Report of the Auditor-General

Auditor-General's Department

Report 8 of 2021

State finances and related matters

Government of South Australia

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Tabled in the House of Assembly and ordered to be published, 30 March 2021

Second Session, Fifty-Fourth Parliament

By authority: S. Smith, Government Printer, South Australia

2021

The Auditor-General's Department acknowledges and respects Aboriginal people as the State's first people and nations, and recognises Aboriginal people as traditional owners and occupants of South Australian land and waters.

Auditor-General's
Department

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29 March 2021

President
Legislative Council
Parliament House
ADELAIDE SA 5000

Speaker
House of Assembly
Parliament House
ADELAIDE SA 5000

Dear President and Speaker

Report of the Auditor-General:
Report 8 of 2021 *State finances and related matters*

As required by the *Public Finance and Audit Act 1987*, I present to each of you Report 8 of 2021 *State finances and related matters*.

Content of the Report

The 2020-21 State Budget was tabled in Parliament in November 2020. This Report provides our observations on the State's public finances based on our review of the Budget. This involved:

- reviewing the Budget against the SA Government's stated fiscal strategy
- analysing new budget measures and initiatives
- examining the actual results for the past year, Budget estimates and forecasts
- analysing major assets and liabilities
- analysing South Australia's key fiscal measures compared to other Australian states
- reviewing credit rating agency reports on South Australia.

Our analysis is based on data provided in the 2020-21 Budget Papers supplemented with representations and information provided by Department of Treasury and Finance. The 2020-21 Budget notes that the COVID-19 pandemic could substantially impact budget revenues and expenses and that forecasting financial outcomes in the present economic environment is particularly difficult.

Acknowledgements

The audit team for this report was Salv Bianco, Ken Anderson and Grace Lum.

We appreciate the cooperation and assistance given by staff of the Department of Treasury and Finance during our review.

Yours sincerely

Andrew Richardson
Auditor-General

Contents

1 Executive summary

1.1 Introduction

The 2020-21 State Budget (2020-21 Budget) was tabled in Parliament in November 2020.

This Budget was delayed in response to the revised timing of the Commonwealth's 2020-21 Budget (released in October 2020) and to enable the SA Government to develop a fiscal response to the emerging impacts of the COVID-19 pandemic.[1]

In the few months since the 2020-21 Budget was released, there have been some positive signs of economic recovery in the national and state economy and the COVID-19 vaccine rollout has started.

This Report provides our observations on some key matters, trends and risks for the State's public finances based on our review of the 2020-21 Budget, including analysis of the SA Government's fiscal response to the COVID-19 pandemic. Events worldwide remain fluid. Consequently, this Report, like all budget reporting in this period, is subject to unexpected events and greater than normal uncertainty about financial forecasts.

Section 2 provides further details on the objective and scope of our review.

1.2 Key observations

1.2.1 2020-21 Budget aims to respond to the unprecedented impact of COVID-19 on South Australia's economy

The SA Government has responded to the impact of COVID-19 in the 2020-21 Budget through a range of new operating expenditure initiatives ($3.76 billion) and investing expenditure initiatives ($1.855 billion) for the general government sector.[2] These have contributed to significant forecast net operating and net lending deficits in 2020-21 and 2021-22, as the SA Government's stimulus package focuses on initiatives that can be completed or significantly completed within the next two years.

Sections 3.3 and 3.4 provide further details on the new operating expenditure and investing expenditure initiatives in the 2020-21 Budget.

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1 The 2020-21 Budget includes actual results for 2019-20 rather than estimated results due to the revised timing. Analysis in this Report uses actual results for all periods up to and including 2019-20 and estimated results for the four years of the Budget (ie 2020-21 to 2023-24).

2 Appendix 1 provides further details on the institutional sectors for Budget reporting purposes.

1.2.2 2020-21 budget forecasts and fiscal targets may not be met due to significant economic uncertainty driven by COVID-19

The 2020-21 Budget notes that COVID-19 could substantially impact budget revenues and expenses and that forecasting financial outcomes in the present economic environment is particularly difficult.

There is still substantial uncertainty about the timing and pace of economic recovery from COVID-19, including the potential for future outbreaks, the timing and effectiveness of the vaccine rollout and timelines for when the economy and international borders can reopen.

The unprecedented economic uncertainties created by COVID-19 mean there is much higher than usual risk that actual results will differ from Budget estimates and that the SA Government's fiscal targets will not be met, including returning to a net operating surplus in 2023-24.

Section 3.1 provides further details on the SA Government's fiscal targets and the uncertainties impacting the 2020-21 Budget.

1.2.3 South Australia's significant net operating deficits and increased levels of net debt are generally consistent with other states

The 2020-21 Budget reflects a significant actual net operating deficit for the general government sector in 2019-20 ($1.485 billion) and substantial expected net operating deficits in 2020-21 ($2.59 billion) and 2021-22 ($1.423 billion). These general government sector net operating deficits, combined with the substantial $16.7 billion infrastructure program for the non-financial public sector (NFPS), result in forecast increases in NFPS net debt from $17.452 billion in 2019-20 to $33.171 billion in 2023-24.

The SA Government's net operating deficits, increases in net debt and capacity to fund borrowing costs from operating revenues are similar to budget forecasts made by other states.

The Reserve Bank of Australia (RBA) encouraged states to borrow to stimulate the economy in response to the economic impact of COVID-19. It argued that interest rates for government borrowings are the lowest since Federation and expected increases in public debt are manageable and affordable.[3] The RBA also stated in March 2021 that interest rates are very likely to remain at current levels until at least 2024.[4]

Further details on how the SA Government's budgeted net operating balances, net debt and interest expenses compare to other States are provided in sections 4.3.2, 5.3.2 and 5.3.4.

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3 Lowe, P, 14 August 2020, *Opening Statement to the House of Representatives Standing Committee on Economics*.

4 Lowe, P, 10 March 2021, *The Recovery, Investment and Monetary Policy,* AFR Business Summit.

1.2.4 Significant GST revenue write-downs continue as both the size of the national pool and South Australia's share shrink

GST revenue is a significant component of the State's revenue base and has the potential to significantly impact its ability to generate operating surpluses. GST revenue has been revised downwards by a combined total of $5.73 billion for the period 2019-20 to 2022-23 in the 2019-20 Budget, 2019-20 mid-year budget review (MYBR) and 2020-21 Budget.

In the 2020-21 Budget, GST revenue grants were revised down by $633 million in 2019-20 and a further $3.005 billion over the period 2020-21 to 2022-23. The downward revisions reflect lower forecasts for both the national GST pool and South Australia's estimated share of the pool.

National GST pool estimates were revised down significantly mainly due to the impact of COVID-19 on consumption expenditure. South Australia's share of the national GST pool reduced from 10.1% in 2019-20 to 9.4% in 2020-21 following the Commonwealth Grant Commission's 2020 Methodology Review.

The 2020-21 Budget states that beyond 2020-21, South Australia's GST share is expected to be influenced by:

- COVID-19 related expenditures, including health costs
- property markets in the eastern states
- changes in South Australia's share of Commonwealth Government payments
- relative population growth in South Australia.

Future trends in GST revenue will be critical to the State's ability to generate operating surpluses and pay down the State's significantly increased net debt. Sections 4.4.3 to 4.4.6 provide further details on trends and risks associated with GST grant revenue.

1.2.5 Significantly higher net debt substantially increases risk from interest rate rises and may potentially limit the State's ability to respond to future economic challenges

The SA Government's exposure to interest rate rises is significantly increased by the higher level of net debt. The 2020-21 Budget states that the impact of a 1% increase in the average interest rate applying to general government sector net debt ranges from $153 million in 2020-21 to $245 million in 2023-24.

The SA Government's ability to reduce net debt from operating surpluses in the short to medium term is also constrained given operating deficits are forecast until 2022-23. This may potentially limit its capacity to respond to future economic and other challenges.

Large infrastructure initiatives included in the 2020-21 Budget may also result in further net debt increases beyond the forward estimates. $6.9 billion of the North-South Corridor Torrens River to Darlington project's $8.9 billion total project cost is expected to be incurred after 2023-24. Additional expenditure beyond the forward estimates is also expected for the new Women's and Children's Hospital, with cost estimates to be finalised pending completion of the business case and detailed planning.

These large infrastructure initiatives may result in further net debt increases. Other upward pressures on net debt include:

- the national GST pool not recovering as quickly as anticipated owing to ongoing COVID-19 impacts on the economy
- Health and Wellbeing portfolio expenditure targets not being achieved
- the winding down of Commonwealth stimulus measures (eg JobKeeper) negatively impacting economic activity and employment, with flow on effects to the State's taxation revenues
- significant budget overruns occurring in major investing program projects
- additional expenditure measures being required by the SA Government to stimulate economic recovery from COVID-19.

Given the current uncertain environment driven by COVID-19, there is also potential for actual net debt increases to be lower than budgeted if the economy recovers more quickly than expected and drives better than forecast GST grant revenues and taxation revenues.

Sections 5.2 and 5.3 provide further details on the State's capital program and net debt increases.

1.2.6 South Australia's credit ratings remain unchanged however Standard & Poor's now has a negative outlook

South Australia's Standard & Poor's (S&P) credit rating remains at AA+ but its outlook has been lowered from stable to negative.

S&P's primary considerations in making its assessment were as follows:

- Significant revenue losses over the next three years due to COVID-19 and lower than previously budgeted GST revenue grants erode buffers at the current rating level and could mean the State's fiscal recovery drags on longer than it does for its peers.
- The relatively large infrastructure program to stimulate local economic recovery will weigh on the State's budgetary performance, resulting in rising debt.
- Fiscal pressures may not be fully offset by the economic recovery in South Australia and the proposed stimulus program could stress its financial indicators more than anticipated.[5]

The Department of Treasury and Finance (DTF) advised us that the impact of the S&P announcement on the South Australian Government Financing Authority (SAFA) financing costs was minimal..

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5 S&P Global Ratings acknowledges a 'high degree of uncertainty about the evolution of the coronavirus pandemic. The current consensus among health experts is that COVID-19 will remain a threat until a vaccine or effective treatment becomes widely available, which could be around mid-2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly'.

Moody's has maintained a stable outlook for South Australia's credit rating (Aa1 stable). Key factors considered by Moody's were as follows:

- Debt affordability remains strong and the State projects that despite the rising debt levels, annual debt servicing costs will be lower compared to 2019-20, reflecting lower-for-longer interest rates.
- The stable outlook reflects the expectation that policy responses will be implemented to reduce debt as economic growth resumes.

Section 5.3.6 provides further details on credit rating agency analysis of the 2020-21 Budget and impacts on State borrowing costs.

1.2.7 The State will face challenges in delivering the economic stimulus benefits of infrastructure projects within two years as planned

A major focus of the expanded capital program is to stimulate economic recovery from COVID-19 in the short term. There will be pressures to progress investing projects as quickly as possible.

The SA Government faces several challenges in ensuring capital program projects are completed on time and within budget consistent with planned designs and specifications.

Major capital projects carry high inherent risks associated with estimating costs, complex contract arrangements, cost escalations and timeliness of completion. Significant revisions may be required to estimated project costs. For example, the 2020-21 Budget reflects significantly increased cost estimates for the Gawler Line Electrification project ($100 million) compared to original estimates.

Procurement processes for large-scale capital projects are also carried out in multiple stages, with each stage often lasting several months. The SA Government will need to manage the ongoing tension between speed and ensuring that procurement practices meet appropriate probity standards and comply with relevant policies and guidelines.

Other significant challenges and risks may include:

- COVID-19 potentially impacting the availability of key building materials
- the capacity of the South Australian building industry to cope with the significant volume of works required within short time frames and the potential for associated cost pressures on project budgets
- ensuring concept design durations and stakeholder consultation time frames are sufficient to meet project objectives and user needs.

Appropriate procurement, contract and project management expertise and resources, as well as sound information systems and financial controls, are required to effectively manage these risks and meet budget targets.

DTF advised us that the SA Government established an Infrastructure Cabinet Committee in October 2020 to monitor the status of major projects within South Australia and ensure delivery of the agreed infrastructure work program.

Section 5.2.4 provides further details on challenges and risks associated with the SA Government's budgeted capital program.

1.2.8 SA Health continues to fall short of savings targets and the objective of achieving the national average efficient price for its services has been delayed by two years to 2023-24

The Department for Health and Wellbeing (DHW) savings task has been reduced from $1.137 billion in the 2019-20 Budget to $646 million in the 2020-21 Budget. The savings task budget measure provides additional funding of $897 million between 2019-20 and 2023-24 to recognise SA Health's overspend in 2019-20 and reduce its savings targets.

The 2020-21 Budget indicates that the SA Government's principal financial objective remains the achievement of national average efficiency in the delivery of public hospital services. It notes that some efficiencies are being achieved as local health networks move closer to the national efficient price. However, the required response by DHW in the face of COVID-19 meant that it did not meet its financial targets in 2019-20. In light of that outcome, and the continuing impacts of the pandemic, the SA Government re-evaluated DHW's savings targets over the forward estimates.

DHW will now be expected to progressively increase the efficiency of its services to provide them in line with the national efficient price by the end of the current forward estimates (2023-24). This represents a delay of two years, as the original planned timeline for achieving national efficient price in the 2018-19 and 2019-20 Budgets was 2021-22.

The total amount allocated to the establishing a sustainable, efficient health system initiative since 2018-19 is now $2.231 billion. The SA Government has provided significant additional funding to DHW compared to that initially budgeted as a result of delays in DHW meeting the budget target of achieving national average efficiency.

We expect the savings task to remain a challenge until there is a demonstrated history of achieving savings goals. DTF has advised us that DHW is forecasting a $170 million overspend for 2020-21 as at 31 January 2021.

Sections 3.5 and 3.6.2 provide further details on the SA Government's health savings initiatives and DHW's 2020-21 budget position.

2 Review mandate, objective and scope

2.1 Our mandate

The Auditor-General has authority to conduct this review under section 36(1)(b) of the *Public Finance and Audit Act 1987*. This section allows the Auditor-General to report on matters that, in his opinion, should be brought to the attention of Parliament and the SA Government.

2.2 Our objective

The objective of this Report is to provide independent commentary and analysis on the 2020-21 Budget to highlight key matters, trends and risks for the State's public finances, including analysis of the SA Government's fiscal response to the COVID-19 pandemic.

2.3 What we reviewed and how

We reviewed the 2020-21 Budget to identify key matters, trends and risks for the State's public finances. This involved:

- reviewing the Budget against the SA Government's stated fiscal strategy
- analysing new budget measures and initiatives
- examining the actual results for the past year, Budget estimates and forecasts
- analysing major assets and liabilities
- analysing South Australia's key fiscal measures compared to other Australian states[6]
- reviewing credit rating agency reports on South Australia.

Our analysis is based on data provided in the 2020-21 Budget Papers supplemented with representations and information provided by DTF. The 2020-21 Budget notes that COVID-19 could substantially impact budget revenues and expenses and that forecasting financial outcomes in the present economic environment is particularly difficult.

We are tabling a separate report on the 2019-20 Consolidated Financial Report, including the actual results for the whole of SA Government, in March 2021.[7]

2.4 What we did not review

This Report primarily comments on Budget information. The data and assumptions underlying this information are not subject to audit and no audit opinion is provided on the accuracy of either the historical or forecast figures presented in the 2020-21 Budget. We have not performed work to provide an opinion on the effectiveness of the SA Government's budgetary control.

[6] Appendix 1 provides further details on key fiscal measures.
[7] Auditor-General's Report 7 of 2021 *Consolidated Financial Report review*.

3 2020-21 Budget policy measures and parameter variations

Key points

- Significant uncertainties about the ongoing and emerging economic impact of COVID-19 increases the risk that actual results will differ from 2020-21 Budget estimates.
- Significant new expenditure initiatives and revenue reductions have led to substantial net operating and net lending deficits.
- New operating expenditure initiatives total $3.76 billion and impact a broad range of agencies, with the most significant being in Health.
- New investing expenditure totals $1.855 billion, with the largest new investing initiatives being road upgrades predominately funded by the Commonwealth Government.
- The Health savings target was reduced significantly as the budget target of achieving national average efficiency in delivering public hospital services was delayed by two years.
- The SA Government will face challenges and risks rolling out large-scale grant schemes to stimulate economic growth within short time frames.

3.1 Overview

3.1.1 2020-21 Budget aims to respond to the unprecedented impact of COVID-19 on South Australia's economy

Global economic activity contracted sharply in 2020 as governments, households and businesses fought the spread of COVID-19. The International Monetary Fund estimated that global output contracted by 4.4% in 2020, with gross domestic product shrinking in virtually all advanced economies and most emerging markets and developing economies. The COVID-19 pandemic is a transformational event unlike any seen since World War II.[8]

The 2020-21 Budget aims to respond to the unprecedented impact of COVID-19 on the economy through timely and targeted stimulus measures. DTF advised us that the size of the SA Government's stimulus response was informed by information provided to National Cabinet, including advice from the Governor of the RBA on the level of fiscal stimulus such as publicly funded infrastructure required by governments to protect and support jobs.

[8] International Monetary Fund 2020, *October 2020 World Economic Outlook – A Long and Difficult Ascent*, viewed 15 January 2021, <https://www.imf.org/en/Publications/WEO/Issues/2020/09/30/world-economic-outlook-october-2020>.

DTF also advised us that the SA Government was in regular communication with the Commonwealth and other states through various inter-government forums to ensure the measures being developed and considered for funding were consistent with advice being provided across Australia on what governments should be doing to respond to the effects of COVID-19. Further development of the stimulus package was informed by the economic conditions that were emerging.

The 2020-21 Budget notes that the stimulus package focuses on initiatives that can be completed or significantly completed within the next two years as South Australia's economy recovers from COVID-19.

3.1.2 Significant uncertainties about the ongoing and emerging impact of COVID-19 increase the risk that actual results will differ from 2020-21 Budget estimates

The 2020-21 Budget notes that COVID-19 could substantially impact budget revenues and expenses and that forecasting financial outcomes in the present economic environment is particularly difficult.

DTF advised us that the 2020-21 Budget is based on economic forecasts that reflect a recovery in the global economy. The economic forecasts also make the following assumptions about COVID-19:

- there will be no further significant domestic outbreaks
- state border restrictions would be lifted by the end of 2020
- international students will start returning in 2021
- there will be staged international border openings in 2021 and 2022.

DTF advised us that these underlying assumptions are broadly in line with those of the 2020-21 Commonwealth Budget, which assumes a population-wide COVID-19 vaccination program will be fully in place for Australia by late 2021.

COVID-19 has introduced significant economic and fiscal uncertainties since early 2020. Substantial uncertainty remains about:

- the timing and pace of recovery from COVID-19 at a global, national and state level and the impacts on State revenue
- future COVID-19 outbreaks in South Australia
- the timing of vaccine rollouts
- timelines for when the economy and international borders can fully reopen.

These uncertainties drive considerable variability in economic forecasts for key State economic indicators. As an example, figure 3.1 compares economic forecasts made by DTF to those made by the SA Centre for Economic Studies (SACES) for the period 2020-21 to 2022-23.

Figure 3.1: Comparison of DTF and SACES key economic indicator forecasts for the period 2020-21 to 2022-23

	DTF			SACES		
Key economic indicator	2020-21	2021-22	2022-23	2020-21	2021-22	2022-23
Gross State Product (GSP)	-0.75%	4.25%	3.00%	-2.50%	2.75%	1.50%
State Final Demand	-1.25%	4.75%	3.00%	-2.25%	3.00%	1.50%

SACES expects growth will be more modest than DTF and that the return to pre-pandemic levels will take several years.

SACES has based its forecasts on the assumption that shutdowns and pre-existing weaknesses in the Australian and South Australian economy have hindered businesses' ability to fund growth, and households' ability to expand consumption and secure employment. SACES is concerned that none of the weaknesses in the Australian economy prior to the pandemic, such as low wages growth, high and persistent household debt and falling business investment, have been resolved.

The other key factor considered by SACES, which was not apparent at the time DTF prepared the 2020-21 Budget, is the scale of the impact of the trade restrictions recently imposed by China. SACES expects net exports to detract from growth in gross state product because of these trade restrictions.

The economic uncertainties created by COVID-19 mean there is a much higher than usual risk that actual results will differ from Budget estimates.

DTF advised us that:

- economic forecasting always carries the inherent risk that actual future results will differ from forecasts made at an earlier point in time. Due to the unpredictable future path of COVID-19 and the timing and success of responses to curtail it, the risks associated with economic forecasting have increased. All economic forecasters are facing this same backdrop of heightened uncertainty
- as part of DTF's measures to address increased uncertainty and mitigate associated forecasting risks, the 2020-21 Budget economic forecasting process incorporated a substantially increased element of analysis and consultation compared with usual forecasting processes. Regular roundtable consultations with Commonwealth Government Treasury and other state treasuries was a feature of the 2020-21 forecasting process, along with greater consultation with peak industry associations
- SACES is one of a number of organisations that prepare forecasts for the South Australian economy. Deloitte-Access Economics and the ANZ Bank also prepare forecasts for the South Australian economy, with both recently upgrading their outlook for the immediate period ahead (2020-21 and 2021-22). Deloitte is forecasting South Australian GSP growth of 1.5% in 2020-21 followed by 3.1% in 2021-22. The ANZ Bank is forecasting GSP growth of 0.75% in 2020-21 followed by 4.25% in 2021-22.

DTF also advised us that in the past it has conducted comparisons of its own Budget forecasts against those of other economic forecasters, including SACES, Deloitte and a range of major banks. These comparisons have revealed that DTF's forecasting performance (as measured by percentage point divergences in growth rates) compares favourably against other forecasters.

