentioned in the introduction to this section of the Report it is also important that effective monitoring and control be exercised over the constituent agency/project components of the capital works program. This responsibility principally rests with the individual agencies and requires that they apply due diligence in respect of establishing and maintaining adequate systems, processes, and controls over their respective capital works/projects outlays. This was not the case in respect of matters identified by Audit in relation to certain capital outlays of the Human Services portfolio.

The audit of the Department of Human Services included a review of large payments processed in May and June 2000 by the Department on its own behalf and that of other agencies within the Human Services portfolio. The review identified payments amounting to more than $20 million where payments were made in advance of the Department, South Australian Health Commission, or Health Units, receiving relevant goods or services. The payments were in two broad categories:

- payments to suppliers in advance of receipt of goods or services where the supplier provided unconditional bank guarantees in exchange for payment from the Department. Payments were with respect to contracts for the supply of medical equipment;

- payments to Health Units with respect to Information Systems projects where costs associated with the projects were not due and payable at the time funds were advanced to the Health Units.

Audit wrote to the Chief Executive of the Department in relation to these payments and noted that the procedures adopted had the potential to misrepresent the outcomes achieved by the portfolio in implementing its capital program. The Department, following communication of this matter, addressed this concern through proper financial statement reporting presentation of the payments.

Nonetheless, the letter to the Chief Executive expressed concern that the Department had compromised fundamental control processes which require that payment is only made where goods and services have been received. In addition the advanced funding measures involved additional and avoidable costs.

Further details regarding this matter is commented on in the section of Part B of this Report titled 'Department of Human Services'.

PUBLIC WORKS COMMITTEE

Definition of a Public Work

The *Parliamentary Committees Act 1991* defines a public work as:-

> *Public work means any work that is proposed to be constructed where:*
>
> *(a) the whole of part of the cost of construction of the work is to be met from money provided or to be provided by Parliament or a State instrumentality; or*
>
> *(b) the work is to be constructed by or on behalf of the Crown or a State instrumentality; or*
>
> *(c) the work is to be constructed on land of the Crown or a State instrumentality.*

Section 16A(1) of the Act provides that:

> *… a public work is referred to the Public Works Committee by force of this section if the total amount to be applied for the construction of the work will, when all stages of construction are complete, exceed $4 000 000.*

While the requirement on the face of it appears quite clear, last year's Report included comment with respect to two major projects where two agencies chose not to refer a project to the Public Works Committee. Both decisions were based upon advice received from the Crown Solicitor.

Public Works Committee Annual Report December 1997 to December 1998

The 102nd Report of the Public Works Committee, being Annual Report 1998, was tabled in Parliament on 28 July 1999. In this Report, the Committee expressed concern with respect to the matter of the definition of public work and the consequence of it's meaning for referral, or otherwise, of a project to the Committee for examination. In particular the Committee reported:

> *The Committee has become concerned about the differing views circulating between itself and Government agencies, particularly Crown Law, regarding the criteria which determine whether a project is required to be heard by the Public Works Committee.*

The Committee also reported that:

> *… the interpretation which created ambiguity in the legislation has provided 'loopholes' for projects to escape the scrutiny of the Public Works Committee, on behalf of Parliament, to determine if they are in the public interest and procured by due process.*

The Committee concluded by indicating that it was considering recommending changes to the *Parliamentary Committees Act 1991* to remove any ambiguity associated with the definition of a 'public work'. Audit notes that in March 1994 the Attorney-General, when introducing an amendment to the definition of a 'public work', indicated that the amendment was to remove the notion that the money for construction must be provided by Parliament or a statutory authority.

This matter is again raised for consideration by the Parliament in the context of the Government's provision of financial assistance to the South Australian National Football League (SANFL) towards a new grandstand at Football Park.

Football Park Grandstand

Arrangement

In November 1999 the Government announced financial assistance in relation to a SANFL project to create a new 7000 seat grandstand for Football Park. It was announced that the Government would contribute $7.65 million (this is in present value terms) to the $14.5 million project.

The announcement was based on direct financial assistance of approximately $810 000 per annum for the project over a period of 15 years — a total of $12.15 million to be offset by SANFL purchasing land for $2 million from the Government. The financial assistance is to meet 50 percent of the scheduled repayments associated with a loan facility taken out by the SANFL for the project. The Government has no requirement for the SANFL to repay funding and has not provided any guarantee in relation to the project.

The first payment of financial assistance was made in 1999-2000 and was funded under the item 'Administered Items for Department of Treasury and Finance Consolidated Account Items — Contingency Provisions'.

Public Works Committee

It is understood that the project was not referred to the Public Works Committee on the basis that no money has been provided directly to the cost of construction and the Government has not assumed any construction risk or liability for any overruns on the project (should they occur) and has not provided any guarantee in relation to the SANFL's financing arrangements.

While acknowledging these points, it is nonetheless strongly arguable, that the level of financial assistance together with its application (whether directly or indirectly) as a contribution to the project construction, makes it a public work pursuant to the *Parliamentary Committees Act 1991*.