3.1.3 No change to fiscal targets following COVID-19 as the SA Government aims to return to a net operating surplus by 2023-24

The SA Government's fiscal targets in the 2020-21 Budget remain unchanged from the prior year's Budget:

- Target 1: Achieve a net operating surplus in the general government sector every year.
- Target 2: Limit general government operating expenditure growth to trend growth in household income.
- Target 3: Achieve a level of net debt that is sustainable over the forward estimates.

The 2020-21 Budget indicates that existing fiscal targets remain appropriate as a medium to long-term strategy. The SA Government is not forecasting budget operating surpluses until 2023-24 given the impact of COVID-19. However, the targets remain a statement of the SA Government's intent as the current response measures phase out and state and national economic activity returns to more normal levels.

DTF advised us that the SA Government monitors the fiscal outlook against its fiscal targets and makes budgeting decisions focussed on directing resources to its identified priorities. These decisions are based on the overall economic and budgetary context at the time. In the 2020-21 Budget, this involved timely and targeted stimulus measures to support and grow jobs and rebuild a resilient economy.

DTF also advised us that:

- it is difficult to respond to cyclical movements for revenues other than to ensure that budget decisions have regard to underlying trends, particularly given structural changes in tax bases are likely to require consideration of legislative change
- continued overspending on service delivery functions requires ongoing attention to the efficiency of service delivery and/or the need for early intervention programs that can reduce demand for services.

DTF advised us that it monitors these issues on an ongoing basis.

Sections 4.3.1, 4.5.2 and 5.3.3 provide further details on fiscal targets.

3.2 Policy and parameter variations

3.2.1 Significant new expenditure initiatives and revenue reductions since the 2019-20 MYBR have led to substantial net operating and net lending deficits

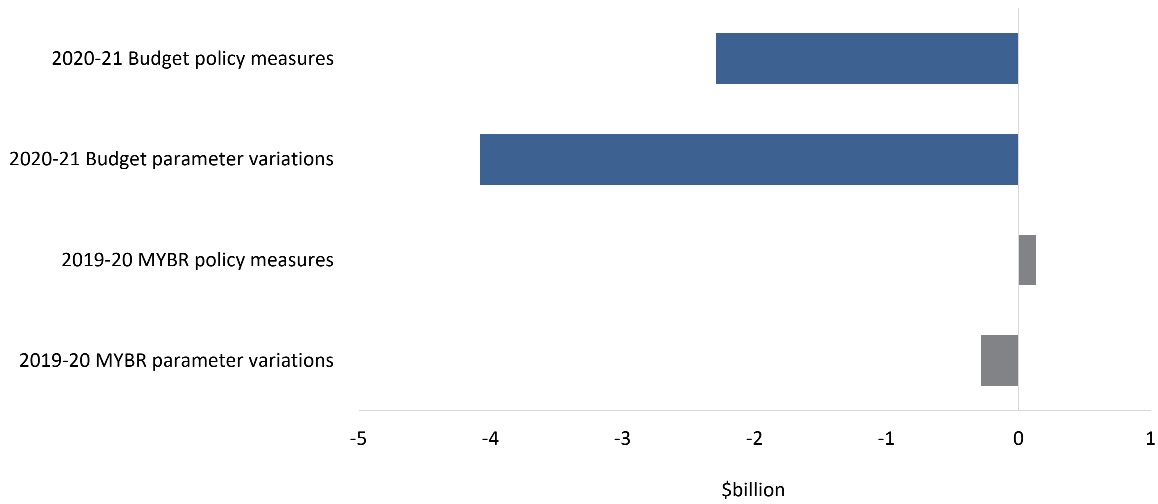
The Budget Papers include a reconciliation of policy and parameter variations since the 2019-20 Budget for the net operating balance and net lending balance.[9] This explains differences between the 2019-20 Budget, 2019-20 MYBR and 2020-21 Budget arising from:

- policy changes – decisions made by the SA Government to increase or decrease taxation, fees and charges and spending
- parameter changes – variations that do not flow from policy choice changes.

The 2019-20 MYBR was released in December 2019. The 2020-21 Budget is the first budget update to reflect the economic impacts of COVID-19 and the SA Government's fiscal response.

Figure 3.2 shows that total policy and parameter variations in the 2020-21 Budget for the period 2019-20 to 2022-23 are far greater than the 2019-20 MYBR and drive significant downward revisions to the net operating balance.

Figure 3.2: Total general government sector net operating balance policy and parameter variations since 2019-20 Budget



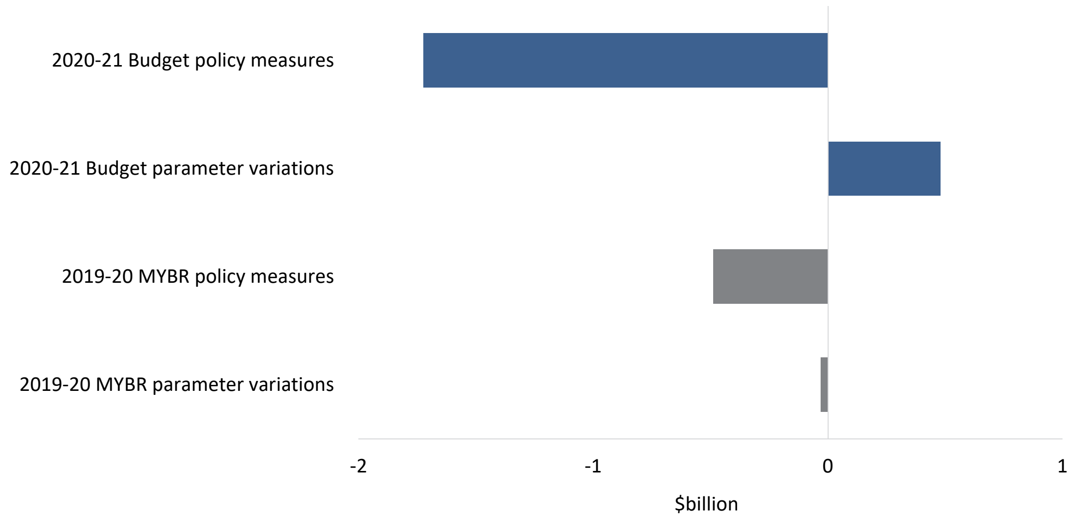
Total 2020-21 Budget parameter variations revise the net operating balance downwards by $4.081 billion. The 2020-21 Budget parameter variations mainly reflect GST revenue write-downs ($3.638 billion). Sections 4.4.3 to 4.4.6 provide further details on trends in GST revenue.

9 2020-21 Budget Paper 3 *Budget Statement,* tables 1.6, 1.7 and 1.8.

Total 2020-21 Budget policy measures add spending and revise the net operating balance downwards by $2.289 billion. These mainly comprise new operating expenditure initiatives that are further detailed in section 3.3.

Figure 3.3 shows that 2020-21 Budget investing policy measures have the most significant impact on the net lending balance, driving a total $1.7 billion downward revision between 2019-20 and 2022-23.

Figure 3.3: Total general government sector net lending policy and parameter variations since 2019-20 Budget



Section 3.4 provides further details on 2020-21 Budget investing policy measures.

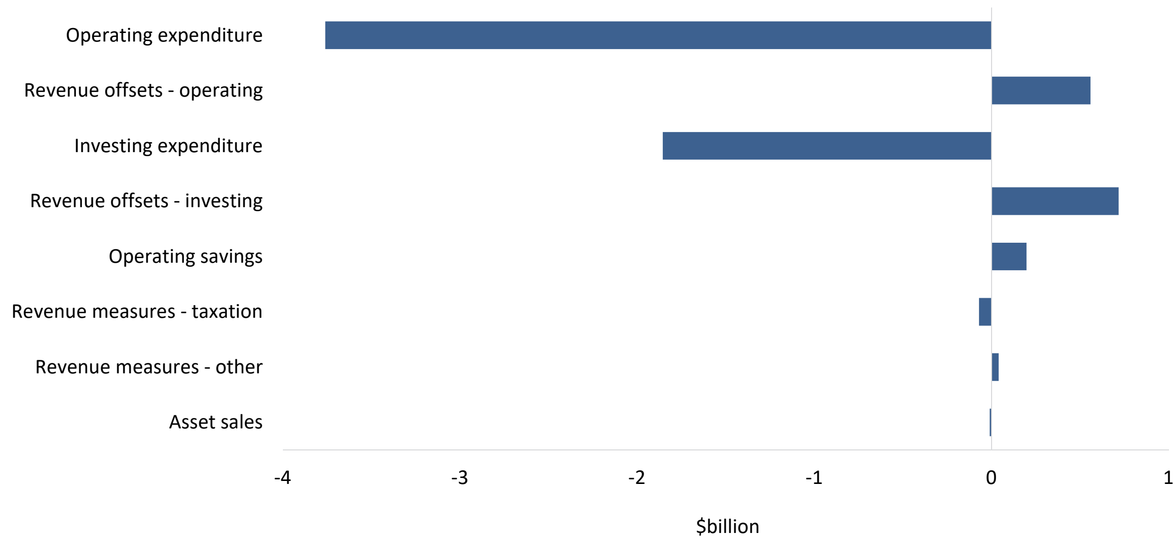
2019-20 MYBR investing policy measures lead to a downward net lending balance revision totalling $488 million and mainly relate to the Accelerating Major Road Projects initiative ($327 million) and Darlington Upgrade project ($88 million) in the Department for Infrastructure and Transport (DIT).

2020-21 Budget investing parameter variations offset the other variations (revise the net lending balance upwards by $478 million) and mainly reflect the changed timing of expected capital project expenditure and valuation and depreciation adjustments.

3.2.2 Operating and investing expenditure initiatives are the most significant new measures in the 2020-21 Budget and mainly impact the next two years

Figure 3.4 provides a breakdown by category of new measures in the 2020-21 Budget for the period 2019-20 to 2023-24.

Figure 3.4: New measures in 2020-21 Budget for period 2019-20 to 2023-24[10]



The most significant new budget measures are operating expenditure initiatives ($3.76 billion) and investing expenditure initiatives ($1.855 billion). Revenue offsets primarily relate to Commonwealth funding for a portion of these expenditure initiatives.[11]

DTF advised us that:

- the measures that were funded were those the SA Government considered would best support businesses, create jobs, and help communities and households affected by COVID-19 restrictions
- given the initiatives were developed and implemented over an extended period, they responded to circumstances at particular points in time
- initiatives that could be completed or significantly completed over two years were prioritised.

A significant proportion of new operating expenditures initiatives (82%) and investing expenditure initiatives (77%) are expected to be spent by the end of 2021-22.[12] This is consistent with the SA Government's stated aim of focussing on initiatives that can be completed or significantly completed within the next two years. For the short-term economic stimulus benefits of these new initiatives to be realised, robust ongoing monitoring will be required to ensure this expenditure is incurred as budgeted where possible and that carryovers of expenditure into future years are limited.

Sections 3.5 and 3.6 provide further details on operating savings.

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[10] Includes new measures for general government sector agencies and public non-financial corporations (PNFCs).

[11] Revenue offsets include revenues received from external parties, including the Commonwealth Government, for the specific purpose of, and incidental to, an expenditure measure.

[12] This includes amounts for 2019-20 initiatives in the 2020-21 Budget that are reflected in the actual 2019-20 result (ie 2019-20 initiatives implemented after the 2019-20 MYBR).

3.2.3 New revenue measures in the 2020-21 Budget are limited with most tax-related relief measures delivered by ex-gratia relief payments through operating expenditure

New revenue measures in the 2020-21 Budget for the period 2019-20 to 2023-24 are limited. Taxation revenue measures reduce the net operating balance by $70 million and other revenue measures increase the net operating balance by $41 million.

Most tax-related relief measures in the 2020-21 Budget are being delivered through ex-gratia relief payments. This relief is shown as a refund and remission expense and not a reduction in taxation revenue.

Taxation and related expenditure measures in the 2020-21 Budget total $281 million. This mainly comprises:

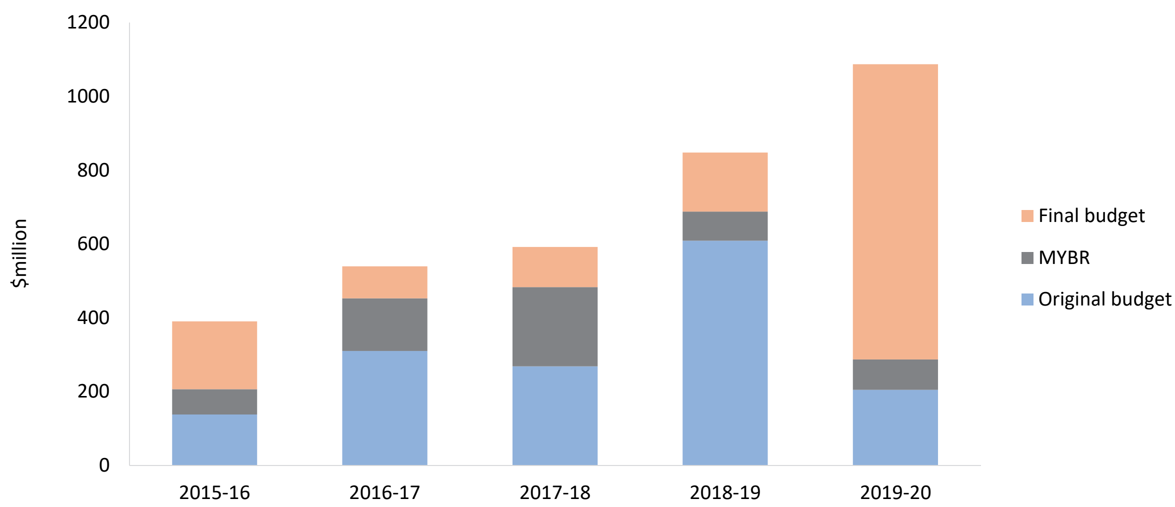
- the COVID-19 payroll tax relief expenditure measure ($158 million)
- the payroll tax exemption for JobKeeper payments revenue measure ($70 million).

3.3 Operating expenditure initiatives

3.3.1 2020-21 Budget includes significant additional spending for 2019-20

Figure 3.5 shows the total new operating expenditure measures at each stage of the annual budget cycle for each year between 2015-16 and 2019-20.[13]

Figure 3.5: New operating expenditure measures for each year between 2015-16 and 2019-20[14]



[13] For example, 2019-20 reflects the total new operating expenditure measures in the 2019-20 Budget (original budget), 2019-20 MYBR (MYBR) and 2020-21 Budget (final budget).

[14] Includes new operating expenditure measures for general government sector agencies and PNFCs.

Total new operating expenditure initiatives are highest in 2019-20 ($1.087 billion) and 2018-19 ($848 million), with totals in earlier years all less than $600 million.

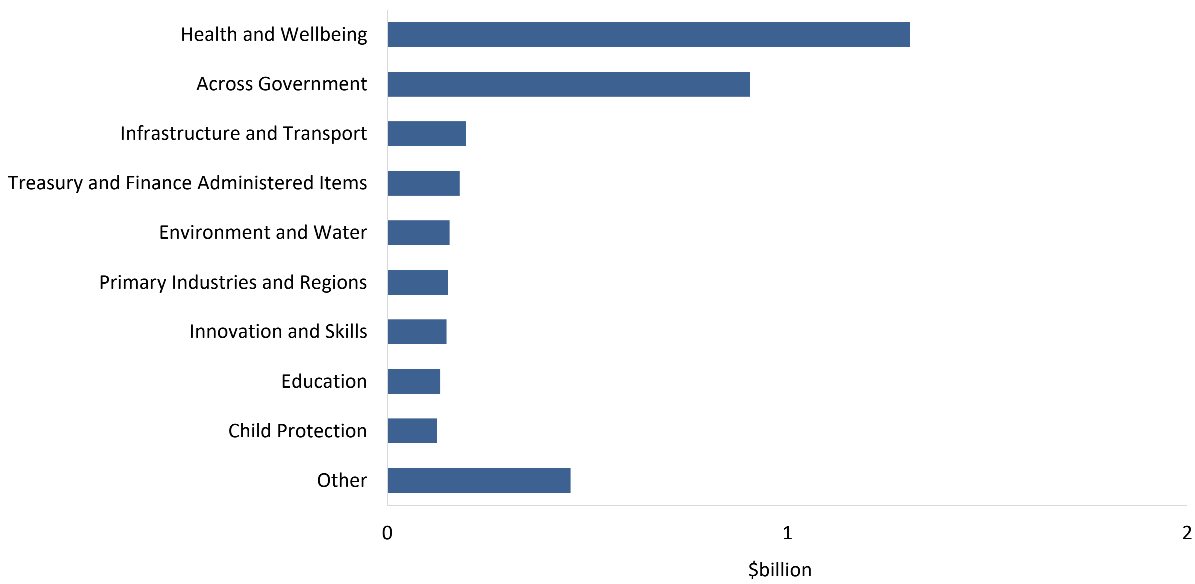
In 2019-20, new operating expenditures in the original budget and MYBR were relatively limited compared to prior years. The high total is due to the very significant initiatives for 2019-20 totalling $800 million in the 2020-21 Budget, in particular:

- Business and Jobs Support Fund ($189 million)
- the bringing forward of non-government school funding ($180 million)
- establishing a sustainable, efficient health system ($160 million)
- COVID-19 payroll tax relief ($40 million)
- Community and Jobs Support Fund ($35 million).

3.3.2 New operating expenditure initiatives in the 2020-21 Budget total $3.76 billion and impact a broad range of agencies with the most significant being in Health

Figure 3.6 shows the breakdown of new operating expenditure initiatives in the 2020-21 Budget by agency.

Figure 3.6: New operating expenditure measures in 2020-21 Budget by agency for period 2019-20 to 2023-24



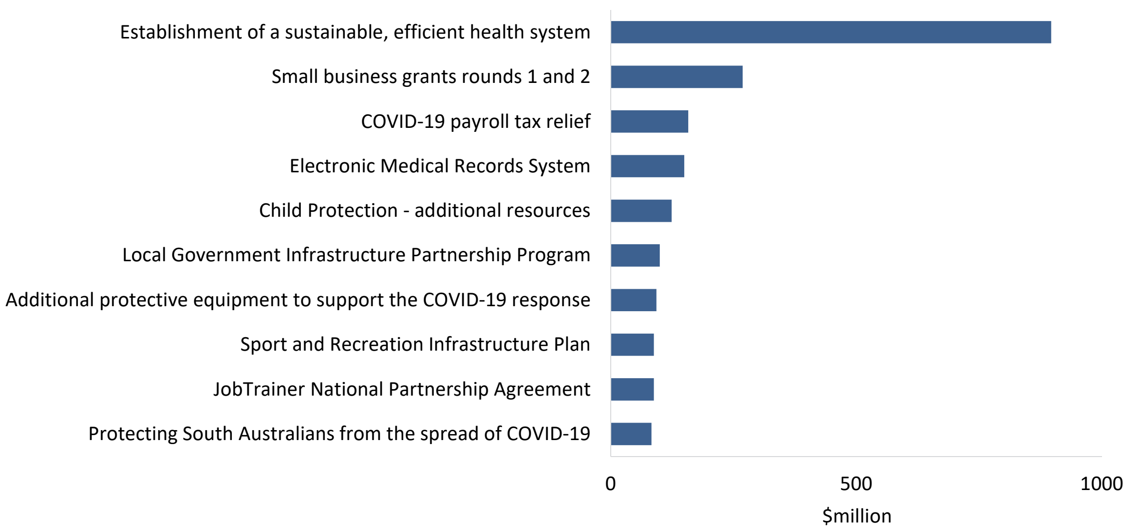
New operating expenditure initiatives total $3.76 billion and are spread across a broad range of agencies, with the most significant being DHW and Across Government initiatives.

New DHW operating expenditure initiatives total $1.306 billion for the period 2019-20 to 2023-24 and represent 35% of total new initiatives. Across Government operating expenditure initiatives are also significant, totalling $907 million (24%), and mainly comprise economic stimulus measures including grant schemes and tax relief.

3.3.3 Operating initiatives in the 2020-21 Budget include specific responses to the economic and health impacts of COVID-19 and the expansion or repurposing of pre-existing initiatives

Figure 3.7 shows that the major new operating expenditure initiatives in the 2020-21 Budget are the establishment of a sustainable, efficient health system and small business grants.

Figure 3.7: Major new operating expenditure measures in 2020-21 Budget for period 2019-20 to 2023-24



Several of the measures are a specific response to the economic and health impacts of COVID-19, including small business grants rounds 1 and 2 ($269 million), COVID-19 payroll tax relief ($158 million), additional protective equipment to support the COVID-19 response ($93 million) and protecting South Australians from the spread of COVID-19 ($83 million).

Some initiatives are funded by the Commonwealth Government and/or cost recovery arrangements including the following:

- Additional protective equipment costs are expected to be mostly funded by the Commonwealth Government and cost recovery from face masks provided for distribution to non-government organisations and the community ($57 million).
- Approximately half of the Protecting South Australians from the spread of COVID-19 initiative is expected to be funded by the Commonwealth Government and cost recovery of hotel quarantine fees ($42 million).
- The Commonwealth Government will provide $34 million in funding for the $88 million JobTrainer National Partnership Agreement.

Initiatives in place prior to the COVID-19 pandemic have also been expanded, including the establishment of a sustainable, efficient health system ($897 million), the Electronic Medical

Records System ($150 million)[15] and additional resources for Child Protection ($124 million).

The establishment of a sustainable, efficient health system initiative represents 24% of total new operating expenditure initiatives in a budget with significant one-off COVID-19 economic stimulus measures. Section 3.5 provides further details on this initiative and Health savings.

3.3.4 The SA Government will face challenges and risks rolling out large-scale stimulus grant schemes within short time frames

The 2020-21 Budget indicates that the emphasis of the stimulus package will be on projects that can be completed or significantly completed within the next two years, including small business grant schemes. My previous Reports have highlighted that there is scope to improve the planning and administration of grant schemes[16] aimed at stimulating economic and employment growth, particularly where time pressures exist.

The goal of getting grants to businesses as quickly as possible and supporting economic activity increases the risk that sound grant administration processes will not be implemented and inappropriate grant payments may be made. While seeking to make grant payments as early as possible, it is critical that agencies responsible for administering the stimulus grant schemes:

- maintain robust application processes and gateways, including sound eligibility criteria
- perform systematic assessments against the eligibility criteria
- carefully monitor grant payments
- assess whether the grant scheme has met its objectives and factor learnings into the development of future schemes.

3.4 Investing expenditure initiatives

3.4.1 New investing expenditure initiatives are primarily in the Department for Infrastructure and Transport

New investing initiatives in the 2020-21 Budget total $1.855 billion between 2019-20 and 2023-24. Figure 3.8 shows the breakdown of them by agency.

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[15] 2020-21 Budget Paper 5 Budget Measures Statement notes that following an independent review, the SA Government announced that it would cancel the EPAS program and deploy Sunrise EMR and PAS at the Royal Adelaide Hospital and the Mount Gambier and District Health Service. Following these deployments, the SA Government has decided to proceed with the roll-out to the remaining metropolitan local health networks.

[16] Refer to section 4.3 of Auditor-General's Report 5 of 2018 *Annual report for the year ended 30 June 2018, Part A: Executive Summary* where scope for improvement in Job Accelerator Scheme business case analysis, performance monitoring and administration was identified.

Figure 3.8: New investing initiatives by agency[17]

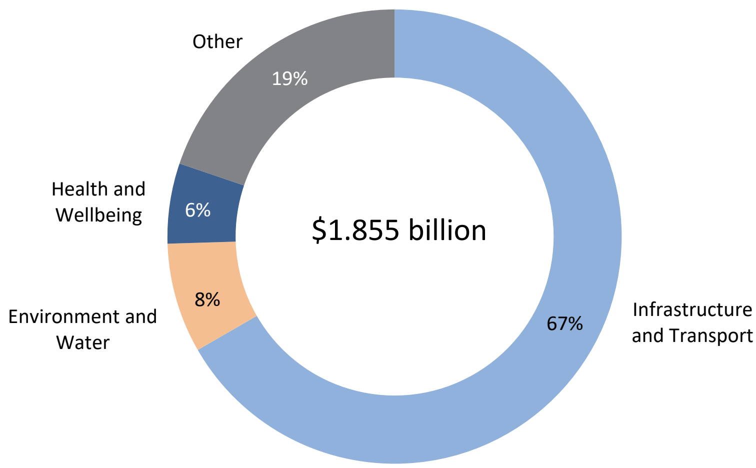
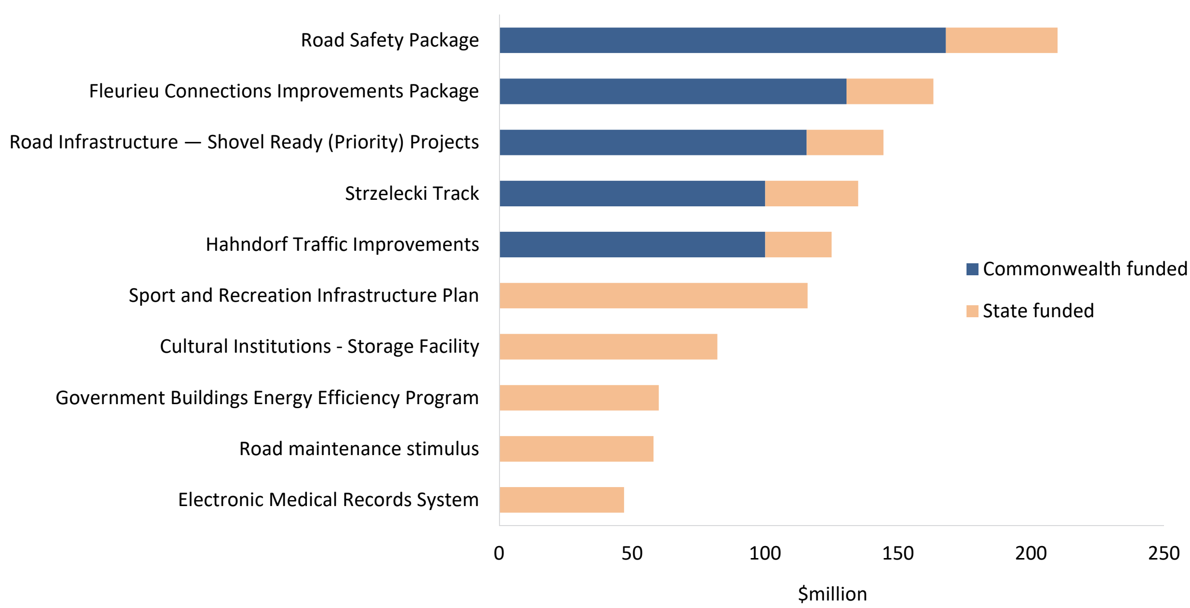


Figure 3.8 shows new DIT investing expenditure initiatives total $1.237 billion and represent 67% of total new initiatives.

3.4.2 The most significant new investing expenditure initiatives are road upgrades predominately funded by the Commonwealth Government

Figure 3.9 shows the most significant new investing initiatives in the 2020-21 Budget and the Commonwealth Government funding provided for each initiative.

Figure 3.9: Major new investing initiatives in 2020-21 Budget



[17] Includes new investing expenditure measures for general government sector agencies and PNFCs.

Most of the significant new investing initiatives focus on road upgrades and several are predominately funded by the Commonwealth Government. The Road Safety Package, Fleurieu Connections Improvement Package, Shovel Ready (Priority) Projects and Hahndorf Traffic Improvements are all 80% funded by the Commonwealth Government, which is also providing $100 million to the Strzelecki Track upgrade.

3.5 Health savings

3.5.1 Health savings target reduced significantly as the budget target of achieving national average efficiency in delivering public hospital services is delayed by two years

Figure 3.10 shows the reprofiled DHW[18] savings requirement reflected in the 2020-21 Budget, as advised by DTF.

Figure 3.10: Summary of DHW's revised savings targets and initiatives

	2019-20 $million	2020-21 $million	2021-22 $million	2022-23 $million	2023-24 $million
2019-20 Budget savings targets	**146**	**263**	**364**	**364**	**364**
2020-21 Budget measure	-160	-227	-248	-168	-94
2020-21 Additional savings measure (departmental efficiencies)	-	6.5	6.5	6.5	6.5
Adjustment for 2019-20 DHW final structural result	-22	-	-	-	-
2020-21 Budget savings targets	**-36**	**43**	**123**	**203**	**277**
Annual growth in savings task		79	80	80	74

Note: Totals may not add due to rounding.

The DHW savings task over the four years of the 2020-21 Budget is $646 million, compared to $1.137 billion in the 2019-20 Budget.

This significantly reduced savings task is mainly due to the establishment of a sustainable, efficient health system budget measure in the 2020-21 Budget. This measure has provided additional funding to reduce savings targets between 2019-20 and 2023-24. It provides a total of $897 million between 2019-20 and 2023-24 to recognise SA Health's estimated overspend in 2019-20 and the revised timing of its financial improvement targets.

DTF advised us that at the time the 2020-21 Budget measure was established, it was based on an estimate of DHW's 2019-20 result prior to its finalisation. On a structural basis, DHW's result ultimately showed a further $22 million deterioration from this initial estimate.

The 2020-21 Budget indicates that the SA Government's principal financial objective for DHW remains achieving national average efficiency in delivering public hospital services. It notes that some efficiencies are being achieved as local health networks move closer to the

[18] The reference to DHW in this section reflects the whole Health and Wellbeing portfolio, including local health networks.

national efficient price. However, the required response by DHW in the face of COVID-19 has meant that it did not meet its financial targets in 2019-20. In light of that outcome, and the continuing impacts of the pandemic, DHW's financial improvement targets over the forward estimates have been re-evaluated.

DHW will now be expected to progressively increase the efficiency of its services to provide them in line with the national efficient price by the end of the current forward estimates (2023-24). This represents a delay of two years, as the original planned timeline for achieving national efficient price in the 2018-19 and 2019-20 Budgets was 2021-22.

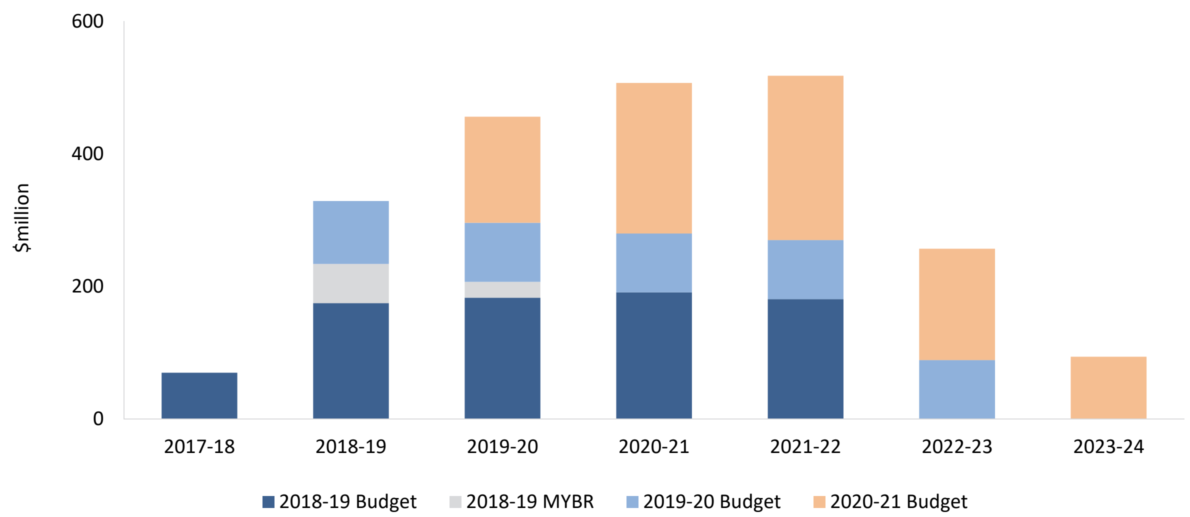
DTF advised us that the national efficient price (the measure of national average efficiency) increased by 3.6% in 2020-21, which led to a reduction in DHW's total savings target by about $94 million in the 2020-21 Budget.

Further details on DHW's 2019-20 budget performance, including analysis of variations between 2019-20 Budget and actual results, are included in the section of my 2019-20 Annual Report titled 'Department for Health and Wellbeing'.

3.5.2 Sustainable health system initiative totals $2.231 billion since it commenced and reflects the ongoing challenge of driving efficiencies across the health sector to meet budgeted outcomes

Figure 3.11 shows the total amounts allocated to the establishment of a sustainable, efficient health system initiative each year since it was commenced by the current SA Government in 2018-19.

Figure 3.11: Total amounts allocated to establishment of sustainable, efficient health system initiative since 2018-19



The total amount allocated to the initiative since 2018-19 is $2.231 billion. This highlights the significant additional funding the SA Government has needed to provide to DHW compared to that initially budgeted, primarily as a result of DHW not meeting its budget target of achieving national average efficiency.

This additional funding relates to DHW's core business-as-usual operations and has not been directly impacted by COVID-19. Other expenditure initiatives were implemented in the 2020-21 Budget to fund DHW's specific responses to COVID-19, including purchasing additional protective equipment to support the COVID-19 response ($93 million) and protecting South Australians from the spread of COVID-19 ($83 million).

We expect the savings task to remain a challenge until there is a demonstrated history of achieving savings goals. DHW and the local health networks will need to continue driving efficiencies across the sector to achieve budgeted outcomes.

3.5.3 KordaMentha contract to identify sustainable savings initiatives at CALHN recommenced in October 2020

In 2019-20, KordaMentha conducted work across a range of areas at the Central Adelaide Local Health Network Incorporated (CALHN) including procurement and workforce planning. Due to the impacts of COVID-19 this financial recovery program was paused in April 2020.

DTF advised us that a Deed of Variation was signed with KordaMentha in October 2020 to recommence the financial recovery program contract. The cost of the varied contract was $4.4 million for a 12-week work program. The scope of the services included:

- analysis to identify and quantify sustainable savings initiatives to be implemented by CALHN and preparing an Industrial Relations Strategy and Implementation Plan for the delivery of CALHN cost savings initiatives
- planning for implementation of the new Salaried Medical Officers enterprise agreement and developing an industrial relations framework to help CALHN navigate the industrial relations landscape in South Australia
- planning for the transition of CALHN's role under the Royal Adelaide Hospital Public Private Partnership arrangement from facility operator to contract administrator.

DTF advised us that this will conclude KordaMentha's engagement by CALHN. CALHN will be responsible for continuing to drive efficiencies to achieve the SA Government's target of achieving national average efficiency by the end of the current forward estimates.

3.6 Other operating savings

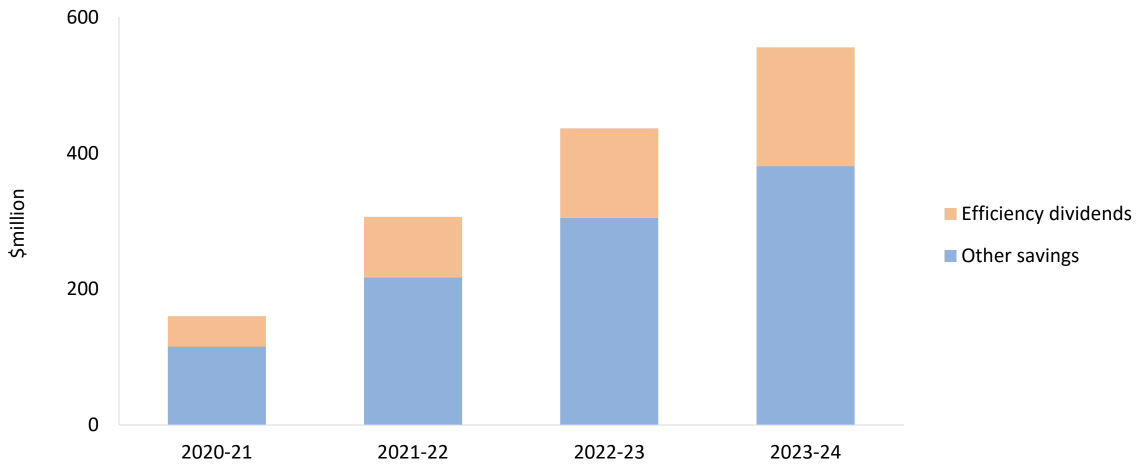
3.6.1 Expected total operating savings reduced by $1.931 billion since prior year budget

Total general government sector savings over the four years of the 2020-21 Budget ($1.459 billion) have reduced by $1.931 billion compared to the 2019-20 Budget ($3.39 billion). This is largely due to the reduction in health savings targets ($897 million) detailed in section 3.5.

New operating savings measures across the four years of the 2020-21 Budget total $198 million, compared to a total of $362 million in the 2019-20 Budget.

Figure 3.12 shows total savings expected in each year over the four years of the 2020-21 Budget, including amounts attributable to efficiency dividends.

Figure 3.12: Total general government operating savings expected over four years of 2020-21 Budget



Total savings are expected to increase steadily over the forward estimates, rising from $160 million in 2020-21 to $556 million in 2023-24. The savings total in 2023-24 represents 2.4% of total expenditure in that year.

Efficiency dividends total $440 million and represent a relatively consistent proportion of total savings across the four years, ranging from 28% in 2020-21 to 31% in 2023-24. The 2020-21 Budget indicates that savings continue to address the SA Government's agenda for an efficient public sector.

An efficiency dividend is a budget policy tool the government uses to constrain growth in departmental operating funding. It is intended to drive efficiencies in public service delivery and realise the associated financial benefits of expense reduction targets. These targets create budgetary pressure and are meant to incentivise departments to seek ways to operate more efficiently.

A well-managed efficiency measure should result in the same quality and level of output as is currently being provided, but at a lower cost. There are some risks associated with efficiency measures. Departments that experience difficulty realising efficiency gains may reduce expenditure through other means, which can negatively impact workloads and outputs.

Achieving the target reductions while maintaining current service levels will also be a challenge, since about 40% of the State's total expenses are on employees, and these costs are generally subject to annual increases included in enterprise bargaining agreements.

If expected efficiency gains are not all realised, the SA Government will need to find alternative funding to deliver against its budgeted service and infrastructure commitments, or refine, rephase or cease one or more of them.

3.6.2 Some agencies including DHW are forecasting budget overruns and that savings targets will not be met in 2020-21

There are some agencies forecasting 2020-21 budget overruns[19] at 31 January 2021, including some cases where savings targets will not be met. The more significant forecast budget overruns advised by DTF include Health and Wellbeing ($170 million), Infrastructure and Transport ($65 million), SA Police ($50 million) and Primary Industries and Regions ($20 million).

3.7 Stimulus package in 2020-21 Budget

3.7.1 $4 billion stimulus package includes repurposed expenditure, expenditure brought forward and some funding from previous budgets

The 2020-21 Budget states that the SA Government has responded to the substantial ongoing challenges arising from COVID-19 with a $4 billion stimulus package. DTF advised us that this package captures a range of measures including:

- tax relief
- cash flow benefits from the deferred collection of revenues
- new government expenditure
- repurposed expenditure and bring-forward of expenditure
- loan facilities for non-government schools.

Appendix 2 provides a detailed breakdown of the measures included in the stimulus package.[20]

The $4 billion stimulus package includes some amounts from previous Budgets. $320 million for the non-government school loans scheme reflects the total value of the scheme. The scheme was announced in the 2016-17 Budget with an initial $250 million allocation. New expenditure for the scheme in the 2020-21 Budget totals $49 million.

3.7.2 Expenditure incurred to 31 January 2021 for some business and community financial assistance funds has been limited

The $4 billion stimulus package includes the following financial assistance funds:

- Business and Jobs Support Fund ($530 million)
- Community and Jobs Support Fund ($265 million)
- Digital Restart Fund ($120 million)

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[19] Budget overruns reflect unfavourable estimated end of year net operating results compared to Budget.

[20] The analysis of new measures in sections 3.2, 3.3 and 3.4 focuses on new measures reflected in Budget Paper 5 *Budget Measures Statement*. The $4 billion stimulus package includes repurposed expenditure and cash flow benefits from the deferred collection of revenues (eg tax deferrals), which DTF has advised do not typically appear in Budget Paper 5.

- Economic and Business Growth Fund ($220 million).

Figure 3.13 shows the expenditure incurred to 31 January 2021 for these funds as advised by DTF.

Figure 3.13: Expenditure incurred to 31 January 2021 on business and community financial assistance funds

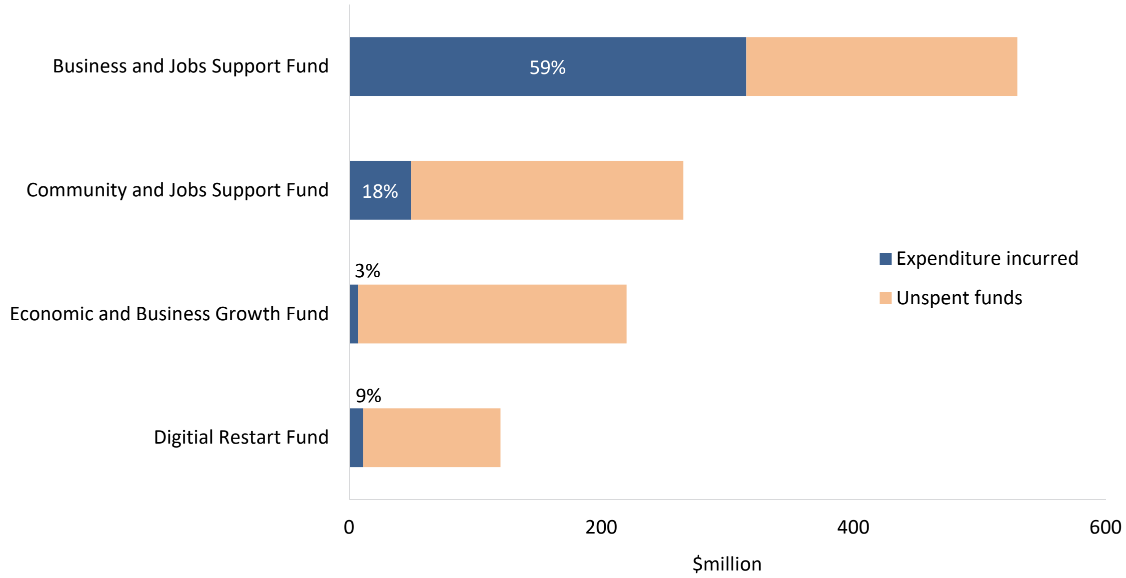


Figure 3.13 highlights that expenditure on financial assistance funds other than the Business and Jobs Support Fund has been limited. Total Business and Jobs Support Fund expenditure to 31 January 2021 ($315 million or 59% of the fund total) mainly relates to Small Business grants rounds 1 ($178 million) and 2 ($60 million) and COVID-19 payroll tax relief ($50 million).

The financial assistance funds with significant unspent amounts at 31 January 2021 include:

- Local Government Infrastructure Partnership Program ($100 million unspent)
- Housing Construction Stimulus Package ($76 million unspent)
- JobTrainer National Partnership Agreement ($53 million unspent)[21]
- Tourism Industry Development Fund ($20 million unspent).

DTF advised us that it is seeking updates on agencies' progress in implementing stimulus initiatives as part of its monitoring process.