This project together with those commented on in last year's Report again emphasises the urgency for a review and consideration by the Parliament of the definition of 'public work'.

CONCLUSIONS

Capital Works Program and Outlays

Capital Works expenditures of Government involve a considerable outlay of taxpayers' money and therefore requires adequate monitoring and control at both central and individual agency levels of government.

During the year Audit reviews have identified deficiencies in this critical area of government operations. At the Department of Treasury and Finance level there is a need for implementation of improvements in information and monitoring processes associated with the Government's Capital Works Program. At the Human Services portfolio level there was a breach of a fundamental control practice within government, that of only making payment for goods and services received as to quantity and quality. The portfolio processed advanced payments in the order of $20 million which is of serious concern.

Public Works Committee

As was stated in last year's Report, given the public importance of the role of the Public Works Committee and the integral role it discharges in providing a control mechanism for the expenditure of public money, in my opinion, Parliament should give consideration to removing what has been identified as an ambiguity with respect to the definition of a 'public work' in the *Parliamentary Committees Act 1991*.

PROCUREMENT REFORM: LEGAL AND POLICY FOUNDATIONS: SOME AUDIT OBSERVATIONS AND COMMENTS

INTRODUCTION

The 1998-99 year saw the commencement of the progressive implementation of fundamental reform to the procurement arrangements of public sector agencies. The reform has involved changes to the functional responsibilities of the State Supply Board and public sector agencies in respect of both ‘goods’ and ‘services’ acquisition processes.

A government endorsed policy framework underpins much of the reform change. No change was effected to the *State Supply Act 1985*. That Act establishes the State Supply Board and specifies functional responsibilities of the Board in connection with public sector agencies in regard to mainly ‘goods’ procurement.

In recognition that the reform changes are directed to achieving millions of dollars in savings and that the changes were in full operative effect during 1999-2000, Audit commenced a review of certain aspects of the change process.

Audit has finished a review of the legal and policy framework underpinning the reform implementation. The soundness of the framework is critical to the achievement of its intent; that of effective government-wide and agency strategic and operational procurement arrangements that will realise economies.

This section of the Report provides a brief insight into the procurement reform program; highlights the changed functional responsibilities of the State Supply Board and public sector agencies under the program; and conveys some Audit observations that have been referred to the Board for examination and clarification due to their importance to the soundness of the legal and policy framework that underpins the reform strategy.

BACKGROUND TO PROCUREMENT REFORM

In December 1996 the State Supply Board completed a review of whole-of-government procurement practices. The review found that the South Australian Government could save in the order of $72 million a year by developing and introducing a range of procurement reform initiatives.

In December 1997 Cabinet issued a document titled ‘SA Government Procurement Reform Strategy’ (Purchasing Strategically). This framework outlines the important policy requirements and responsibilities of the State Supply Board and government agencies in the context of the reform strategy. Purchasing Strategically also establishes some guiding principles to be applied by government agencies to all procurement decision making strategies and practices. These principles included value for money in the expenditure of public funds, open and fair competition, professional integrity and probity and management of risk and accountability.

CHANGED ROLES FOR STATE SUPPLY BOARD AND PUBLIC SECTOR AGENCIES

Unified Supply Policy

A core requirement enunciated in the 'Purchasing Strategically' document is the Government's unified supply policy. This policy enforces the same level of control and accountability to the supply of goods and services and has resulted in changed roles and responsibilities for the State Supply Board and public sector agencies.

Key aspects of the policy are:

- A unified approach to the purchasing of goods and services, including a role for the State Supply Board in relation to both goods and services.
- The State Supply Board devolving purchasing accountability to public sector agencies with an oversight, monitoring and support role provided by the Board.
- To underpin the devolution of purchasing accountability to public sector agencies, the implementation of delegation and accreditation arrangements in respect of the ministerial portfolio based government department agencies, notably:
    - A delegation of authority by the State Supply Board to the Agency Chief Executive to underscore the direct accountability of the latter for procurement of both goods and services.
    - The accreditation by the State Supply Board of senior officers of the Agency (collectively, 'Accredited Purchasing Unit) as a condition of the Board's willingness to confer the abovementioned delegation.

      The establishment of Accredited Purchasing Units (APUs) within the ministerial portfolio government department agencies, to support the respective Chief Executives in overseeing goods and services purchasing and tendering at the government agency level, is a key component of the reform strategy.

      By September 1998 the ten operational portfolio department agencies had established an APU and secured from the State Supply Board certain accreditation status with a procurement contract delegation of $200 000. For contracts above that limit the APU is responsible for ensuring processes comply with the Board's policies before purchasing recommendations are forwarded to the Board for consideration and certification.

Reform Strategy Implementation

In brief terms the following steps were taken to implement the procurement reform strategy involving changes to the roles and responsibilities of the State Supply Board and public sector agencies. As mentioned earlier its implementation was effected without change to the *State Supply Act 1985.* The main steps taken were:

- as described above, the Government approved the unified regime for procurement of goods and services in the 'Purchasing Strategically' document;
- the responsible Minister under section 17(1)[97] of the *State Supply Act 1985* has directed the State Supply Board to have regard to the Government's unified supply policy;
- the implementation of a new Treasurer's Instruction 'Expenditure for Goods, Services and Works' (Treasurer's Instruction 8), effective from 1 July 1998, which includes a statement of recognition that:

> *'…that the State Supply board has been requested to undertake the acquisition of services for public authorities pursuant to section 14B[98] of the State Supply Act 1985.*

The steps taken were based on consideration of legal advice received from the Attorney-General's Department, including the Crown Solicitor's Office.

AUDIT OBSERVATIONS AND COMMENTS

As mentioned, Audit has undertaken a review of some aspects of the legal and policy framework relating to the procurement reform strategy implementation.

The review has given rise to several observations that Audit has raised formally with the Chair, State Supply Board, in the latter part of August 2000. The observations indicate the need for clarification of some issues of a legal and policy nature concerning the implementation strategy.

It should be noted that the State Supply Board's 'SA Government Procurement Reform Program: 1998-99 Implementation Report' has identified as a target program of work the requirement to clarify the scope of the procurement reform application in some areas. This clarification envisaged review of some matters of a legal nature.

---

97 Section 17(1) states 'The Minister may require the Board to have regard to a particular policy, principle or matter in the exercise of its powers and performance of its functions under this Act'.

98 Section 14B states 'The Board may undertake the acquisition of services for a public authority at the request of the authority or the Minister'.

Audit's communication of August 2000 to the Chair of the Board indicated that the issues being referred by Audit for clarification may assist or support the Board's target program of work.

Audit Issues

Audit observations referred to the State Supply Board for consideration and clarification relate to:

1. **State Supply Act 1985** ***and the Role of the State Supply Board in relation to Procurement of other than 'Goods'***

It is Executive Government's intent, as articulated in the 'Purchasing Strategically' policy document, that a 'unified approach in relation to the procurement of goods and services' be taken by government agencies, including that the State Supply Board have a role in relation to both classes of procurement.

It is clear that the State Supply Board has been required by its Minister to have regard to the Government's 'Purchasing Strategically' policy by written requirement in terms of section 17(1) of the *State Supply Act 1985*. Also, the new Treasurer's Instruction 8 refers to the State Supply Board as having been requested to undertake the acquisition of services for public authorities pursuant to section 14B of the *State Supply Act 1985*.

Audit's view is that the steps taken as referred to above in relation to section 17(1) and section 14B may not be sufficient to confer upon the Board functions in relation to the procurement of 'services' as distinct from 'goods'.

2. Treasurer's Instructions

The new Treasurer's Instruction 8 was implemented as part of the new legal and policy framework for the procurement reform strategy. The implementation of the Instruction was viewed as important to the efficacy of the 'unified' approach to procurement of goods and services and that the instruction included a requirement of compliance with a single government policy dealing with the acquisition of goods and the acquisition of services.

Audit has reviewed Treasurer's Instruction 8 and considers that it does not address a number of issues in relation to the Government's reform strategy. Some of these issues have been noted by the State Supply Board in its 'SA Government Procurement Reform Program: 1998-99 Implementation Report' as issues requiring to be addressed.

Response to Audit Issues

The Chair of the State Supply Board has provided interim responses to the Audit Management letter forwarded in the latter part of August 2000. The responses indicate that immediate attention and proper consideration is being given to matters relating to the legal and policy framework for the Government's procurement reform program. The latest response of 21 September 2000 indicates clarification being sought from the Crown Solicitor's Office regarding some matters and that following receipt of that information Audit is to be advised in detail of the advice received.

CONCLUSIONS

The Government's Procurement Reform Strategy which commenced in 1998-99 represents a significant reform program of government. Its implementation is expected to achieve millions of dollars of savings annually.

The reform change involved changed roles and responsibilities of the State Supply Board and public sector agencies. A government endorsed policy framework underpins much of the reform change. No change was effected to the *State Supply Act 1985*.

In 1999-2000 Audit commenced a review of certain aspects of the Procurement Reform Strategy and has finished that component of the review relating to the legal and policy framework underpinning the reform implementation. Audit has identified issues of a legal and policy nature that it is considered required clarification by the State Supply Board to ensure the soundness of the overall implementation framework.

These issues have been referred to the State Supply Board in August 2000 and are currently being examined by the Board.

Audit is now proceeding to review other operational and accountability matters associated with the Procurement Reform Strategy.

PUBLIC GOVERNANCE: EMPLOYMENT CONTRACTS FOR CHIEF EXECUTIVES: SOME FURTHER AUDIT COMMENTS

INTRODUCTION

The appointment of a Chief Executive and the management of the relationship between a Chief Executive of an administrative unit under the *Public Sector Management Act 1995* and a Minister are of central importance in the public administrative arrangements of this State.

Under the new statutory regime introduced with the passage of the *Public Sector Management Act 1995*, the discharge of the function of the Office of Chief Executive and his or her performance against a performance-based contract was a central element through which public sector agencies would be administered to achieve, and be accountable for, the efficient delivery of public services.