Part A of my 2019-20 Annual Report to Parliament provides further details on the SA Government's initial financial assistance response to the COVID-19 pandemic.

[21] This initiative is partly funded by the Commonwealth Government ($35 million).

4 Operating Statement

Key points

- The 2019-20 net operating balance has deteriorated by $1.576 billion since the 2019-20 MYBR.
- The fiscal target of achieving a net operating surplus in the general government sector every year is not expected to be met until 2023-24.
- South Australia's expected net operating balances over the four years of the 2020-21 Budget are generally comparable to other Australian states.
- South Australia is more reliant on Commonwealth grant revenue than all other Australian states except Tasmania.
- Estimated GST revenue has been revised downwards by a combined total of $5.73 billion in the 2019-20 Budget, 2019-20 MYBR and 2020-21 Budget. GST revenue is a significant component of the State's revenue base and has the potential to significantly impact the State's ability to generate operating surpluses.
- Annual expenditure growth is expected to be lower over the forward estimates after a significant peak in 2019-20.
- A limited change in total public sector workforce numbers is expected between 2019-20 and 2023-24.

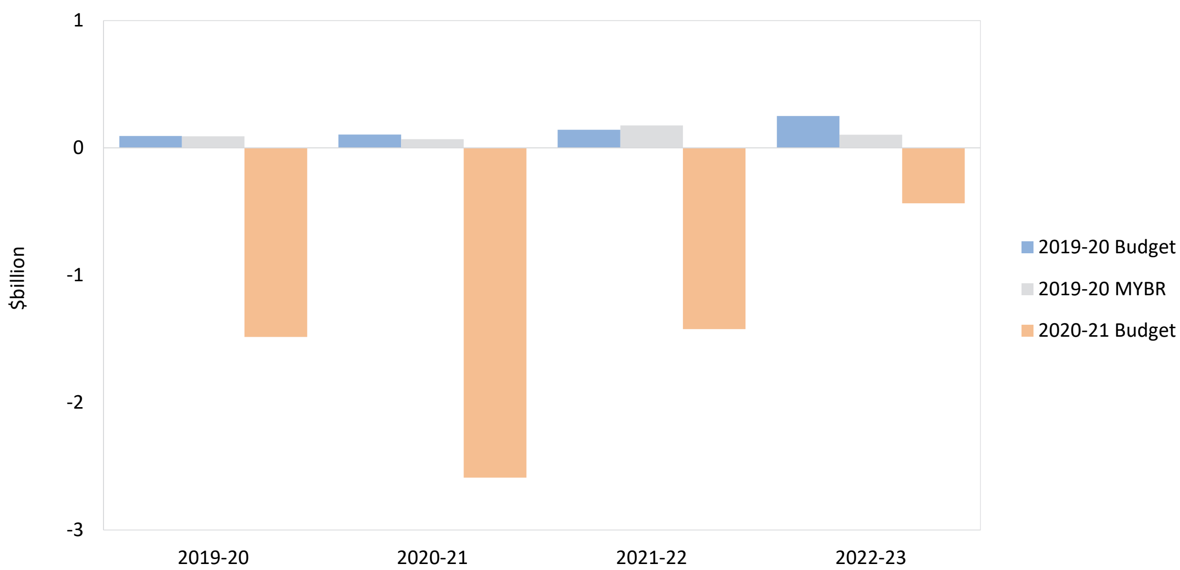
4.1 2019-20 actual results

4.1.1 Net operating balance deteriorated by $1.576 billion since the 2019-20 mid-year budget review

The 2019-20 actual net operating balance[22] result for the general government sector was a deficit of $1.485 billion, compared to a budgeted surplus of $94 million in the 2019-20 Budget and $91 million in the 2019-20 MYBR. Figure 4.1 shows the significant downward revisions in the general government sector net operating balance since the 2019-20 MYBR, driven by the SA Government's response to the effects of COVID-19.

[22] The net operating balance is the net result of revenue and expenses from transactions. It is a summary measure of the sustainability of operations that shows whether the SA Government has to borrow money to cover operating activities. If this measure is in surplus, operating revenue is sufficient to fund operating expenses.

Figure 4.1: Revisions to net operating balance between 2019-20 Budget and 2020-21 Budget for period 2019-20 to 2022-23



4.1.2 Significant deterioration in actual 2019-20 net operating result compared to Budget mainly due to much lower than expected GST revenue and substantially higher other operating expenses

Figure 4.2 summarises the key factors contributing to the $1.579 billion deterioration in the general government sector 2019-20 net operating balance since the 2019-20 Budget.

Figure 4.2: Key account balances contributing to variance between 2019-20 budget and actual result for net operating balance

	2019-20 Budget		2019-20 Actual
TOTAL REVENUE	$20.2b	1%	$20.3b
Other grants	$4.9b	7%	$5.2b
Other revenue	$0.8b	75%	$1.4b
GST revenue	$6.8b	10%	$6.1b

	2019-20 Budget		2019-20 Actual
TOTAL EXPENSES	$20.1b	9%	$21.8b
Other operating expenses	$5.8b	16%	$6.8b
Grants	$2.8b	20%	$3.4b

Total actual 2019-20 revenue was within 1% of budget, with higher than budgeted other grants ($356 million) and other revenue ($585 million), largely offset by lower than budgeted GST receipts ($663 million). The main drivers of these variances were:

- other grants were higher mainly due to the bring-forward of grant revenue passed on to non-government schools ($217 million) and additional COVID-19 private hospital viability payments revenue ($89 million)

- other revenues were impacted by presentation changes to Compulsory Third Party (CTP) premiums resulting in revenues and expenses that were previously netted off now being shown in full ($578 million recorded as other revenue)
- GST receipts were lower due mainly to the reduced national GST pool, reflecting decreased national consumption spending resulting from COVID-19 restrictions.

Total actual 2019-20 expenses were $1.713 billion (9%) above budget. The main drivers of this variance were:

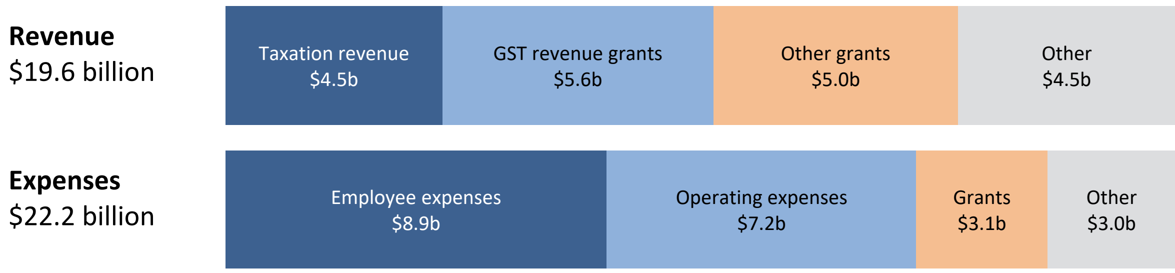
- other operating expenses were $928 million higher than budget primarily due to the CTP premium presentation changes, new operating initiatives announced in the 2019-20 MYBR and 2020-21 Budget ($238 million) and the reclassification of Child Protection expenses from grants to other operating expenses ($162 million)
- grant expenses were $574 million higher than budget mainly due to the passing through of $217 million in Commonwealth funding for non-government schools brought forward and grants paid from the Business and Jobs Support Fund ($189 million) and Community and Jobs Support Fund ($35 million).

4.2 Operating Statement overview

4.2.1 Grants and taxation represent 77% of total revenue while employee expenses and operating expenses comprise 73% of total expenses

Figure 4.3 shows the main components of total general government sector revenue and expenses for the 2020-21 budget year.

Figure 4.3: Main components of total general government sector revenue and expenses in 2020-21 Budget



Budgeted revenue in 2020-21 primarily comprises grants (54%) and taxation revenue (23%). Payroll tax, property taxes, conveyance duty and motor vehicle taxes make up 79% of taxation revenue.

Employee expenses and operating expenses make up 73% of total budgeted revenue. Operating expenses include items such as supplies and services, consultancies, contractors, National Disability Insurance Scheme contributions, and repairs and maintenance expenses.

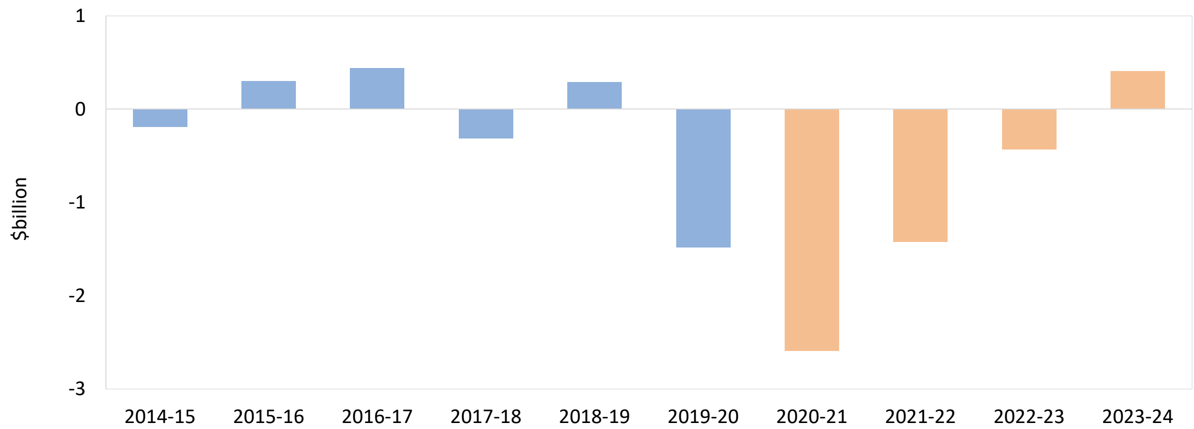
4.3 Net operating balance

4.3.1 The fiscal target of achieving a net operating surplus in the general government sector every year is not expected to be met until 2023-24

The SA Government has a fiscal target of achieving a net operating surplus in the general government sector every year, to enable the funding of operating expenditures from operating revenues. The Budget notes that this target is not currently achievable as the SA Government responds to the effects of the COVID-19 pandemic.

Figure 4.4 shows the actual outcomes for the general government sector net operating balance for the period 2014-15 to 2019-20 and the estimated results for the four years of the 2020-21 Budget.

Figure 4.4: General government sector net operating balance for period 2014-15 to 2023-24



The Budget is expected to return to a modest surplus in 2023-24 ($406 million) following significant deficits in 2019-20 ($1.485 billion), 2020-21 ($2.59 billion) and 2021-22 ($1.423 billion) and a less significant deficit in 2022-23 ($435 million).

The SA Government maintains that this fiscal target, as well as others, remains appropriate as a medium to long-term strategy. While achieving budget surpluses is not forecast in the short term given the impact of COVID-19, the targets remain a statement of the SA Government's intent as the current response measures phase out and state and national economic activity returns to more normal levels.

The estimates in the 2020-21 Budget are subject to a higher than normal degree of uncertainty. The Budget Papers note that forecasting financial outcomes in the present economic environment is particularly difficult and that COVID-19 could substantially impact budget revenues and expenses. There are number of risk factors that might prevent a return to surplus by 2023-24, for example:

- the GST national pool may not recover as quickly as anticipated from the ongoing COVID-19 impacts on the economy, resulting in lower GST revenue grants

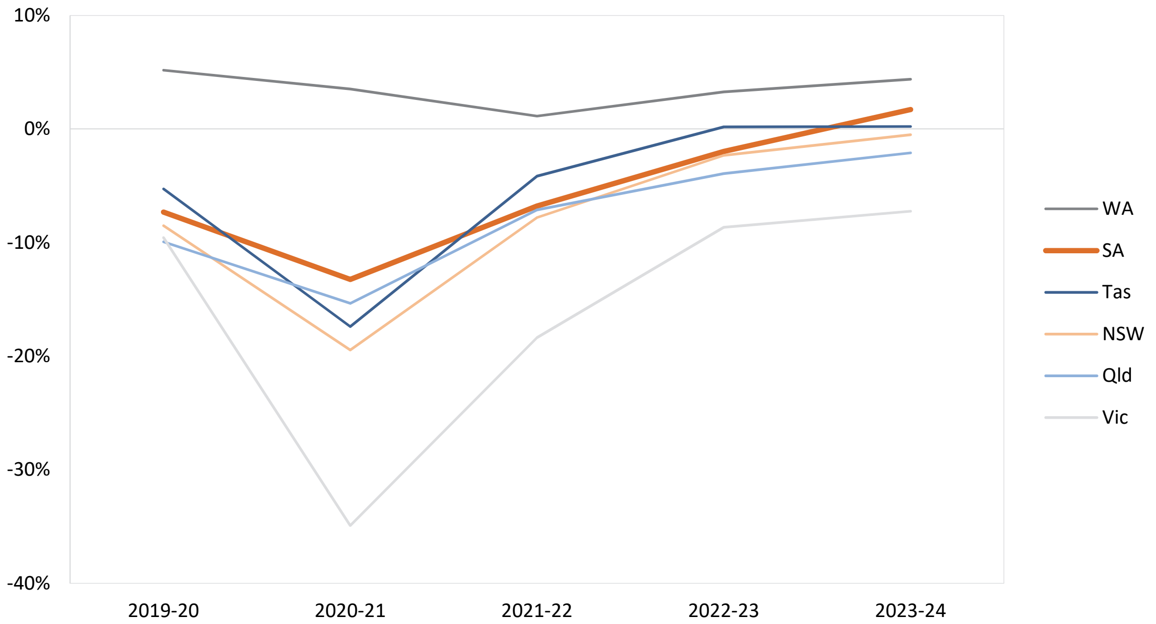
- softening growth in economic activity as national and state stimulus measures (eg JobKeeper and JobSeeker) wind down may reduce payroll tax and conveyance duty revenue
- new expenditure measures may be required to stimulate the State economy
- the Health and Wellbeing portfolio may not achieve its savings targets. A significant proportion of the overall savings target relates to the Health and Wellbeing portfolio (48%), which has historically experienced challenges meeting its savings targets
- agency efficiency (savings) dividends may not be achieved
- growth in employee expenses may exceed that allowed for in the forward estimates due to enterprise agreement negotiation outcomes.

Section 3.6.2 highlights that some of these risk factors may be realised, as certain agencies, including DHW, are forecasting budget overruns in 2020-21 and that savings targets may not be met.

4.3.2 South Australia’s expected net operating balances over the four years of the 2020-21 Budget are generally comparable to other Australian states

Figure 4.5 shows the expected trend in general government sector net operating balance as a percentage of total revenue[23] compared to other Australian states for the period 2019-20 to 2023-24.

Figure 4.5: Net operating balance as a share of total revenue for Australian states between 2019-20 to 2023-24



Source: South Australian and interstate budget papers.

[23] Due to substantial differences in the size of state budgets, net operating balance as a percentage of total revenue has been used to compare net operating balances between states on a comparable basis.

COVID-19 has had a significant impact on expenditure needs and revenue sources across all states, impacting net operating balances to varying extents.

South Australia's net operating balance trend over the four years of the 2020-21 Budget is generally comparable to New South Wales, Queensland and Tasmania, with deficits in the range of 13% to 20% of revenue, before steadily trending back towards surplus. South Australia is one of only three states forecasting to return to surplus by 2023-24.

Western Australia is the only state with consistent operating surpluses across the four years of the budget. Despite the significant impact of COVID-19 on state finances across the country, Western Australia expects to achieve a surplus in 2020-21 partly owing to strong iron ore royalties from its mining industry, which has fared well during the pandemic.

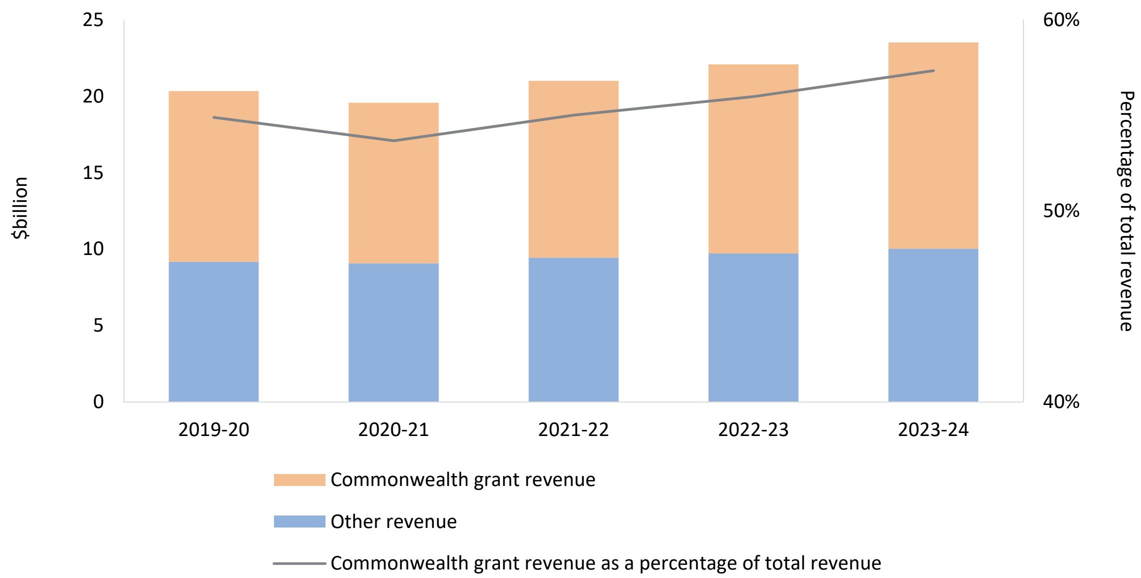
Meanwhile, Victoria is expecting significant operating deficits, peaking at $23.281 billion in 2020-21, equivalent to 35% of its revenue base. The 2020-21 Victorian budget papers indicate this is mainly due to longer periods of public health restrictions in Victoria compared to the rest of Australia, which contributed to an economic downturn and a weakened state revenue base.

4.4 Revenue

4.4.1 The State's reliance on Commonwealth grant revenue is expected to increase over the forward estimates to 57% of total revenue

Figure 4.6 shows Commonwealth grants revenue as a percentage of total general government sector revenue between 2019-20 and 2023-24.

Figure 4.6: General government sector Commonwealth grants revenue as percentage of total revenue



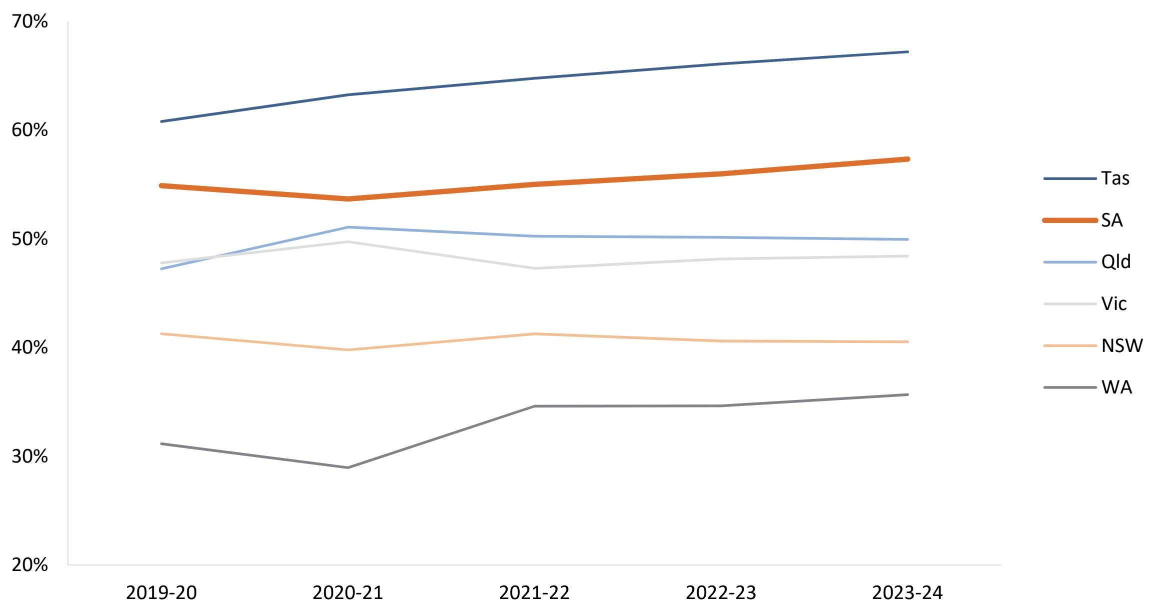
The State’s reliance on Commonwealth grant revenue is expected to increase over the four years of the Budget, from 54% in 2020-21 to 57% in 2023-24. Over half of this revenue relates to GST revenue grants.

Given the significance of Commonwealth grant revenue to the State’s revenue base, future trends in Commonwealth grant revenue, and in particular GST revenue, will be critical to the State’s ability to generate operating surpluses and pay down its significantly increased net debt.

4.4.2 South Australia is more reliant on Commonwealth grant revenue than any other Australian state except Tasmania

Figure 4.7 compares total Commonwealth grant revenue as a percentage of total revenue to other Australian states for the period 2019-20 to 2023-24.

Figure 4.7: General government sector Commonwealth grants revenue as percentage of total revenue in Australian states for period 2019-20 to 2023-24



Source: South Australian and interstate budget papers.