During 1998-99, Audit carried out a review of employment contracts for Chief Executives. Issues arising from this review were the subject of comment in Volume A3 (Audit Overview) of the 'Report of the Auditor-General for the year ended 30 June 1999'.

Further comment in respect to two of those issues is outlined hereunder.

PERFORMANCE CRITERIA

As indicated in last year's Report, performance was the fundamental principle driving the reforms that introduced employment contracts for Chief Executives and senior public servants.

The efficiency and effectiveness of such contractual performance related arrangements can be measured only by an analysis of the relationship of the contractual framework, on the one hand, to enhanced performance outcomes achieved by Chief Executives and other senior public servants, on the other hand.

The review of employment contracts for Chief Executives during 1998-99 revealed an absence of contractual performance provisions. Whilst there was reference to performance reviews and performance criteria, the contracts did not state when the review would occur nor what the performance criteria would be.

Audit concluded that there was significant room for improvement in the terms of the contractual arrangements in order to remove the more obvious shortcomings and inconsistencies. If nothing else, this would help to reduce the risk of possible litigation that is costly, not only to the State, but also to the individuals concerned. Moreover, such changes to the contract could serve to foster the achievement and maintenance of a constructive working relationship between a Chief Executive and the responsible portfolio Minister and the Government.

Accordingly Audit recommended that:

- performance standards should be clearly stated in the contractual instrument that is executed by both parties at the commencement of the contract term;
- the review of performance standards be undertaken by the responsible portfolio Minister/Premier and an independent party;
- Chief Executive contracts be public documents.

In May 2000 the Office for the Commissioner for Public Employment developed a comprehensive proposal for Chief Executive Performance Reviews. The proposal was discussed by the Senior Management Council in June 2000. The various members of the Council resolved to take up the issues raised in the proposal with their respective Ministers.

The Commissioner for Public Employment has advised Audit that he will be following up this matter during 2000-01.

Audit will continue to monitor developments during 2000-01.

PROTOCOL DOCUMENTS

Reports over the last few years have drawn attention to various issues that have arisen as a consequence of the administrative changes adopted by the Government in 1997. One of these issues was that a Chief Executive and possibly other senior public servants appointed on contract, may be responsible and accountable to more than one Minister for the operations of their administrative unit.

In establishing the new administrative structures, the Premier indicated that a formal protocol would be developed between the Cabinet Ministers and their respective delegates, to address, amongst other things, operational arrangements to support Ministers' responsibilities.

It may have been intended that the protocol documents as between the Cabinet and delegate Minister identify the areas of responsibility, of particularly the delegate Minister, for different facets of departmental operations. However, as some Chief Executives are now required to serve two masters, there needs to be a basis for resolving conflicts between those two masters consistent with the administrative arrangements now in place.

It was Audit's view, that the Chief Executive under these arrangements is potentially in a difficult position.

Accordingly, Audit recommended that in the interests of clarity of the required lines of accountability and responsibility, the conditions of appointment of Chief Executives of administrative units for which a Cabinet and delegate Minister are responsible should reflect, as appropriate, the terms of the Ministerial protocol documents as adopted or amended from time-to-time.

While this matter has not been actioned by the Government during 1999-2000, Audit is of the view that any proposed action concerning this matter would need to consider actions implemented in respect of performance reviews of Chief Executives.

CONCLUSION

The importance of matters associated with the appointment of a Chief Executive under a performance based contract and the management of the relationship between Ministers and Chief Executives of the agency for which the Minister is administratively responsible should not be underestimated.

Audit restates its view that there are inadequacies in the existing contractual arrangements with Chief Executives and in the management of the relationship between Ministers and Chief Executives that directly and indirectly impact on the financial position of the State. In the interests of good public administration, in my opinion, it is important that the Government revisit the recommendations made in last years Report to the Parliament concerning:

- performance criteria in employment contracts for Chief Executives;
- the employment contracts for Chief Executives reflecting the terms of the Ministerial protocol documents.

CONSULTANTS AND CONTRACTORS: MANAGEMENT AND CONTROL ARRANGEMENTS: AUDIT COMMENTS

INTRODUCTION

Recent Annual Audit Reports to Parliament have highlighted areas of concern with respect to the engagement and management of consultants and contractors by a number of public authorities. In drawing these areas of concern to Parliament's attention, Audit has stressed the need for public authorities to ensure that sound public administrative processes are adhered to in the engagement and management of consultants and contractors.

Administrative deficiencies have the tendency to undermine confidence in the integrity of governmental processes and raise questions of whether value-for-money has been obtained.

During 1999-2000, Audit has again noted some areas of concern with respect to the engagement and management of consultants by a public authority. The following commentary outlines those concerns.

CONSULTANCY ENGAGEMENTS

Audit review of the operations of the National Wine Centre in the latter part of 1999-2000 identified matters concerning the engagement of two consultancies, relating respectively to marketing services and electronic commerce initiatives.