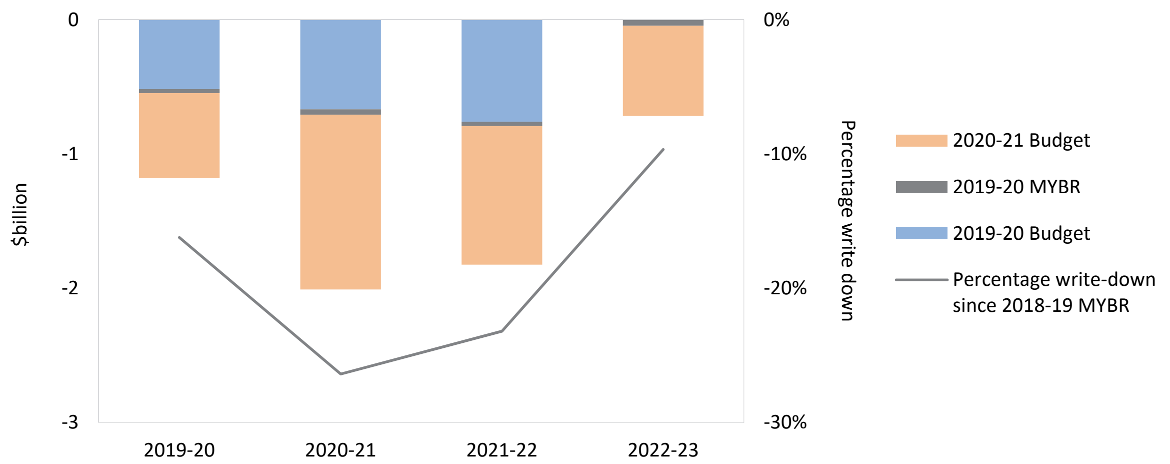
Figure 4.7 shows that South Australia is the second most reliant state on Commonwealth grant revenue after Tasmania, which is the most reliant. This reflects South Australia having a more limited ability to generate its own revenue (ie weaker fiscal capacity[24]) compared to most other states and therefore a greater need for Commonwealth revenue to provide public services.

[24] States have different fiscal capacities due to differences in economic, social and demographic characteristics that affect their expenditure and revenues. Some of the main reasons for the differences are mining production, property sales, taxable payrolls, remoteness, Indigenous status and population growth.

4.4.3 Estimated total GST revenue for the period 2019-20 to 2022-23 has been revised down by $5.73 billion since the 2018-19 MYBR

Figure 4.8 shows the revisions to GST grant revenue in the 2019-20 Budget, 2019-20 MYBR and 2020-21 Budget.

Figure 4.8: GST revenue revisions in 2019-20 Budget, 2019-20 MYBR and 2020-21 Budget



GST grant revenue for the period 2019-20 to 2022-23 has been consistently revised downwards since the 2018-19 MYBR, with combined revisions totalling $5.73 billion. The percentage of the write-down relative to the 2018-19 MYBR amount is particularly significant in 2020-21 (26%) and 2021-22 (23%).[25]

The most significant revisions to GST revenue estimates are in the 2020-21 Budget, which resulted in GST grant revenue deteriorating by $3.638 billion.

4.4.4 GST downward revisions in the 2020-21 Budget are mainly due to the reduced national pool driven by COVID-19 restrictions and a significant drop in South Australia's share

Since the 2019-20 Budget, GST revenue grants have been revised down by $3.786 billion, comprising $663 million in 2019-20 and a further $3.123 billion over the period 2020-21 to 2022-23. The downward revisions reflect the impact of lower forecasts for the national GST pool and South Australia's estimated share of the pool.

The size of the national GST pool is impacted by the amount of GST collected across Australia. GST pool estimates have been revised downwards significantly, mainly reflecting the impact of COVID-19 health restrictions on expenditure subject to GST (consumption expenditure).

[25] The percentage write-down for 2022-23 in figure 4.8 reflects the percentage write-down in estimated GST revenue since the 2019-20 Budget.

The Commonwealth Grants Commission (CGC) makes recommendations to the Commonwealth Government on the distribution of the GST pool between states and territories based on their relative fiscal capacities. Following the CGC's 2020 Methodology Review, South Australia's share of the GST pool will reduce significantly from 10.1% in 2019-20 to an estimated 9.4% in 2020-21. The Budget papers attribute this reduction to South Australia being in a stronger fiscal position than previously assessed by the CGC. According to the Budget papers this is the largest annual reduction in South Australia's share of the GST pool since the introduction of the GST in 2000.

DTF advised us that the portion of the $3.786 billion write-down attributable to changes in the national GST pool is $2.8 billion (74%), with changes in the State's share of the pool representing $999 million (26%).

4.4.5 Expected GST revenue receipts revised up by $300 million following Commonwealth MYEFO

Following the release of the 2020-21 Budget in November 2020, the Commonwealth Government released its 2020-21 Mid-Year Economic and Fiscal Outlook (MYEFO), in which the national GST entitlement pool for 2020-21 was revised up by around $3.2 billion. This resulted in an upward revision to South Australia's GST revenue of around $300 million in 2020-21 compared to estimates in the 2020-21 Budget, bringing GST revenue in 2020-21 to approximately $5.906 billion.

The MYEFO does not include estimates of the share of GST revenue expected to be received by each jurisdiction beyond 2020-21.

4.4.6 The State has a significant risk exposure to GST revenue reductions

GST revenue is a substantial component of the State's revenue base and revisions to the State's share have the potential to significantly impact the State's budget position.

Risk analysis in the Budget Papers highlights the importance of GST revenue to the Budget projections:

- A 1% change in GST pool growth has a revenue impact for South Australia of about $56 million per annum.
- A 0.01 change in South Australia's relativity would result in a change in GST revenue grants of about $37 million.[26]

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[26] The CGC provides its recommendations in the form of GST distribution relativities, which reflect the relationship between a state's GST entitlement under horizontal fiscal equalisation and its population share of total GST grants. For example, a relativity above 1.0 indicates that a state requires more than its population share of GST grants, due to a lower capacity to raise revenue compared to other states and/or higher costs of providing services and infrastructure to the same standard as other states.

The Budget Papers state that the Commonwealth Government is expecting growth in the national GST pool to rebound in 2021-22 and 2022-23, in line with the lifting of COVID-19 health restrictions and a return to more normal levels of consumption expenditure growth. Growth rates are based on various assumptions about the timing and magnitude of economic recovery, which are difficult to forecast as the COVID-19 pandemic continues to evolve. Outcomes may materially differ if these assumptions do not eventuate, such as if further prolonged lockdowns occur, and given the State's dependency on GST revenue it could pose a real challenge to its ability to fund and deliver services if the State's share further diminishes.

The 2020-21 Budget indicates that beyond 2020-21, South Australia's GST relativity is expected to be influenced by:

- COVID-19 related expenditures, including health costs
- property markets in the eastern states
- changes in South Australia's share of Commonwealth Government payments
- relative population growth in South Australia.

The CGC released a paper in December 2020 looking at the impact of COVID-19 on GST distribution.[27] It notes that the economic downturn resulting from COVID-19, with significant variation in the economic performance of the states and territories, along with a substantial reduction in the GST pool, may raise issues for the distribution of GST receipts among the states. The issues may include:

- gaps between assessed and actual fiscal circumstances of the states and, in turn, gaps between a state's GST needs and the GST it receives in a given year. However, any change in the timing of assessments to reduce such gaps may introduce additional volatility in GST distributions

- whether a reduction in a state's fiscal capacity as a consequence of the pandemic is in part a consequence of its own policy decisions rather than an event beyond its control. It may, however, be very difficult for the CGC to assess and decide the extent to which this is the case.

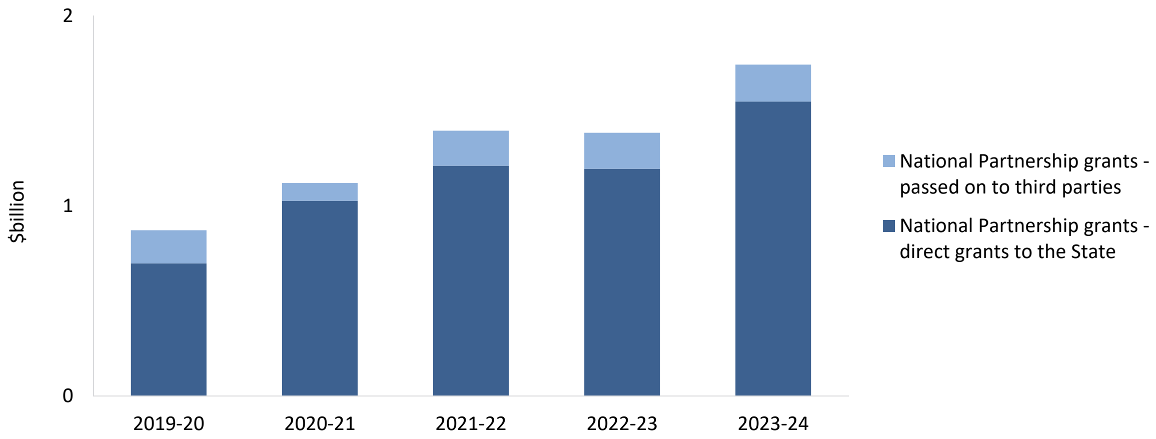
4.4.7 Changes to the timing of National Partnership funding for infrastructure projects could impact operating outcomes

Figure 4.9 shows National Partnership Payment (NPP) funding[28] for the period 2019-20 to 2023-24.

[27] Commonwealth Grants Commission, Occasional Paper No. 1: *Impact of the COVID-19 pandemic on GST distribution*, viewed March 2021 <https://www.cgc.gov.au/sites/default/files/occasional_paper_covid-19_final.pdf>.

[28] NPPs are time limited agreements between the state and Commonwealth to support specific projects, facilitate major reforms and/or reward states that deliver on nationally significant reform. Funding may be in the form of direct grants to the state or grants passed on to third parties.

Figure 4.9: National Partnership grants 2019-20 to 2023-24



In 2019-20, South Australia received $698 million in direct NPP funding. This funding is expected to increase over the four years of the Budget from $1.026 billion in 2020-21 to $1.549 billion in 2023-24. The Budget papers indicate that these NPPs largely reflect the timing of funding for major infrastructure projects. The proportion of total NPP funding relating to infrastructure projects is expected to rise from 55% in 2020-21 to 80% in 2023-24.

Most of this capital grant funding does not have a corresponding operating expenditure in the operating statement. Rather, the expenditure from this funding is reflected in the 'purchases of non-financial assets' line item, which impacts directly on the net lending balance as it is spent. The operating result is impacted once assets are complete and in use through the annual charging of depreciation expense over their useful life.

Given the sizeable amount of NPP funding expected, projected net operating balance outcomes could differ significantly if the timing of this funding changes.

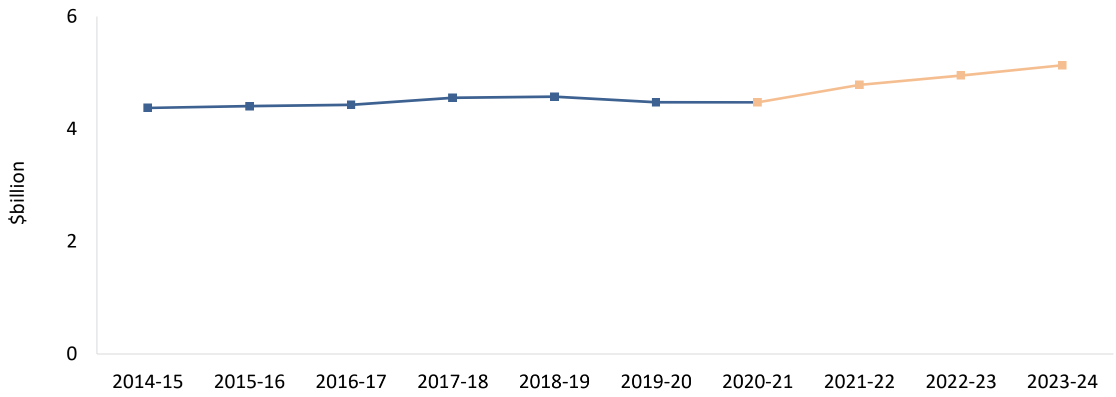
4.4.8 Marginal revisions to total taxation revenue since the 2019-20 MYBR

Taxation revenue from 2020-21 to 2022-23 has been revised down marginally between 1% to 3% since the 2019-20 MYBR. Unlike GST grant revenue, the impact of COVID-19 on estimated overall tax collections has been marginal, however there remains potential for tax revenue to fall further if unanticipated extended COVID-19 related restrictions occur, such as those impacting employment levels (payroll tax), gaming venues (gambling tax) and property market transactions (conveyance duties).

4.4.9 Payroll tax and motor vehicle taxes expected to increase significantly over 10-year period to 2023-24 with only marginal increases in conveyance duty and property taxes

Figure 4.10 shows the trend in taxation revenue between 2014-15 and 2023-24.

Figure 4.10: Taxation revenue 2014-15 to 2023-24



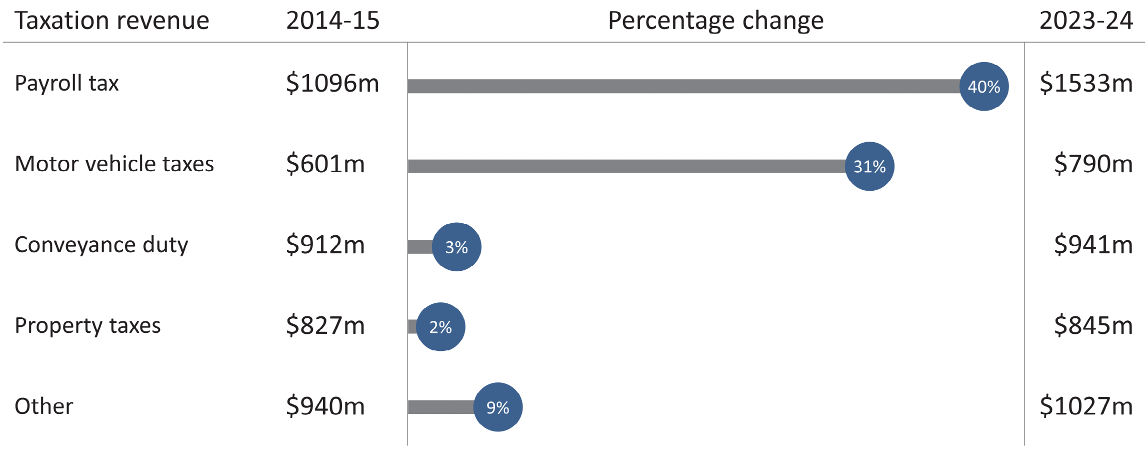
The Budget papers state that growth in taxation revenue in 2020-21 is expected to be relatively flat, largely due to:

- reduced conveyance duties, with COVID-19 restrictions expected to lead to a decline in residential property transactions
- the start of land tax reforms which involve reductions in tax rates, as well as changes to thresholds, aggregation rules and surcharge tax rates
- offset by higher gambling tax collections reflecting an expected return to a full 12 months of activity in 2020-21.

Taxation revenue is expected to bounce back and grow by 6.9% from $4.476 billion in 2020-21 to $4.786 billion in 2021-22, with steady increases averaging 3.6% over the remainder of the forward estimates reflecting a return to more normal growth rates.

Figure 4.11 shows the trend in taxation revenue categories between 2014-15 and 2023-24.

Figure 4.11: Taxation revenue changes by category between 2014-15 and 2023-24



Payroll tax, which is the largest source of taxation revenue, is expected to reach $1.533 billion in 2023-24 representing a 40% increase over the 10-year period to 2023-24. Strong growth in payroll tax is expected in 2021-22 (10.7%), and to a lesser extent in 2022-23 (4.9%) and 2023-24 (4.4%), reflecting the expected recovery in employment levels as the economy recovers from COVID-19.

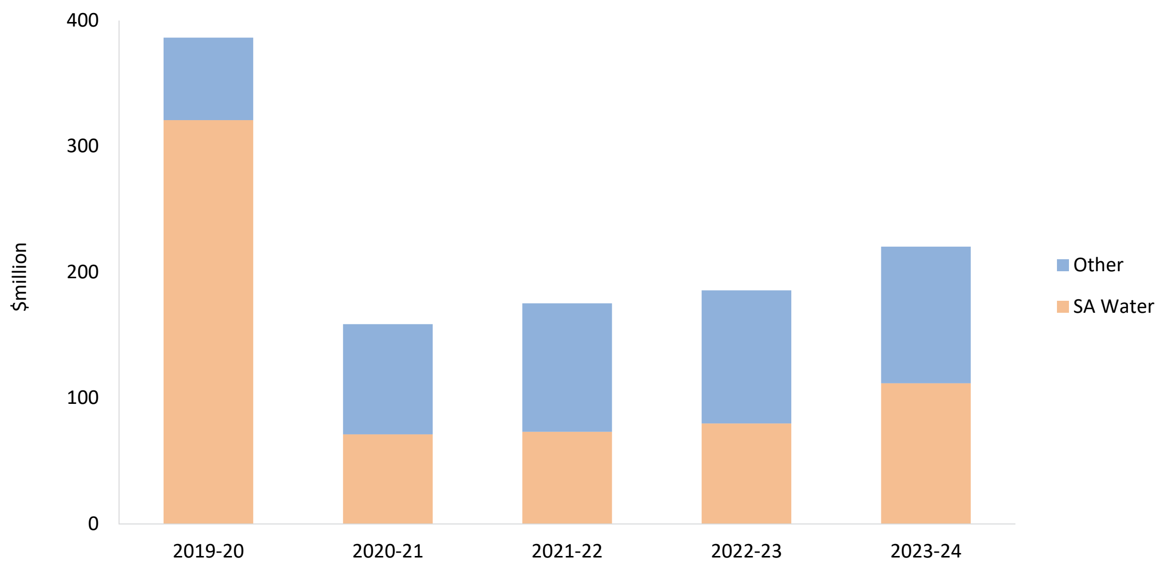
Motor vehicle taxes generally increase by about 2.6% per annum over the 10 years, however the annual increase in 2019-20 was 7.1%. There was a once-off 5% increase in motor vehicle registration fees in 2019-20 as well as a separate increase in the administration fee component payable on motor vehicle registration renewals from 1 July 2019. In addition, the outer area concession for motor vehicle registrations was phased out, with a 50% reduction in 2019-20 and full abolition from 2020-21.

Increases in conveyance duty and property taxes over the 10 years are marginal and have been impacted by policy measures, including the abolition of duty on non-residential property.

4.4.10 Dividend and income tax equivalent income expected to drop significantly from 2020-21 mainly due to lower SA Water distributions resulting from 2020 regulatory determination

Figure 4.12 shows the expected trend for general government sector dividend and income tax equivalent (ITE) income in the 2020-21 Budget.

Figure 4.12: Trend in dividend and ITE income between 2019-20 and 2023-24



Total dividend and ITE income is expected to decline significantly from $386 million in 2019-20 to an average of $185 million over the four years of the Budget. The decline reflects lower distributions from the South Australian Water Corporation (SA Water) from 2020-21 onwards mainly due to the SA Water Final Regulatory Determination 2020. The regulatory determination reduces the total revenue that SA Water may recover for drinking water and sewerage retail services, thereby reducing distributions from SA Water. It will also result in lower water and sewerage prices for customers.

The proportion of dividend and ITE income from SA Water will reduce from 83% of total dividend and ITE income in 2019-20 to an average of 45% over the four years of the Budget.

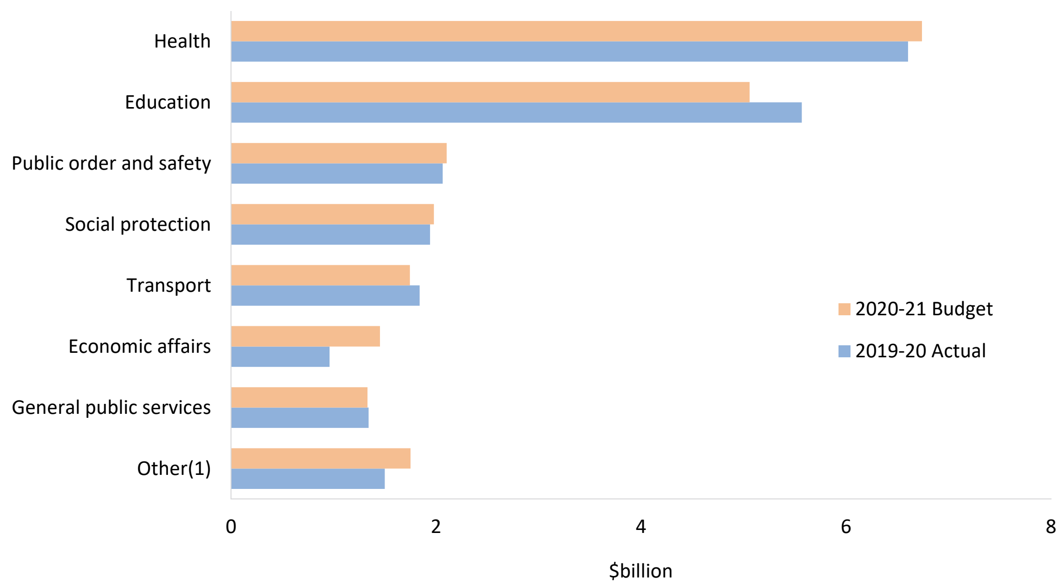
Chapter 5 of the 2020-21 Budget Paper 3 contains more detail about the regulatory determination and its impacts.

4.5 Expenditure

4.5.1 Health and education sectors comprise the majority of total expenses in the 2020-21 Budget

Figure 4.13 shows the split of 2019-20 actual expenses and 2020-21 Budget expenses by sector and demonstrates the extent to which the health and education sectors dominate SA Government expenditure overall.

Figure 4.13: General government expenses by function[29]



(1) Includes recreation, culture and religion, environmental protection, and housing and community amenities.

The health and education sectors combined make up 53% of total general government expenditure in the 2020-21 Budget.

Significant expenditure growth is expected in the economic affairs[30] sector, with an increase of $492 million (51%) in 2020-21 compared to the prior year. This increase is mainly due to payments for business, community and jobs support funds in the Budget and expenses for

29 Sourced from 2019-20 Budget Paper 3 *Budget Statement*, table A.13.

30 Includes general economic, commercial and labour affairs, agriculture, forestry, fishing and hunting, fuel and energy, mining, manufacturing and construction, communications, other industries and research and development.

the South Australia and New South Wales electricity interconnector, fruit fly eradication and home battery scheme.

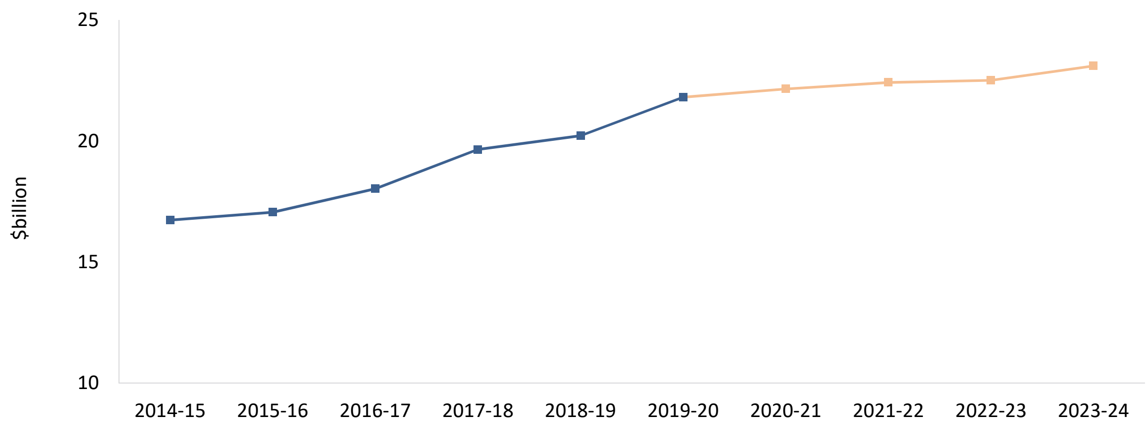
Expenditure in the health sector is also expected to increase in 2020-21 ($136 million), due to budget items relating to the pharmaceutical benefits scheme, essential vaccines, additional masks, contributions to the Cancer Council and ICT minor projects.

Expenditure in the education sector is expected to decline by $509 million (9%) largely due to the bring-forward of grants passed on to non-government schools from 2020-21 to 2019-20 ($217 million).

4.5.2 Annual expenditure growth is expected to be lower over forward estimates after a significant peak in 2019-20

Figure 4.14 shows trends in total expenses and annual expenditure growth in the 2020-21 Budget against the experience of the previous six years.

Figure 4.14: General government sector total expenses 2014-15 to 2023-24



Annual expenditure growth	2.0%	1.9%	5.7%	9.0%	2.9%	7.9%	1.6%	1.2%	0.4%	2.6%

Higher levels of expenditure growth occurred in 2016-17 and 2017-18 mainly due to:

- a number of one-off factors in 2016-17 including additional lease payments for TAFE SA assets transferred to the Urban Renewal Authority, the timing of on-passing Commonwealth Government funding to local government and additional resources for the State’s response to the Child Protection Systems Royal Commission
- the start of full-year operating service payments associated with the new Royal Adelaide Hospital in 2017-18 and the implementation of significant initiatives introduced in the 2016-17 MYBR and 2017-18 Budget (including the Our Energy Plan initiative and the full-year impact of the State’s response to the Child Protection Systems Royal Commission).

Annual expenditure growth is also high in 2019-20, reflecting costs for stimulus measures introduced in 2019-20 to support the South Australian economy and the commencement of budget presentation changes to bring the budget in line with the Uniform Presentation Framework (UPF).[31] The budget presentation changes meant that expenses and revenue that were previously netted off are now shown in full. Budget Paper 3 indicates that in the absence of these presentation changes, the growth rate would be 2% rather than 8%.

The Budget shows expenditure growth is expected to stabilise across the forward estimates as time limited stimulus expenditure winds down. Growth rates are expected to remain below trend growth in household income (4% per annum) over the forward estimates, consistent with the SA Government's fiscal target.

Expenditure over the four years of the Budget primarily comprises employee expenses (40%), other operating expenses (32%) and grants (13%). Risks associated with employee expenses and grants are discussed below.

4.5.3 Growth in total public sector workforce numbers between 2014-15 and 2019-20 are relatively consistent with State population growth

Figure 4.15 shows the annual growth in the total SA public sector workforce (FTEs) compared to SA population growth for the period 2014-15 to 2019-20.

Figure 4.15: Annual growth in SA public sector workforce (FTEs) compared to SA population for period 2014-15 to 2019-20[32]

	Population change (%)	FTE change (%)	FTEs per capita
2014-15	0.8%	0.2%	0.0478
2015-16	0.7%	0.1%	0.0475
2016-17	0.6%	2.1%	0.0482
2017-18	0.7%	2.2%	0.0489
2018-19	0.9%	0.7%	0.0488
2019-20	0.9%	0.1%	0.0484

With the exception of 2016-17 and 2017-18, growth in the public sector workforce has been in line with growth in the SA population over the past six years. Annual growth in FTEs has generally been within 1.5% of population changes. Higher FTE growth rates compared to population growth occurred in 2016-17 and 2017-18 due to additional resources in the health and education sectors.

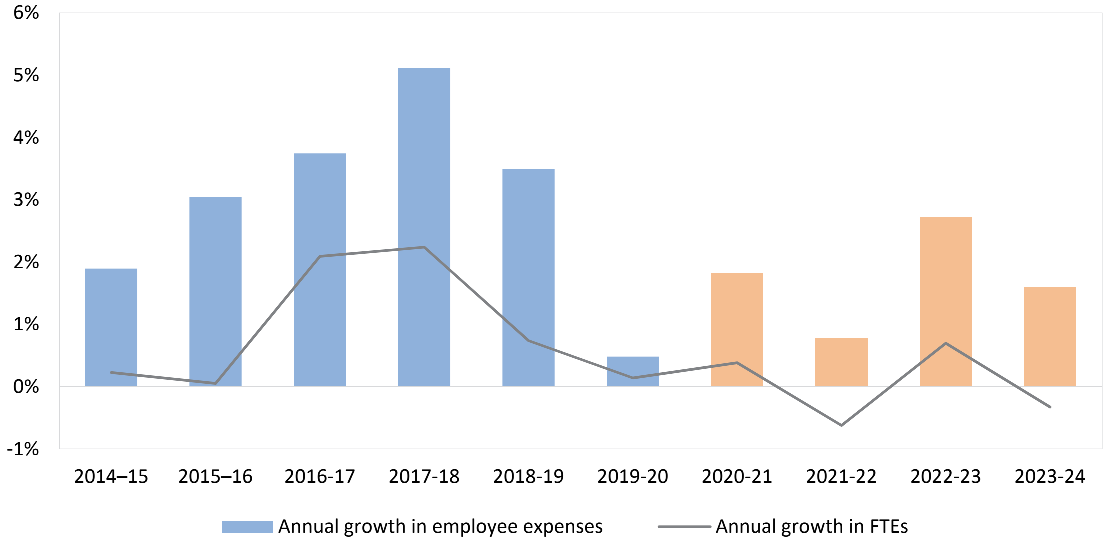
4.5.4 Limited change in total public sector workforce numbers expected between 2019-20 and 2023-24

Figure 4.16 shows the relationship between general government sector employee expenses and FTEs for the period 2014-15 to 2023-24.

31 Appendix 1 provides further details on the Uniform Presentation Framework.

32 Population data obtained from ABS (June 2020) 'Table 4. Estimated Resident Population, States and Territories (Number)' [time series spreadsheet], <https://www.abs.gov.au/statistics/people/population/national-state-and-territory-population/jun-2020/310104.xls> , accessed 1 March 2021.

Figure 4.16: Annual movement between years for employee expenses and FTEs for period 2014-15 to 2023-24



Annual growth in FTEs over the four years of the Budget is limited to less than 1% each year, with falls expected in 2021-22 and 2023-24. This contrasts with growth of more than 2% per annum in 2016-17 and 2017-18. This trend is consistent with the SA Government's aim in recent years to reduce employment levels and contain wage growth.

Trends in FTE and employee expenses up to 2018-19 are discussed in Auditor-General's Report 8 of 2019 *State finances and related matters*.

DTF advised us that the changed presentation of the 2019-20 State Budget to achieve full compliance with the Uniform Presentation Framework resulted in the reclassification of workers compensation claims expenses from employee expenses to other operating expenses. The change occurred from 1 July 2019 and resulted in the lower growth in employee expenditure in 2019-20. DTF also indicated that excluding this presentational change, the annual growth in employee expenses in 2019-20 would have reflected a profile which is more consistent with the historical relationship to annual growth in FTEs.

The Budget Papers indicate that most of the FTE increases in 2020-21 and across the forward estimates are in Health and Wellbeing, including:

- an additional one-off increase of 330 FTEs expected to occur in 2020-21 due to COVID-19 response measures
- a further 1984 FTEs expected to be provided in 2020-21 to support new initiatives
- further increases expected from 2021-22 onwards but at lower levels.

Growth in employee expenses is generally 2% to 3% more than annual growth in FTEs mainly owing to enterprise agreement salary increases.

4.5.5 Future wage negotiations critical to expenditure control

Salaries and wages are a major public sector operating cost and wage negotiations will occur for major employee groups in 2020-21. The 2020-21 Budget notes enterprise bargaining negotiations are continuing for:

- South Australian Ambulance Service operational employees
- TAFE SA education staff
- wages parity salaried staff
- wages parity weekly paid staff
- firefighters
- salaried medical officers.

The wage outcomes for these employee groups will be critical to expenditure control as DTF advised that they collectively represent 50% of total general government sector employees, with an estimated total cost base in 2019-20 of $4.744 billion.

The Budget highlights that the outcomes of future wage negotiations will be crucial in determining whether expenditure forward estimates in this Budget can be achieved and the planned level of government services can be delivered.

The 2020-21 Budget provides for anticipated public sector wage increases from enterprise agreement outcomes over the forward estimates, both in individual agency budgets and in the total of the contingency items in the administered items for DTF.

The 2020-21 Budget indicates that if public sector-wide wage outcomes for new enterprise agreements vary by 1% per annum from allowances in the forward estimates, the Budget impact is estimated to be around $286 million in 2023-24.

4.5.6 The 2020-21 Budget extends central TVSP reimbursement arrangements for certain agencies

The 2019-20 Budget included $60 million in 2019-20 to help agencies meet the cost of targeted voluntary separation packages (TVSPs) and separation costs associated with workforce reductions.

DTF advised us that 872 TVSPs and executive separations (761 FTEs) were accepted in 2019-20 totalling $75 million, $15 million more than budgeted.[33] Expenses totalling $65 million for 754 TVSP and executive separation acceptances were centrally reimbursed by DTF, with the remaining of costs met by agencies.

The agencies with the highest number and amount of TVSPs and executive separations were:

- DHW (324 acceptances totalling $28 million)
- Department of Human Services (165 acceptances totalling $13 million)
- TAFE SA (113 acceptances totalling $11 million).

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[33] The total of $75 million includes payroll tax and shared services fees of $1.1 million but excludes payments associated with accrued leave. DTF centrally reimbursed $1 million of the payroll tax and shared services fees.

The 2019-20 Budget originally provided for central reimbursement of TVSPs until 31 December 2019, however these arrangements have since been extended on an ongoing basis for the following agencies that are in the process of implementing significant reform initiatives:

- DHW
- TAFE SA
- Department of Human Services (for disability reforms)
- Courts Administration Authority (for the duration of its new system implementation)
- Department for Correctional Services (for its better prisons reform program)
- DIT (for road maintenance, rail transformation (train and tram) and Across Government Facilities Management Arrangement programs).

All other agencies became responsible for managing costs associated with their TVSPs and separation payments from 1 January 2020.

4.5.7 Grant expenses vary quite substantially from year to year with a significant proportion relating to on-passing of grants received

Grant expenses are the third largest expense, comprising on average 13% of total general government expenditure over the four years of the Budget. A substantial proportion of this expenditure relates to grants received by the State that are on-passed to local government, private and non-government organisations and therefore have a corresponding revenue (pass through grants).

As grant expenses are generally driven by specific programs or projects, expenditure levels and amounts on-passed can vary from year to year.[34]

In 2019-20, 42% of grant expenditure related to pass through grants and this is expected to rise to 48% by the end of the forward estimates as the level of non-government school grants on-passed under the National School Reform Agreement increases.

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34 Table B.4 in 2020-21 Budget Paper 3 *Budget Statement* provides further details on the trend in grant expenses for the period 2014-15 to 2023-24.

5 Balance sheet

Key points

- The NFPS capital program has increased by $4.8 billion since the prior year Budget due mainly to expected expenditure on the North-South Corridor project and new Women's and Children's Hospital. The SA Government will face substantial challenges in managing the significantly expanded capital program to provide short-term economic stimulus.
- Significant increases in net debt reflect substantial net operating deficits and the large capital program. The increases in net debt are generally comparable to other Australian states and reflect RBA advice to take on debt to fund economic stimulus.
- South Australia's ability to fund budgeted expenditure after meeting borrowing costs is generally comparable to other Australian states.
- South Australia's risk exposure to interest rate rises is significantly increased by higher net debt levels.
- S&P's AA+ credit rating for South Australia was downgraded from a stable to negative outlook following the release of the 2020-21 Budget, but the outlook for Moody's Aa1 credit rating remains steady.
- There is a high likelihood that net debt levels will rise further due to substantial infrastructure project expenditure planned beyond the forward estimates and other budget risk factors.

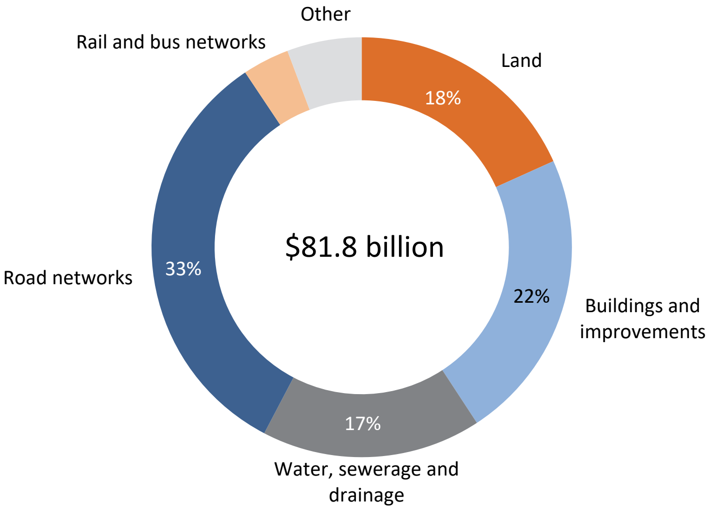
5.1 Balance sheet overview

5.1.1 Land and other fixed assets represent the vast majority of total assets

The vast majority of NFPS total assets at 30 June 2020 were land and other fixed assets (87%).[35] Figure 5.1 shows the composition of land and other fixed assets.

[35] Balance sheet data is for the NFPS as detailed in 2020-21 Budget Paper 3 *Budget Statement*, table B.10, unless otherwise stated. The NFPS consolidates the general government and PNFC sectors.

Figure 5.1: Composition of NFPS land and other fixed assets estimated at 30 June 2020



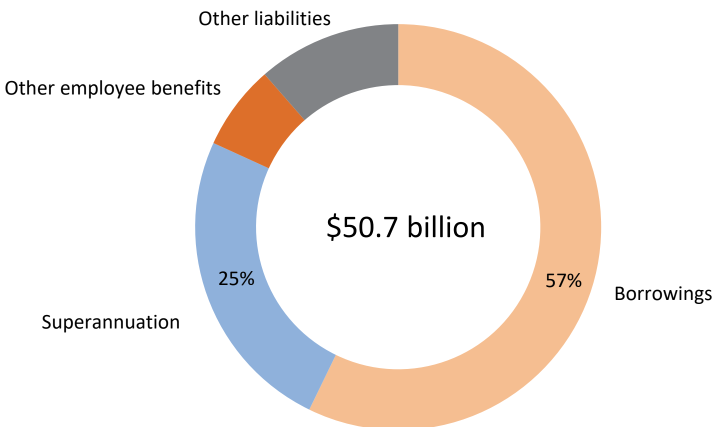
Road networks represent the largest component (33%), with the other major components including buildings and improvements (22%), land (18%) and water, sewerage and drainage assets (17%).

Road networks have increased as a proportion of total assets from 2018-19 (28%). This is mainly due to the upward revaluation of road assets in 2019-20 ($5.5 billion) resulting from changes to costing assumptions, increases in the cost of road and structure making materials and increases in labour costs for construction. Further details on the revaluation are included in the section of my 2019-20 Annual Report titled 'Department of Planning, Transport and Infrastructure'.

5.1.2 Liabilities primarily comprise borrowings and the unfunded superannuation liability

Figure 5.2 shows the composition of total NFPS liabilities at 30 June 2020.

Figure 5.2: Composition of total NFPS liabilities estimated at 30 June 2020



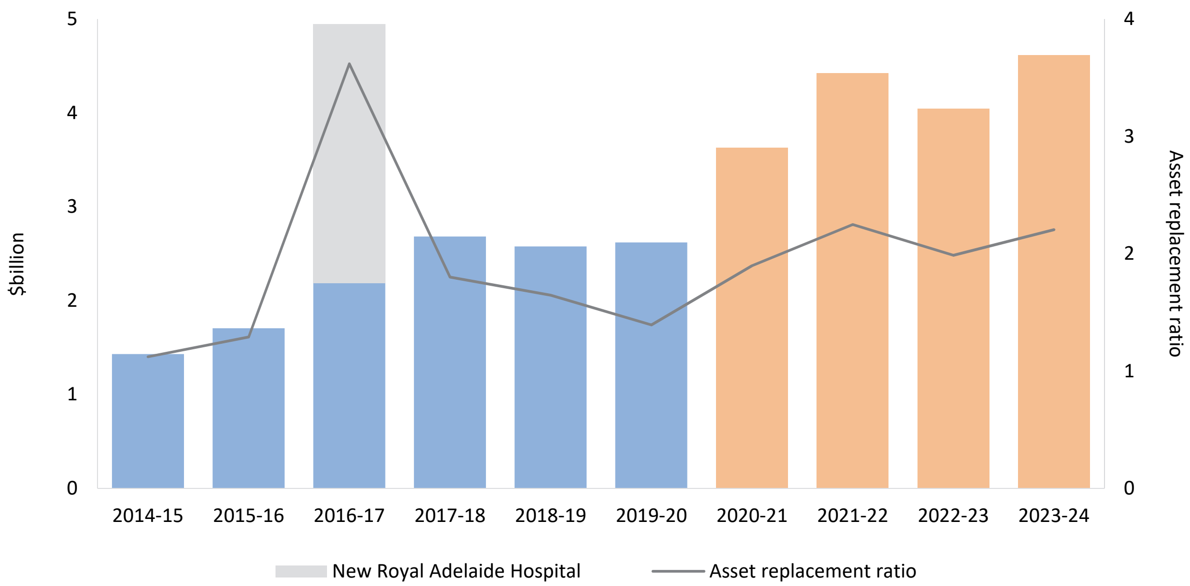
The major components of total liabilities are borrowings (57%) and the unfunded superannuation liability (25%).

5.2 Purchases of non-financial assets

5.2.1 NFPS capital program has increased by $4.8 billion due mainly to the North-South Corridor project and new Women's and Children's Hospital

Figure 5.3 shows the purchase of non-financial assets (capital payments) for the NFPS over the 10 years to 2023-24 compared to the asset replacement ratio.[36]

Figure 5.3: NFPS purchases of non-financial assets for period 2014-15 to 2023-24



Purchases of non-financial assets for the NFPS are projected to total $16.712 billion over the four years of the 2020-21 Budget, compared to $11.886 billion over the four years of the 2019-20 Budget. This $4.826 billion increase is mainly due to:

- $1.855 billion in new investing initiatives in the 2020-21 Budget (refer section 3.4 for further detail)
- investing expenditure increases for the North-South Corridor ($1.962 billion up to 2023-24), the new Women's and Children's Hospital ($682 million up to 2023-24) and the Aboriginal Art and Cultures Centre ($200 million up to 2023-24).[37]

New investing projects in the 2020-21 Budget account for 38% of the capital spending increase. Most of the increase in investing expenditure relates to additional funding for initiatives announced in previous Budgets.

[36] The asset replacement ratio compares capital expenditure to depreciation to assess whether assets are being consumed at a rate consistent with their replacement. Ratios higher than 1:1 indicate that assets are being replaced faster than they are consumed.

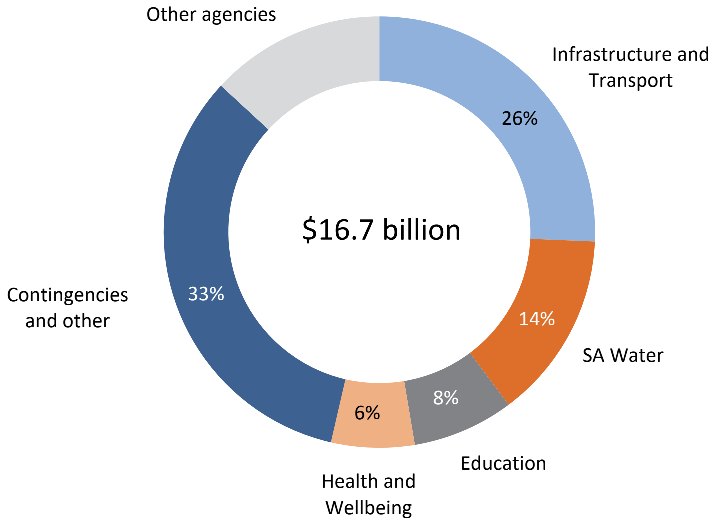
[37] Most of the budgets for these projects are currently held in contingency pending finalisation of project costings, at which stage they will be allocated to agency budgets.