With respect to the marketing services, a tender process was followed regarding the initial component at a cost of $40 000. The scope of services was extended to cover further aspects and this was not subject to a tender process. The extension of the consultancy was fully considered at the Board level. Whilst there was an exchange of letters to evidence the agreement for these additional services to an approved limit of $100,000, formal contract documentation outlining the specific nature and scope of services to be provided and the associated costs had not been established. Costs incurred on this consultancy, which commenced in 1998-99, as at 30 June 2000 amounted to $228 000. These costs have been subject to approval by the Chief Executive and/or Board Chairman.

In regard to the electronic commerce initiatives Audit noted that a tender process was not followed. The Centre indicated that the tender process was bypassed as the project resulted from a consultancy already in its preliminary stages of development when the decision was made to pursue the electronic commerce opportunity that had been identified by the consultant. In addition, as was the case with marketing services, formal contractual documentation was not established. The costs of this consultancy, which commenced in 1998-99, as at 30 June 2000 amounted to $169 000. These costs have been subject to approval by the Chief Executive and/or Board Chairman.

The Centre has provided an interim response indicating that a procedural review of tendering and contracting processes is being undertaken and this will involve ensuring that contractual details are documented in a manner that would reflect Government best practice. This review is expected to be completed by the end of October.

POLICY DIRECTION ON CONSULTANCIES

As reported last year, notwithstanding the Department of the Premier and Cabinet having issued guidelines for the engagement and use of external consultants in 1992, Audit has since that time continued to note deficiencies in the processes used by some public authorities. Accordingly, Audit recommended that the Government consider promulgating guidelines developed by the Department of Treasury and Finance for use by all public authorities. These guidelines were developed in 1995 and built on the requirements of the 1992 Department of the Premier and Cabinet guidelines.

The Government has not actioned this recommendation.

However, on the 13 June 2000, the Treasurer issued a media release in which he announced that as a major reform, the State Government would reduce its spending on consultants by $40 million over the next two financial years. The Treasurer also indicated that this reform would require all government agencies to look for ways to reduce their expenditure on consultancies and channel that spending to new and existing government initiatives.

CONCLUSION AND RECOMMENDATION

Audit continues to note deficiencies in the processes followed in the engagement and management of consultancies by some public sector agencies. Public authorities that ignore the fundamental principles of ensuring the integrity of processes involving the engagement of consultants and contractors create financial risks for themselves and the Government.

In view of the Government's recent announcement to cut spending on consultants over the next two years, it is Audit's opinion that it would be an opportune time for the Government to consider appropriate processes for the engagement and management of consultants. Accordingly, it is again recommended that the Government promulgate the guidelines developed by the Department of Treasury and Finance for use by all public authorities.

INFORMATION TECHNOLOGY POLICY AND MANAGEMENT ARRANGEMENTS

INTRODUCTORY COMMENT

Since 1996 I have reported on the important matters of Information Technology policy and major Information Technology developments both within and across government agencies.

This section of my Report again emphasises the critical need for the formulation of an overall government Information Technology Strategic Plan and policy documents that provide direction to agencies in respect of important matters. The requirement for these deliverables recognises the changing technological environment involving increased risks through the use by government agencies of web based electronic commerce systems for communication and financial transactions.

The following commentary examines some of these challenges in a general context and with a specific focus on developments occurring in the South Australian public sector.

CHANGING TECHNOLOGICAL ENVIRONMENT AND RISKS

Developments

The past few years have seen major ongoing developments in the public sector relating to Information Technology direction and use. These developments have included wide spread government agency adoption of the Internet for promulgation of information and the introduction of electronic commerce. Examples of this are the contracting out to the private sector of Internet bill payment facility operations for a number of government agencies.

There are also some initiatives under consideration involving the Federal Government and various State Governments regarding legislation for electronic commerce, (more notably the Australian Electronic Transactions Acts), and addressing concerns of access, privacy, and confidentiality. Notwithstanding, the policy, regulatory and legislative framework and codes of practice for management and operation in the electronic community are far from fully established.

In South Australia, agency developments have taken place against a background of non-finalisation of government-wide Information Technology Strategic Planning and communication to agencies of Government Information Technology initiatives and directions.

Agency and Audit Risk

The changing environment brings with it increased risks both for government agencies and the Auditor-General. Examples of this risk include, a potential for loss of audit trails and control; the increasing importance of privacy and confidentiality issues for government, private sector and individuals; and the need to deal with the matter of intellectual property rights and ownership in Internet based web developments and financial systems. All of these matters have the potential to expose government agencies to financial loss or liability if not adequately considered and addressed.

The risk to entities and Audit has recently been recognised by the Australian Accounting Research Foundation (The Foundation) in its Auditing Guidance Statement document AGS 1056 'Electronic Commerce: Audit Risk Assessments and Control Considerations'. The Foundation noted that growth in electronic commerce without due attention to the risks in an electronic trading environment impacts on both business risk and audit risk.

The Foundation also noted that when entities engage in electronic commerce there are many new aspects of business risk that confront those entities. For example, when transactions are initiated by unknown parties on the Internet, there are risks relating to the authenticity and integrity of trading partners and electronic commerce transactions.