Figure 5.2 also highlights that the asset replacement ratio has generally been trending higher. It ranges between 1 and 2 for the period 2014-15 to 2020-21 and rises to 2 or higher between 2021-22 and 2023-24. This indicates the SA Government has spent or expects to spend more on replacing and renewing assets each year than the consumption of assets through depreciation. The one-off large increase in 2016-17 was mainly due to the recognition of the new Royal Adelaide Hospital finance lease asset ($2.758 billion), which represented 56% of total NFPS capital payments in that year.

5.2.2 Department for Infrastructure and Transport and SA Water have the most significant capital projects

Figure 5.4 provides a breakdown of the capital program by agency and the portion of the program allocated to contingencies over the four years of the Budget.

Figure 5.4: Breakdown of NFPS capital program by agency



A large proportion of the capital program over the four Budget years is attributable to DIT (26%) and SA Water (14%). Education (8%) and Health and Wellbeing (6%) also have significant capital programs.

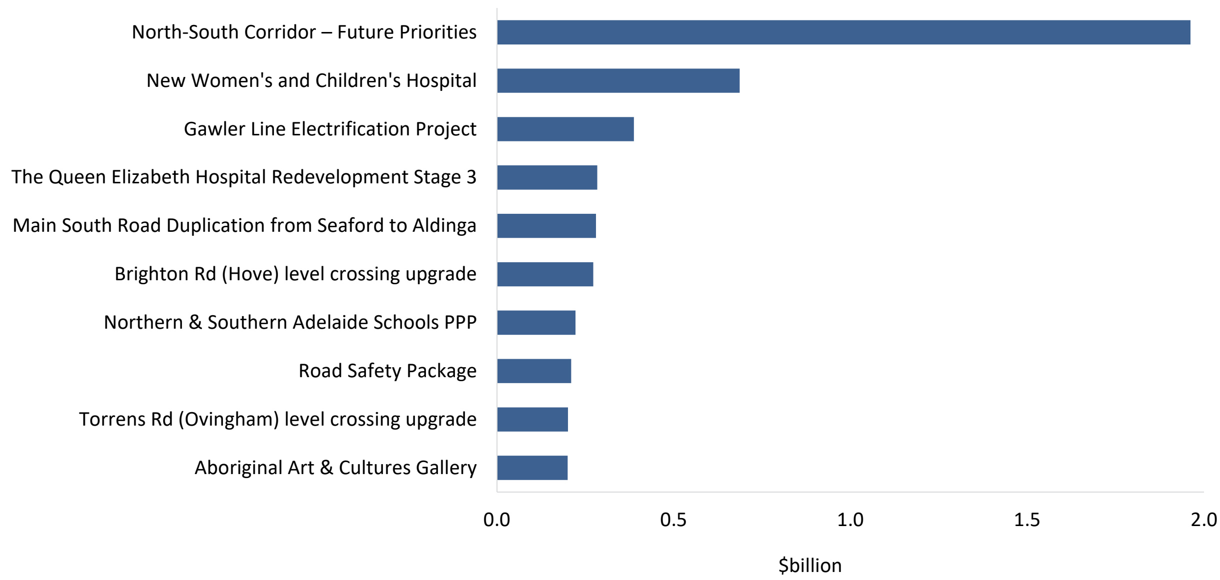
The general government sector budget holds a contingency provision over the forward estimates to maintain the overall size of the SA Government's investing budget. While agency budgets typically decline over the forward estimates as projects are scheduled to finish, the contingency provision rises as the unallocated component of the overall general government sector budget increases. Figure 5.4 highlights that $5.578 billion (33%) of the total NFPS capital program over the four years of the Budget is allocated to contingencies and other.[38]

[38] Table 2.17 in 2020-21 Budget Paper 3 *Budget Statement* notes that contingencies include a capital slippage provision to reflect the tendency, on a whole-of-government basis, for underspending due to some projects slipping from their current budgeted expenditure profile. Contingencies also include consolidation adjustments to eliminate inter-agency transactions and recognise contributed assets.

5.2.3 North-South Corridor and new Women's and Children's Hospital projects expected to incur the most expenditure over the four years of the Budget

Figure 5.5 provides an overview of the most significant capital projects over the four years of the Budget.

Figure 5.5: Major capital projects over the four years of the 2020-21 Budget



The North-South Corridor River Torrens to Darlington ($1.962 billion) and new Women's and Children's Hospital ($682 million) projects are expected to incur the most investing expenditure over the four years of the Budget.[39] Capital expenditure for all other projects except the Gawler Line Electrification project ($387 million) is expected to be under $300 million.

The 2020-21 Budget notes that the SA Government has decided a final design for the remaining section of the North-South Corridor River Torrens to Darlington, with construction to be completed by 2030. Current estimates put the project cost at $8.9 billion and the final cost estimate will be determined later in 2021 after a detailed business case and consideration by Infrastructure SA and Infrastructure Australia. The project will be funded jointly with the Commonwealth Government.

DTF advised us that the $682 million included for the new Women's and Children's Hospital is a high-level estimate only and does not reflect the final total expected cost. The business case currently being prepared will inform the ultimate quantum and timing of expenditure flows.

5.2.4 The SA Government will face substantial challenges in managing the capital program to provide short-term economic stimulus

The 2020-21 Budget notes that the large increase in investing expenditure compared to

[39] Includes amounts held in contingencies for these projects.

previous programs reflects significant economic stimulus and provides an expanded pipeline of projects over the forward estimates. The Budget indicates that this significant stimulus response is consistent with information provided to National Cabinet. This includes advice from the Governor of the RBA on the level of fiscal stimulus such as publicly funded infrastructure required by governments to protect and support jobs.

As a major focus of the expanded capital program is to stimulate economic recovery from COVID-19 in the short term, there will be pressures to progress investing projects as quickly as possible.

The SA Government will face several challenges in ensuring capital program projects are completed on time and budget, consistent with planned designs and specifications. The S&P credit rating agency has noted:

> *We believe the level of infrastructure budgeted over the next three years will be difficult to achieve, given capacity constraints, border restrictions, and the massive infrastructure investment programs down the east coast. Therefore, we believe the state will deliver between 80% and 90% of its budget infrastructure each year.*[40]

Major capital projects carry high inherent risks associated with estimating costs, complex contract arrangements, cost escalations and timeliness of completion. Significant revisions may be required to project cost estimates. For example, DTF advised us that a contingency provision was established as part of the 2020-21 Budget for the Gawler Line Electrification project ($100 million) to reflect estimated increases in the costs for the project compared to original estimates.

Procurement processes for large-scale capital projects also often take a long time, with multiple stages each lasting several months. The SA Government will need to manage the ongoing tension between speed and ensuring that procurement practices meet appropriate probity standards and comply with relevant policies and guidelines.

Other significant challenges and risks may include:

- COVID-19 potentially impacting the availability of key building materials
- the capacity of the South Australian building industry to cope with the significant volume of works required within short time frames and the potential for associated cost pressures on project budgets
- ensuring concept design durations and stakeholder consultation time frames are sufficient to meet project objectives and user needs.

Appropriate procurement, contract and project management expertise, as well as sound information systems and financial controls, are required to effectively manage these risks and meet budget targets.

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40 S&P Global Ratings, November 2020, South Australia Outlook Revised to Negative on Rising Deficits and Debt; ‘AA+/A-1+’ Ratings Affirmed.

Capital projects that develop from long-term plans and have robust business cases are likely to be the most successful. It is also important that project performance is monitored and measured to ensure planned benefits are realised and the SA Government captures and actions learnings from previous infrastructure projects.[41]

My previous Reports have highlighted significant scope to improve the planning, procurement, project management and contract management of major capital projects.[42] It is important that due consideration be given to the findings and recommendations in these Reports when planning and managing the State's capital program.

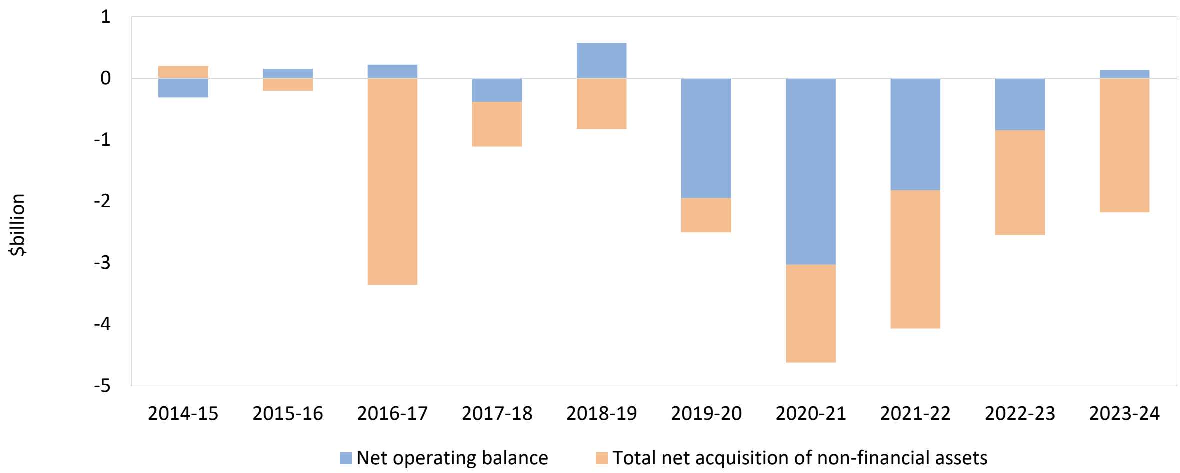
DTF advised us that the SA Government established an Infrastructure Cabinet Committee in October 2020 to monitor the status of major projects within South Australia and ensure delivery of the agreed infrastructure work program.

5.3 Borrowings and net debt

5.3.1 Significant increases in net debt reflect substantial net operating deficits and the large capital program

Figure 5.6 shows the NFPS net lending balance for the period 2014-15 to 2023-24 and the extent to which it is driven by the net operating balance and total net acquisition of non-financial assets in each year.

Figure 5.6: NFPS net lending balance for period 2014-15 to 2023-24[43]



Net lending balance	-$0.116b	-$0.054b	-$3.140b	-$1.112b	-$0.259b	-$2.506b	-$4.622b	-$4.070b	-$2.551b	-$2.052b

41 Terrill, M 2016, *Cost overruns in transport infrastructure,* Grattan Institute, 23 October, viewed March 2021, <https://grattan.edu.au/report/cost-overruns-in-transport-infrastructure>.

42 Refer to Auditor-General's Report 7 of 2020 *Flinders Link Project* and Auditor-General's Report 11 of 2019 *Darlington Upgrade Project* for projects where significant scope for improvement in planning, procurement, project management and contract management of major capital projects was identified.

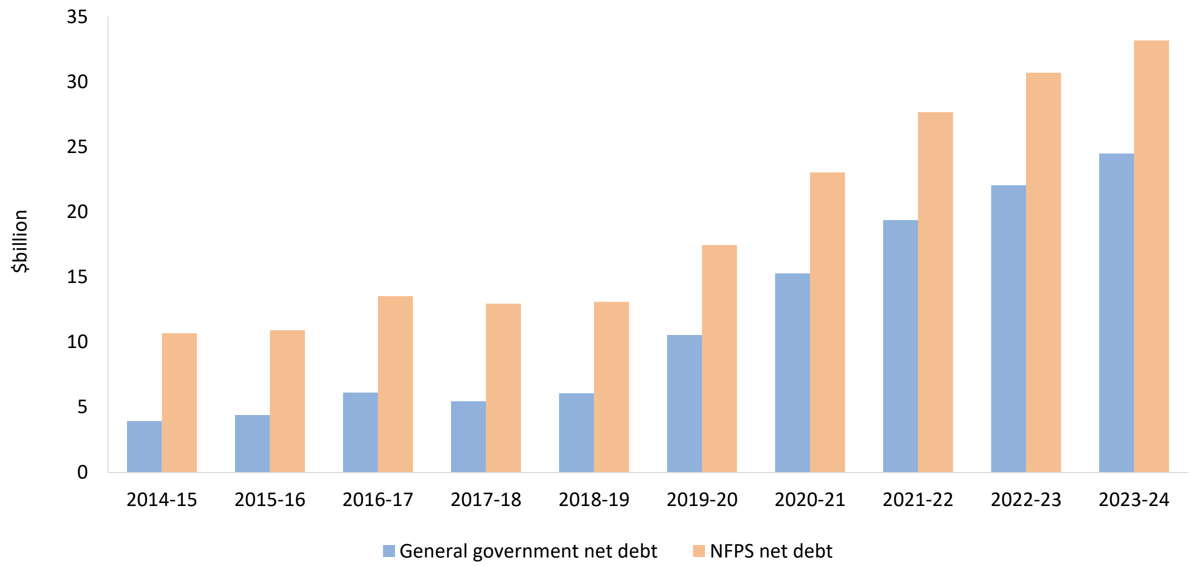
43 Total net acquisition of non-financial assets comprises purchases of non-financial assets less sales of non-financial assets less depreciation.

Net lending deficits over the period 2019-20 to 2023-24 are significantly larger than in the previous five years, except 2016-17. The significant net lending deficit in 2016-17 mainly reflected the recognition of the financial obligations for the new Royal Adelaide Hospital.

The net lending deficits in 2019-20 ($2.506 billion) and 2020-21 ($4.622 billion) are mainly driven by the very large net operating deficits in those years. The total net acquisition of non-financial assets, in particular the significant capital program reflected through purchases of non-financial assets, is the main driver of the net lending deficits in 2021-22 ($4.07 billion) and 2022-23 ($2.551 billion). The expected return to operating surplus in 2023-24 means the net lending deficit in 2023-24 ($2.052 billion) is due to very significant purchases of non-financial assets in that year ($4.615 billion).

The net lending deficits result in significant expected increases in net debt over the four years of the Budget. Figure 5.7 shows net debt for the general government sector and NFPS for the period 2014-15 to 2023-24.

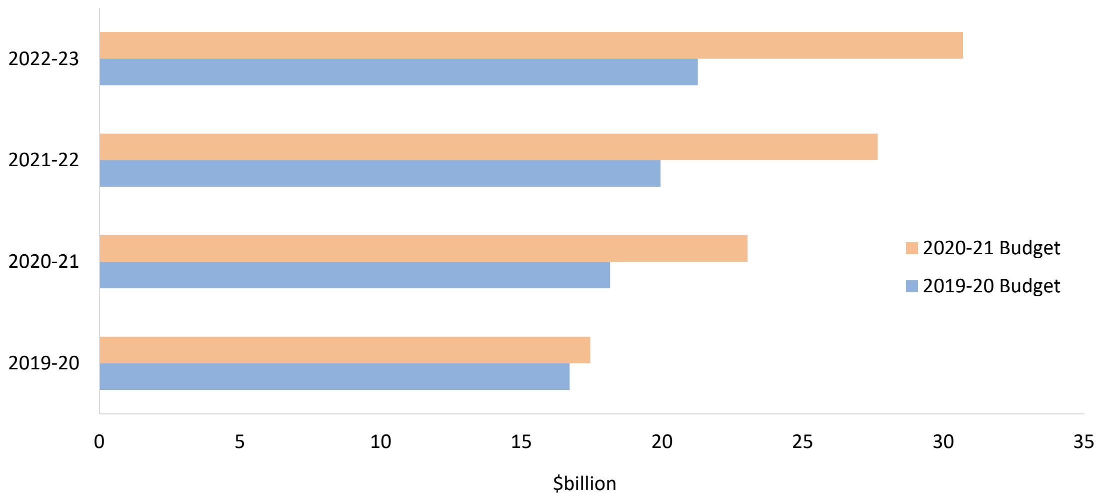
Figure 5.7: General government sector and NFPS net debt for period 2014-15 to 2023-24



NFPS net debt in 2023-24 ($33.171 billion) is expected to be more than triple that in 2014-15 ($10.676 billion).

Figure 5.8 compares NFPS net debt in the 2019-20 and 2020-21 Budgets.

Figure 5.8: Comparison of NFPS net debt in 2019-20 and 2020-21 Budgets

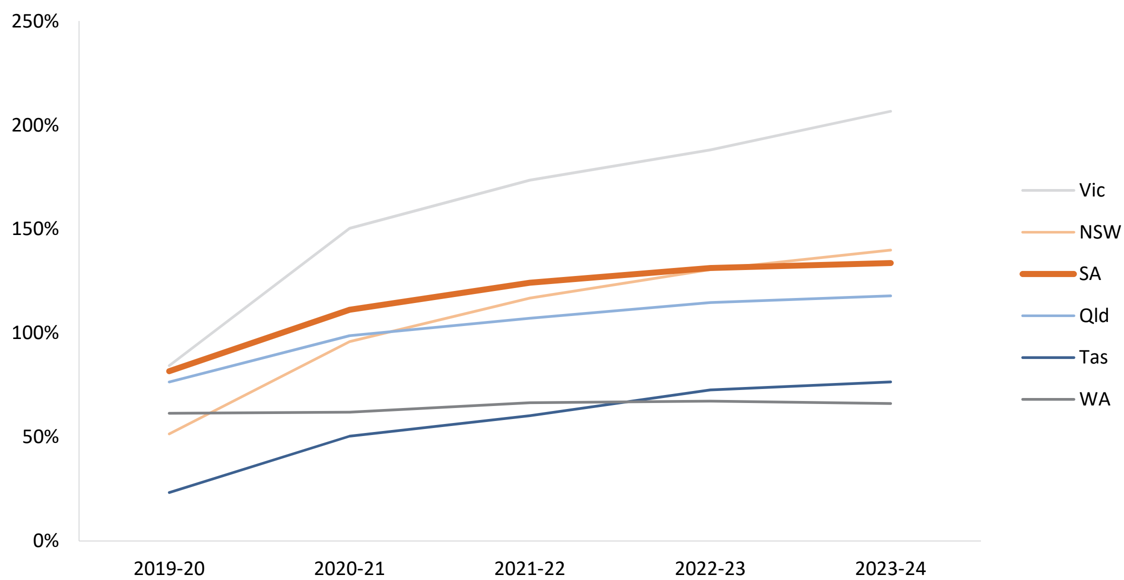


NFPS net debt in the 2020-21 Budget has increased significantly compared to the 2019-20 Budget and is $9.424 billion higher in 2022-23.

5.3.2 Increases in net debt generally similar to other Australian states and reflects RBA advice provided to all states to take on debt to fund economic stimulus

Figure 5.9 compares NFPS net debt as a percentage of total revenue to other Australian states for the period 2019-20 to 2023-24.

Figure 5.9: Comparison of NFPS net debt to revenue ratio to other Australian states



Source: South Australian and interstate budget papers.

Figure 5.9 highlights that the NFPS net debt to revenue ratio for all Australian states other than Western Australia is expected to increase significantly by 2023-24. Western Australia's NFPS net debt is expected to remain relatively stable as the only state to forecast operating surpluses over the period.

South Australia's NFPS net debt was comparable to Victoria and higher than other states coming into the COVID-19 pandemic in 2019-20. By 2023-24, South Australia's NFPS net debt to revenue ratio (134%) is forecast to be similar to Queensland (118%) and New South Wales (140%), and lower than Victoria (207%).

Victoria's NFPS net debt to revenue ratio is expected to be significantly higher than all other Australian states by 2023-24. This is mainly due to longer periods of public health restrictions in Victoria compared with Australia overall, which contributed to a larger economic downturn and a weakened State revenue base. The Victorian Government is also increasing its borrowings to fund its response to the COVID-19 pandemic.

The increases in net debt across Australian states are consistent with advice provided by the RBA. The Governor of the RBA has indicated that by:

> *… borrowing today to support the economy we are avoiding an even bigger loss of output and jobs that would damage our economy and society for years to come, which would put ongoing strain on the budget.*[44]

The RBA Governor has also noted that:

> *Government's financing costs have never been lower, with interest rates being the lowest since Federation. This all means that the expected increase in public debt is entirely manageable and affordable. It is the right thing to do to borrow today to help people, keep them in jobs and boost public investment at a time when private investment is very weak.*[45]

5.3.3 No specific measure established to monitor performance against the fiscal target of achieving sustainable level of net debt

The SA Government's Fiscal Target 3 aims to achieve a level of net debt that is sustainable over the forward estimates. The 2020-21 Budget notes that this target requires the maintenance of sustainable debt levels that allow for sustainable borrowings for investment in key infrastructure without placing undue burdens on future generations. The Budget also indicates that the increase in debt is an inevitable consequence of the impact of COVID-19 and that the SA Government maintains it is sustainable given the relatively low cost of debt currently available.

DTF advised us that in monitoring Fiscal Target 3, there can be variability in debt levels over time as decisions are made to invest in infrastructure or the budget responds to challenging

[44] Lowe, P, 14 August 2020, *Opening Statement to the House of Representatives Standing Committee on Economics*.
[45] ibid.

short and medium-term fiscal circumstances. A range of factors can be considered in determining whether net debt levels are sustainable. The SA Government assesses the sustainability of net debt levels on an annual basis through the budget process. The SA Government's position, and budget, is then assessed annually by the credit rating agencies. DTF notes that the SA Government retains AA+ and Aa1 credit ratings with both major credit rating agencies (section 5.3.6 provides further details).

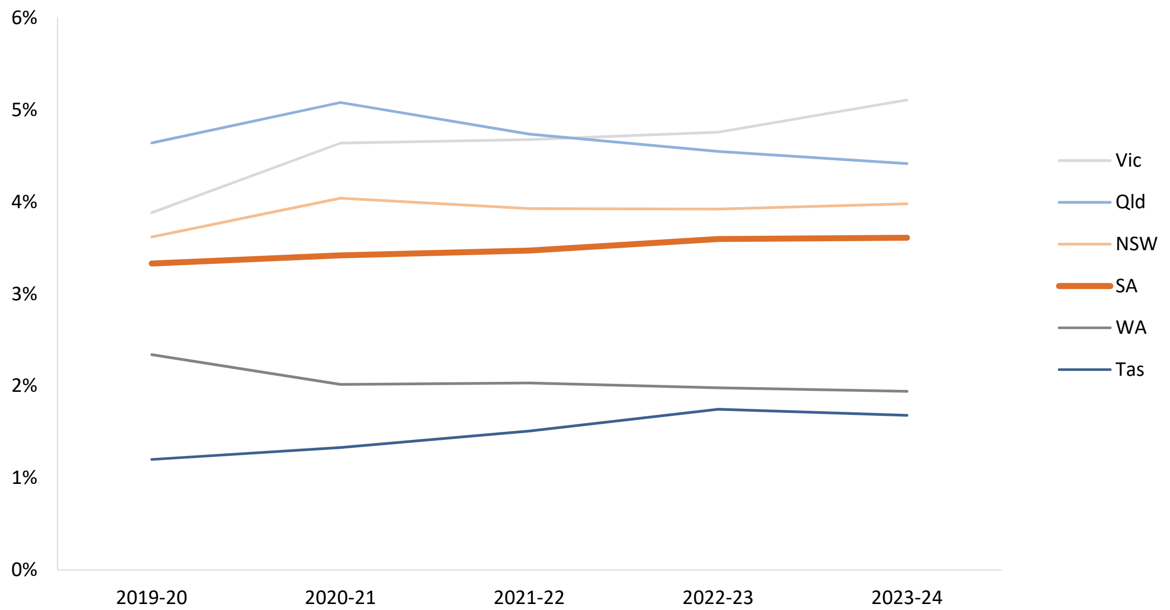
The SA Government also considers the views of the credit rating agencies benchmarking against interstate peers and the level of interest cost burden in assessing the sustainability of debt levels. The 2020-21 Budget notes that compared to the 2019-20 Budget, general government sector interest expenses decreased by $113 million in 2020-21 and up to $200 million in 2022-23 due to historically low interest rates.

The SA Government has not, however, set a clear quantifiable measure for Fiscal Target 3. In the absence of specific criteria, indicators or measures it may be difficult to assess what represents a sustainable level of debt and whether this fiscal target has been satisfactorily achieved.

5.3.4 South Australia's ability to fund borrowing costs from operating revenues is generally comparable to other states

Figure 5.10 compares NFPS interest expenses as a percentage of total revenue (interest expense to total revenue ratio) for all Australian states for the period 2019-20 to 2023-24.

Figure 5.10: NFPS interest expense to total revenue ratio compared to other states



Source: South Australian and interstate budget papers.

The interest expense to total revenue ratio is an indicator of a state's capacity to fund its borrowing costs from operating revenues. Figure 5.10 highlights that South Australia's interest expense to total revenue ratio is very similar to New South Wales and generally comparable to other states over the four years of the Budget.

5.3.5 South Australia's risk exposure to interest rate rises significantly, increased by the higher level of net debt

The SA Government's exposure to interest rate rises is significantly increased by the higher level of net debt. The 2020-21 Budget states that the borrowing cost impact of a 1% increase in the average interest rate applying to general government sector net debt ranges from $153 million in 2020-21 to $245 million in 2023-24. This is far larger than the impact of such a rate increase on annual interest expense in the prior year Budget, which peaked at $132 million in 2022-23.

The SA Government's ability to reduce net debt from operating surpluses in the short to medium-term is also expected to be constrained, as an operating surplus is not forecast until 2023-24. This will potentially limit the SA Government's capacity to respond to future economic and other challenges.

DTF advised us that the risk of interest rate rises is mitigated to some degree by the majority of existing debt being on a fixed rate basis.

The RBA also stated in March 2021 that interest rates are very likely to remain at current levels until at least 2024.[46]

5.3.6 South Australia's credit rating outlook lowered by Standard & Poor's but remains steady with Moody's

Figure 5.11 shows the S&P credit rating for each Australian state following the release of their 2020-21 Budgets compared to the prior year.

Figure 5.11: S&P credit ratings for Australian states in 2019 and 2020

	2019	2020	Change from 2019
SA	AA+ (Stable)	AA+ (Negative)	↔
WA	AA+ (Stable)	AA+ (Stable)	↔
Tas	AA+ (Stable)	AA+ (Stable)	↔
NSW	AAA (Stable)	AA+ (Stable)	↓
Vic	AAA (Stable)	AA (Stable)	↓
Qld	AA+ (Stable)	AA+ (Stable)	↔

[46] Lowe, P, 10 March 2021, *The Recovery, Investment and Monetary Policy,* AFR Business Summit.

Two states (Victoria and New South Wales) have had their credit ratings downgraded by S&P since 2019. South Australia's S&P credit rating remains at AA+ but its outlook has been lowered from stable to negative. There have been no changes to the S&P credit ratings for Western Australia, Tasmania and Queensland.

South Australia has the same S&P credit rating (AA+) as all other states (apart from Victoria) following the release of its 2020-21 Budget. Victoria (AA Stable) has a lower S&P credit rating.

Moody's credit rating for South Australia has a stable outlook (Aa1 stable). Moody's credit rating for South Australia is the same as Western Australia, Victoria and Queensland and higher than Tasmania (Aa2 stable)

S&P noted that South Australia benefits from a strong economy and financial management, which allow the State to absorb some stresses on creditworthiness. Its primary considerations in assessing South Australia's outlook were as follows:

- South Australia will experience significant revenue losses over the next three years due to COVID-19 and lower than previously budgeted GST revenue, which erode buffers at the current rating level.
- GST grants have been revised down by $3.8 billion over the next four years. These changes could mean the State's fiscal recovery drags on longer than other states.
- South Australia is undertaking a relatively large infrastructure program to stimulate local economic recovery, which will weigh on the state's budgetary performance resulting in rising debt.
- Fiscal pressures may not be fully offset by the economic recovery in the State and the State's proposed stimulus program could stress its financial indicators more than anticipated.[47]

S&P notes it could lower its ratings on South Australia over the next 24 months if its fiscal metrics do not recover to the degree it forecasts. This could occur if operating deficits persist while the SA Government rolls out large infrastructure spending, resulting in wider after-capital account deficits.

DTF advised us that a change in credit rating or outlook (positive or negative) does not necessarily impact the interest costs of new state debt. The market usually anticipates both the timing and action a rating agency may take against an issuer, including the State of South Australia. This is due to the periodical reporting from the ratings agencies that highlight the risks to a rating in advance of any actions being taken. DTF also advised us that the majority of existing debt is on a fixed rate basis, so any debt raised prior to the outlook change is unaffected.

[47] S&P Global Ratings 'acknowledges a high degree of uncertainty about the evolution of the COVID-19 pandemic. The current consensus among health experts is that COVID-19 will remain a threat until a vaccine or effective treatment becomes widely available, which could be around mid-2021. We are using this assumption in assessing the economic and credit implications associated with the pandemic (see our research here: www.spglobal.com/ratings). As the situation evolves, we will update our assumptions and estimates accordingly'.

DTF noted that following the 2020-21 Budget and S&P announcement in November 2020, the differential between Commonwealth and SAFA bonds of 10-year maturity rose from 0.20% to 0.25%. The differential fell to 0.16% in January 2021.

Moody's maintained a stable outlook for South Australia given:

- debt affordability remains strong and the State projects that despite the rising debt levels, annual debt servicing costs will be lower compared to 2019-20, reflecting lower-for-longer interest rates
- South Australia entered the coronavirus crisis from a position of relative fiscal strength, however the projected lower GST revenues combined with the State's rising debt burden to fund infrastructure spending is credit negative. The stable outlook reflects the expectation that policy responses will be implemented to reduce debt as economic growth resumes.

Moody's notes that additional debt funding could be required if the State cannot meet its low expenditure targets or if there are cost blowouts to its proposed capital program.

5.3.7 Net debt levels will likely rise further as a result of substantial infrastructure project expenditure planned beyond the forward estimates and other budget risk factors

DTF advised us that the following major investing expenditure commitments exist outside the forward estimates:

- North-South Corridor Torrens River to Darlington project – $8.9 billion total project cost, of which $6.9 billion is beyond the forward estimates
- Hahndorf Traffic Improvements – $250 million total project cost of which $125 million is beyond the forward estimates.

In addition, the new Women's and Children's Hospital will have expenditure outside the current forward estimates period. Final cost estimates are still subject to completion of the business case and detailed planning. This work is progressing in 2020-21.

These large infrastructure initiatives may result in further net debt increases. Debt levels may also increase if:

- the national GST pool does not recover as quickly as anticipated owing to ongoing COVID-19 impacts on the economy
- Health and Wellbeing portfolio expenditure targets are not achieved
- the winding down of Commonwealth stimulus measures (eg JobKeeper) negatively impacts economic activity and employment with flow on effects to the State's taxation revenues
- agency savings targets are not achieved

- growth in employee expenses exceeds that allowed for in the forward estimates due to enterprise agreement negotiation outcomes
- significant budget overruns occur in major investing program projects
- additional expenditure measures are required by the SA Government to stimulate economic recovery from the COVID-19 pandemic.

5.3.8 SAFA manages most of the State's debt

SAFA is the State's central borrowing authority and is also responsible for managing most of the State's debt. It lends funds raised from financial markets to various South Australian public sector clients, including the Treasurer (who borrows on behalf of public sector agencies to support their operational requirements) and SA Water.

At 30 June 2020, SAFA's liabilities were $35.454 billion. It had loans to the Treasurer ($17.859 billion), loans to PNFCs ($8.334 billion) and loans to public financial corporations (PFC) ($1.927 billion).

DTF advised us that SAFA has focussed on lengthening the maturity profile[48] of the State debt out to 2032 to meet borrowing requirements. It will look to extend its maturity profile out to 2034 in 2020-21 and is considering issuing debt in the 2036 and 2038 maturities over the forward estimates.

DTF also advised that the duration[49] of general government sector debt has been gradually lengthened from 3.4 years at the start of the 2019-20 to 4.6 years currently. The Treasurer recently approved SAFA's recommendation to increase the duration of his debt to between four and eight years as the size of the debt grows. During the first half of 2020-21, SAFA plans to consider maturities out to 30 years both due to the low level of rates and the spreading of refinancing risk.

Further details on SAFA are included in the section of my 2019-20 Annual Report titled 'South Australian Government Financing Authority'.

5.4 Unfunded superannuation

5.4.1 The Budget reports the SA Government is on target to fully fund the unfunded superannuation liability by 2034

The unfunded superannuation liability is a long-term liability to current and past members of closed defined benefit superannuation schemes. It is forecast to decrease by $2.842 billion between 2019-20 and 2023-24, from $12.474 billion to $9.632 billion.

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[48] A bond's term to maturity is the length of time during which the owner will receive interest payments. When the bond reaches maturity the principal is repaid.

[49] Duration means how long it takes, in years, for an investor to be repaid the bond's price by the bond's total cash flows.

The unfunded superannuation liability is calculated in line with Australian Accounting Standards as the net difference between the estimated value of accrued defined benefit superannuation obligations and the value of assets set aside to meet these obligations.

In estimating the unfunded superannuation liability, a range of variable factors and assumptions are considered, including scheduled past service contributions by the SA Government. The superannuation liability may change periodically as assumptions and earnings experience change and, because of discounting, as the Government bond rate changes and the period of settlement approaches.

The Budget reports that the SA Government has a long-term funding strategy in place and is on target to fully fund the State's defined benefit superannuation liability by 2034. By then, superannuation assets are projected to reach $10.6 billion, fully offsetting projected superannuation liabilities. Figure 4.1 in 2020-21 Budget Paper 3 provides further detail on trends in the unfunded superannuation liability and superannuation assets.

The Superannuation Funds Management Corporation of South Australia is responsible for investing and managing the funds of South Australia's public sector superannuation schemes. Further details on its functions are included in the section of my 2019-20 Annual Report titled 'Superannuation Funds Management Corporation of South Australia'.

5.4.2 Unfunded superannuation liability impacted by movements in risk-free interest rate used as discount rate and triennial review of the South Australian Superannuation Scheme

The actual 2019-20 unfunded superannuation liability in the 2020-21 Budget is $12.474 billion, a $116 million increase from the 2019-20 Budget estimate of $12.358 billion. This is mainly due to changes in discount rates used for the 2019-20 MYBR and 2020-21 Budget compared to the 2019-20 Budget ($1.579 billion increase) and changes in earnings assumptions ($506 million increase), largely offset by the impact of the triennial review of the South Australian Superannuation Scheme ($1.94 billion decrease).

Unfunded superannuation liabilities are valued at points in time by discounting future superannuation benefit payments by a discount rate that reflects the prevailing risk-free interest rate. A discount rate of 1.5% was used for the 2020-21 Budget, compared with 2.1% for the 2019-20 Budget and 1.4% for the 2019-20 MYBR. The discount rate is set on the basis of the Commonwealth Government nominal bond rate that reflects the average maturity of the superannuation liabilities.

A triennial review of the South Australian Superannuation Scheme was conducted by an independent actuary for the scheme as at 30 June 2019 as required by the *Superannuation Act 1988*. The 2019 triennial review recommended changes to the economic assumptions underpinning the superannuation model, which resulted in a substantial reduction in the unfunded superannuation liability. Figure 5.12 shows the changes in economic assumptions between the 2019-20 Budget and the triennial review.

Figure 5.12: Changes in economic assumptions from 2019 triennial review

Economic assumption	2019-20 Budget	2019 triennial review
Consumer Price Index	2.5%	2.0%
Salary inflation rate	4.0%	2.5%
Long-term investment earnings	7.0%	6.5%

These triennial review rates have been adopted for the first time in the 2020-21 Budget.

Table 4.3 in 2020-21 Budget Paper 3 provides further detail on changes in the unfunded superannuation liability since the 2019-20 Budget.

Appendix 1 – Reporting framework

Uniform Presentation Framework

By agreement between the Commonwealth, States and Territories, each jurisdiction presents its Budget Papers and mid-year budget update on a UPF basis.

The primary objective of the UPF is to ensure that Commonwealth, State and Territory Governments provide a common core of financial information in Budget Papers to enable direct comparisons across jurisdictions.

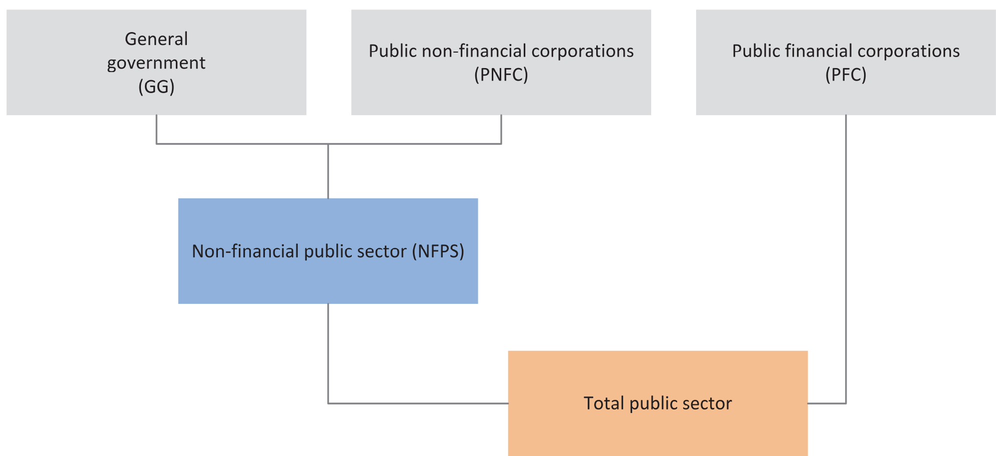
Institutional sectors

Budget reporting is prepared for the following institutional sectors:

- **General government sector** –agencies providing services free of charge or at prices below their cost of production or service cost. These are the services that tend to be primarily financed through taxes and other charges, and for this reason this sector tends to be the focus of fiscal targets.
- **Public non-financial corporations (PNFC) sector** – trading enterprises mainly engaged in producing goods and services for sale in the marketplace at prices that aim to recover most or all of the costs involved. In South Australia this sector includes SA Water and the SA Housing Authority.
- **PFC sector** – bodies primarily engaged in providing financial services. This includes financial institutions such as SAFA, HomeStart Finance and the Superannuation Funds Management Corporation of South Australia.
- **NFPS** – the consolidation of the general government and PNFC sectors.

Figure A1 shows the structure of the sectors, which when consolidated form the total public sector (whole of government).

Figure A1: Sectors of government activity



Budget reporting

Budget estimates are presented on an accrual basis. Three primary statements are prepared for the general government sector, PNFC sector and NFPS:

- operating statement including other economic flows
- balance sheet
- cash flow statement.

PFC sector data is not published in the Budget Papers.

Fiscal measures

The UPF prescribes various fiscal measures as a basis to evaluate the soundness of the government's fiscal position and the effect of fiscal policy.

Figure A2 sets out the key fiscal measures in the UPF referred to in this report.

Figure A2: UPF – key fiscal measures

Fiscal measure	Description
Net operating balance	Revenue from transactions less expenses from transactions. The net operating balance excludes expenditure on the acquisition of capital assets, but includes non-cash costs such as accruing superannuation entitlements and the consumption of capital (depreciation). Provides a measure of the sustainability of the government's fiscal position over time and provides an indication of the sustainability of the existing level of government services.
Net lending/borrowing (fiscal balance)	Net operating balance less the net acquisition of non-financial assets. Measures a government's investment-saving balance. A net lending balance (fiscal surplus) indicates that a government is saving more than is required to finance all of its investment spending. A net borrowing (fiscal deficit) position indicates that the public sector's level of investment exceeds its level of savings.
Net debt	Sum of deposits held, advances received and borrowings, less the sum of cash and deposits, advances paid, investments, loans and placements.

The glossary in Budget Paper 3 provides further detail on the terms used in the Budget Statement and definitions.

Appendix 2 – $4 billion State economic stimulus package

Description	Amount ($million)
Business and Jobs Support Fund and Community and Jobs Support Fund	
Business and Jobs Support Fund	530
Community and Jobs Support Fund	265
Support for our educational institutions	
Non-government School Loans Scheme – expanded	320
Non-government school funding (bring forward)	180
Acceleration of Education Capital Works Program	67
Additional resources for government schools and preschools	37
Preschool/School maintenance works – use of Gonski funds in 2019-20	32
Other	21
Support for the community and community infrastructure	
Sport and Recreation Infrastructure Plan	204
Aboriginal Art and Cultures Centre – additional resources	50
Flinders Chase Kangaroo Island rebuild	45
Protecting South Australians from the spread of COVID-19	42
Additional protective equipment to support the COVID-19 response	36
Parks 2025	32
Festival Plaza upgrade	31
Leigh Creek Township Future	31
Cost of living concession – Boost	28
SA Local Economic Recovery Package	26
Initial upgrade of Penneshaw and Cape Jervis Ports	22
COVID-19 resources (SA Police)	21
Home Battery Scheme – additional support	18
Transport relief for hospital staff to support the COVID-19 response	17
COVID-19 mental health support (Health)	15
Planning and Development Fund (bring forward)	15
Other	114
Tax and fee relief	
Payroll tax deferral	180
Land tax deferral	180
Exempting JobKeeper from payroll tax	70
COVID-19 payroll tax relief	60
Gaming machine tax deferral	59
Other	44
Economic and business growth	
Economic and Business Growth Fund	220
Government Supported Traineeships and Apprenticeships	33
Regional Growth Fund	25
Event Bid Fund – leisure events	22
Training funding	16

Description	Amount ($million)
Other	38
Investment in road infrastructure	
Road maintenance stimulus	58
Hahndorf traffic improvements	50
Road safety package	42
Fleurieu Connections Improvements package	37
Golden Grove Road – Stage 2	30
Road infrastructure	29
Critical Road Bridge Maintenance stimulus package	20
New state school road works	20
Other	31
Investment in our assets	
Cultural institutions – storage facility	87
Government buildings energy efficiency program	60
Port Bonython Jetty	30
Golden Grove Park ‘n’ Ride	25
Marine stimulus package	20
Consolidation of Youth Custodial services	19
Upgrade of the SA Aquatic Sciences centre	16
Other	40
Digital Restart Fund	
Digital Restart Fund	120
Investment in health infrastructure	
Queen Elizabeth Hospital stage 3 development	50
Improving our health facilities	43
Other	25
Total State Economic Stimulus package	3 998

Source: Department of Treasury and Finance.

Note: Totals may not add due to rounding.

Appendix 3 – Abbreviations used in this Report

Abbreviation	Description
ABS	Australian Bureau of Statistics
CALHN	Central Adelaide Local Health Network
CGC	Commonwealth Grants Commission
CTP	Compulsory third party
DHW	Department for Health and Wellbeing
DIT	Department for Infrastructure and Transport
DTF	Department of Treasury and Finance
FTE	Full-time equivalent
GSP	Gross State Product
GST	Goods and services tax
ITE	Income tax equivalent
MYBR	Mid-year budget review
NFPS	Non-financial public sector
NPP	National Partnership Payment
PFC	Public financial corporations
PNFC	Public non-financial corporation
S&P	Standard & Poor’s
SACES	SA Centre for Economic Studies
SAFA	South Australian Government Financing Authority
SA Water	South Australian Water Corporation
TVSP	Targeted voluntary separation package
UPF	Uniform Presentation Framework