The Guidance Statement further recognises risks including, the potential repudiation of electronic commerce transactions, the lack of paper trails, the nature of relationships with trading partners, pervasive security risks including privacy issues, possibility of unauthorised Internet access to customer information and the increased potential for fraud. The Guidance Statement specifically recognises that a legal framework for international electronic commerce and an efficient infrastructure to support such a framework (including electronic signatures) does not yet exist.

The use of the Internet for electronic commerce is growing rapidly. The auditor needs to develop audit strategies to respond to different risks arising from electronic commerce activities. The audit risk in relation to this matter is that the financial report may be materially misstated.

Both the increased government and audit risk inherent in the above environment demands that attention be directed at ensuring there are adequate strategic planning, policy guidance and legislative arrangements in place to facilitate major IT initiatives of government and its agencies.

EXISTING POLICIES AND STANDARDS

The South Australian Government, through the Department for Administrative and Information Services (DAIS), the Information Economy Policy Office (IEPO), Information and Communication Services (ICS) and Online Services, has developed a number of Information Technology policies and standards over the past few years relevant to South Australian government agencies. These policies and standards broadly cover the following areas:

Information Technology (IT Policy) — Government IT policy provides mandated guidelines for all government agencies with regard to the management and ownership of government data, information, software, hardware, and management of government Information Technology infrastructure in an outsourced environment. Specifically, the policy deals with custodianship, privacy and confidentiality, security, internet access and usage, and internet web page design.

Information Technology (IT standards) — Government IT standards cover Information Technology products, suppliers, and protocols which are to be used by government agencies. The IT standards are established to achieve a standard implementation for whole-of-government hardware, systems control software, application service and software, and communication and distribution services.

AUDIT OBSERVATIONS ON IT POLICY AND MANAGEMENT ARRANGEMENTS

Need for Finalisation of Strategic IT Plan for Public Sector

In last year's Report I commented that DAIS in conjunction with key stakeholders from agencies and external contracted experts had developed a draft Government Information Framework document. It was intended that the Framework would contribute to the achievement and redevelopment of the Government's IT2000 vision promulgated in 1994.

Given the importance of this matter, Audit again raised with DAIS during the year the matter of progress towards development and finalisation of a Public Sector Information Technology Strategic Plan. Recent advice from DAIS indicated that:

- DAIS is in the process of developing an Information and Communications Services (ICS) Strategic Plan, to be known as ICS Directions, for application across government portfolios;
- it is proposed that the Senior Management Council — Information and Communication Services Committee — be responsible for driving the plan, monitoring progress, aligning portfolio initiatives, and determining which portfolio will drive key projects;

- a set of key principles has been developed to provide a framework for the application of ICS across government. The key principles recognise the Government will adopt a cooperative cross-agency approach to ICS issues, and that the availability of appropriate ICS policies and standards will assist interaction between government agencies and encourage consistency in government-wide outcomes. The key principles have been endorsed at Ministerial level as the basis for further development of ICS strategic planning within the Government;

- a list of practical actions, outcomes and quality checks that must be met if ICS strategic planning is to be effective across government, has also been developed. The list recognises the need to manage government information in terms of ownership, privacy, access, pricing, quality and security;

- endorsement of the ICS Strategic Plan by the Senior Management Council — Information and Communication Services Committee, will be sought in September 2000.

It is important that the ICS Strategic Plan for the public sector be given priority for completion and communication to agencies of government. The Plan should clearly communicate the government direction and expectations for Information Technology management and use, and reflect significant initiatives and projects of government agencies.

Audit will review the Plan to ensure it adequately communicates the Government's Information Technology direction and expectations, and that effective monitoring is undertaken of those significant projects of government agencies identified in the Plan with respect to planned achievements.

Need for Framework and Related Policy Guidance Review

In Audit's view, the DAIS IT Policy and Standards Framework in relation to some key matters has not provided specific guidance to government agencies to assist the management and review of IT initiatives including those with the private sector. In other areas where guidance has been promulgated it is outdated.

One example where specific guidance is required is the crucial matter of provision of access and audit clauses for agencies and the Auditor-General in some contracts with the private sector. Without such access, agencies cannot ensure the security, integrity and control of government information and processes, and the ability of the Auditor-General to discharge statutory responsibilities may be inhibited. The right of access and audit by the Auditor-General under the *Public Finance and Audit Act 1987* is well recognised within government agencies, but is known or understood to a far lesser extent within private sector service providers contracting with the Government and its agencies.

An example where guidance requires an update relates to the South Australian Government Information Technology and Security Standards in an Outsourced Environment document. As the title suggests, it is an important document in today's public sector operations.

In Audit's opinion the overall policy framework developed by DAIS for IT should be reviewed in light of the changing technological environment and developing codes of practice in Information Technology. A more comprehensive framework is needed to accommodate best practice considerations in implementing and operating systems in an electronic/Internet environment, such as risk assessment, security control and review, contract management arrangements, privacy, intellectual property, and legal considerations.

Audit raised these issues with DAIS and the DAIS response (September 2000) indicated it is aware of the need for a review and update of the Government standards and guidelines for ICS. A project to address these issues had been initiated and a team now established to undertake the work. DAIS also advised a scoping study had been completed for a full IT security review for Government which would develop a new framework to replace the South Australian Government Information Technology and Security Standards in an Outsourced Environment document.

Need for Improved Contract Access and Audit Arrangements

The *Public Finance and Audit Act 1987* provides for the Auditor-General to have free and unrestricted access to computing facilities, systems and government information to adequately discharge auditability and reporting requirements. There is no similar access provision for the State or agencies of government in relation to ensuring controls are exercised over government information and systems.

Access and audit requirements are in some cases not adequately communicated to parties involved in contracting with government, and appropriate contract arrangements to provide access and audit are not consistently addressed. Thus existing contract access and audit arrangements present a fragmented approach by some individual agencies of government. This may very well in certain instances frustrate or render ineffective the monitoring role of government agencies and inhibit the audit process and the efficient ability of the Auditor-General to efficiently discharge responsibilities under the *Public Finance and Audit Act 1987*.

During the year, Audit deferred a planned review of a specific agency electronic commerce IT initiative, pending the consideration of access and audit arrangements.

Audit raised with DAIS during the year the matter of the need for access and review clauses, for the State (relevant government agency) and for the Auditor-General, to be included in private sector contracts which impact the storage, processing and security of government information and systems. This matter of critical importance has been taken up by DAIS as the central IT agency of government, in conjunction with the Crown Solicitor's Office and this Department, and was under consideration at the time of preparation of this Report.

CONCLUSIONS

Risks

The changed Information Technology environment within which government agencies operate has significantly increased operational and financial risks to both government agencies and Audit. This situation demands that there be adequate strategic planning, policy guidance and legislative arrangements in place to facilitate the implementation and control of major IT initiatives of government agencies.

ICS Strategic Plan

The need for finalisation and communication of an Information and Communication Services (ICS) Strategic Plan for the public sector has been the subject of comment in previous Reports.

Development of a plan which communicates the government direction and expectations for Information Technology management and use and reflects significant initiatives and projects of government portfolio agencies, is well overdue. This matter needs to be given priority for completion and communication to agencies of government.

Policies, Standards and Guidelines

The DAIS project to review government standards and guidelines for ICS requires priority for completion and communication to government agencies.

A more comprehensive framework needs to recognise the evolving technology and best practice considerations in an electronic/Internet environment, and provide more detailed guidance to government agencies in initiating and operating systems in that environment.

Outsourced Services — Access and Audit

It is essential that private sector service providers considering projects involving the storage, processing and security of government information and systems, be advised at an early stage of both government agency and Auditor-General rights in regard to access and audit. This matter requires due contractual and legal consideration by the Government and its agencies to ensure the adequacy of safeguards over the security, integrity and control of government information and processes, and to accommodate the Auditor-General’s statutory audit responsibilities.

INFORMATION SYSTEMS CONTROL: AGENCY RESPONSIBILITIES AND AUDIT REVIEW DIRECTION

INTRODUCTORY COMMENTS

Information Systems represent a major investment for agencies of government and are an essential element in supporting agency operations as well as being integral to the completeness and accuracy of agency financial management, accounting and reporting. These systems need to operate within a sound Computer Processing Environment (CPE) to ensure that agency assets (physical, financial and data) are protected, and that the systems operate in an efficient and effective manner.

Previous Reports have included comment in relation to concerns regarding control arrangements for major financial systems of government and its agencies. Many of those matters have been of a recurring nature relating to inadequate security policies and procedures; deficient password access controls; provision of audit trails; and systems continuity planning.

The ongoing nature of those matters raises the risk exposure for error or fraud in agency financial affairs, together with concern over the arrangements for continuity of operations of those systems. Specific commentary with respect to individual agency system observations for 1999-2000 is contained in Part B of this Report where appropriate.

This section of the Report indicates the direction to be taken by Audit in the ensuing two years in the context of measurement of agency compliance with required standards of government information systems control, and in recognition of Audit's new methodology extended review and evaluation of the risks associated with agency systems and computer processing environments.

The latter part of this section also includes Audit's key findings of a review of certain EDS managed computer processing environments.

AGENCY CONTROL RESPONSIBILITY

The establishment and the maintenance of a sound internal control environment and specific internal controls covering agency activities, systems and processes is given prominence in the Financial Management Framework (FMF) that has been promulgated by the Department of Treasury and Finance and which has been effective from 1 July 1998.

To quote from the Financial Management Framework document:

Chief Executives must ensure internal controls are in place to mitigate risk by:

11. Developing and preserving the integrity, accuracy and reliability of information systems ...

13. Developing and documenting an appropriate disaster recovery plan for all major risks.

The Framework document also includes comment that:

Chief Executives must establish and maintain a control environment within an agency by:

9 Documenting and distributing policies and procedures for all major activities.

The FMF emphasises the requirement for agency management to implement and document policies and procedures that result in effective control over all significant operations of the agency including Information Technology operations. The standards set by the Framework are a critical measurement factor for the purpose of Audit review of systems and processes.

AUDIT REVIEW RESPONSIBILITY AND FOCUS

The Auditor-General is required by the *Public Finance and Audit Act 1987* to form an opinion on the internal controls and financial statements of government agencies.

In regard to that responsibility, this Department is implementing a more advanced audit methodology. The new audit methodology requires an extended Audit review and documentation of the agency's key Information Systems and related CPEs. The use of the new audit methodology requires Audit to more fully evaluate and document the risk/control attributes associated with Information Systems and the CPE in forming an opinion on agency internal controls and financial statements.

The new audit methodology was introduced in respect of a small number of agencies during 1999-2000 with implementation to most agencies programmed for 2000-01.

Communication with Agencies

In conjunction with the introduction of the new audit methodology, Audit has sought from agency Chief Executives, information of a policy, planning, procedural and control nature associated with agency key financial information systems and/or major non financial operational systems that are critical to the agency business and service delivery outcomes, and related CPEs within which those systems operate.

The information being sought will facilitate the planning of audit review of aspects of agency Information System developments and activities over the next two financial years.

Observations from Information Gathering

With respect to information received from some agencies so far, a number of important matters have come to Audit's attention. Those matters are commented on below:

Reliance on Key Personnel — Audit's observations in regard to the current environment indicate that government agencies are placing reliance on a small number of key personnel for knowledge of agency IT operations and systems and the management and control of those resources.

Information Security Policies and Procedures — Information Security Policies and Procedures as required by the South Australian Government Information Technology and Security Standards in an Outsourced Environment document have not been finalised in some agencies and formally incorporated in Service Level Agreements with EDS.

Business Continuity Planning Arrangements — Not all agencies have in place formal documented plans to ensure the continuity of agency financial and operational computer systems.

REVIEW OF EDS (AUSTRALIA) PTY LTD (EDS) MANAGED CPEs

In last year's Report, I advised that a security and control review of certain EDS managed Information Technology Sites (including the EDS Information Processing Centre) was in progress and would be finalised in 1999-2000. The review addressed the Unix operating system based CPEs for Concept HRMS, Land Ownership and Tenure System (LOTS), selected Health Unit systems, and the Business Resumption Planning arrangements for certain government infrastructure services. The findings of the review were communicated to DAIS in November 1999 and a satisfactory response received.

Key audit findings from the review are commented on as follows:

Unix Operating System CPEs

Past reviews have focussed on the Unix operating system computer processing environment for the Concept Human Resource Management System (HRMS) which has been regarded as unsatisfactory from a control perspective. Since that time, improvements have been made in system security controls, however, there continues to be potential for further improvement.

This year's review of the LOTS Unix operating system CPE revealed weaknesses in operating system security arrangements covering system access and control.

Review of the Health Unit Unix operating system CPEs revealed weaknesses relating to password practices (particularly for privileged users), management of user accounts and the level of monitoring of key system access by users.

The findings show that control improvements made to the Concept HRMS CPE have not been translated to other Unix operating system CPEs. Audit has raised with DAIS the benefit of promulgation of the lessons learnt from the Concept environment in enhancing the Unix operating system CPEs within other Government systems.

Business Resumption Planning

In regard to the Unix operating system CPEs reviewed there continues to be no overall Business Resumption Plans (BRP) to address their recovery in the event of major system/hardware malfunction or disaster situation. There is some provision for off-site storage of data, however, Audit has identified limitations with some of these arrangements in relation to the Health Unit systems.

In addition, for the Health Unit sites, it has been recognised by the Units that a more co-ordinated approach on a Department of Human Services wide basis is required to address business resumption planning. Audit has been advised of a project to establish requirements and a strategy in relation to BRP across a range of Health Units in South Australia.

CONCLUSION

Agency Control Responsibility

The changed Information Technology environment within which government agencies operate requires effective management and control. Agency systems need to operate within a sound Computer Processing Environment (CPE) to ensure safeguards are in place over agency information and systems. As required by the FMF, it is obligatory for Chief Executives to ensure that effective internal controls are in place and operating within their agency.

Audit Review Methodology and Direction

Audit, in responding to the changed environment, is implementing a more advanced audit methodology which requires it to more fully evaluate and document the risk/control attributes associated with Information Systems and the CPE in forming opinions on agency internal controls and financial statements.

In implementing the new methodology in a small number of agencies during 1999-2000, Audit sought certain information of a policy, planning, procedural and control nature. Audit's observations from some of the information gathered to date show that agencies are placing reliance on a small number of key personnel for knowledge of agency IT operations and systems and the management and control of those resources. This places agencies in a situation of potential risk in the event of loss of those personnel and highlights the need for comprehensive documentation of agency key systems operations and control mechanisms, including arrangement for continuity of operations.

Audit will concentrate over the next two years on the extended review and documentation of agency key Information Systems and related CPEs and on agency compliance with standards set by the Financial Management Framework.

General Index to Part A

of the

Report

of the

Auditor-General

for the

Year ended 30 June 2000

A

B

C

D

E

F

G

H

I

L

M

N

O

P

R