[P.P.4

SOUTH AUSTRALIA

Report

of the

Auditor-General

Annual Report
for the
year ended 30 June 2007

Tabled in the House of Assembly and ordered to be published, 16 October 2007

Second Session, Fifty-First Parliament

Part C: State Finances and Related Matters

By Authority: T. Goodes, Government Printer, South Australia

2007

Report of the Auditor-General
Annual Report for the year ended 30 June 2007

TABLE OF CONTENTS TO PART C: STATE FINANCES AND RELATED MATTERS

Page

Report of the Auditor-General
Annual Report for the year ended 30 June 2007

TABLE OF CONTENTS TO PART C: STATE FINANCES AND RELATED MATTERS

Page

TABLE OF CONTENTS TO PART C: STATE FINANCES AND RELATED MATTERS

Page

TABLE OF CONTENTS TO PART C: STATE FINANCES AND RELATED MATTERS

Page

STATE FINANCES AND RELATED MATTERS

1 INTRODUCTION

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

- an overview of matters currently relevant to the State's public finances;
- the reporting frameworks that exist for reporting on the State's finances. There are three separate reporting requirements involving statutory and conventional accounting, each providing a different perspective;
- a brief analysis of the financial performance of the State for the year, based on the three different reporting frameworks used in the public sector. This primarily involves an examination of the results for the past year, and the Budget and forward projections included in the Budget Papers;
- a review of the financial position of the State, including understanding some of the major assets and liabilities, and the impact that they have on the State's finances.

Limitations on Audit Analysis

Most of the audit analysis in this Report is based on data provided in the Budget Papers, particularly for the 2007-08 Budget, supplemented with information provided by the Department of Treasury and Finance.

There are some limitations associated with the data when analysing results. These limitations include the following.

- The Audit commentary in this Report is based on a review of the budget material and related information. It is not an audit in the same sense as work conducted to provide an audit opinion on financial statements. The budget data are estimates and are unaudited.
- This review considers the estimated result for 2006-07. Past experience is that actual results have varied, sometimes substantially, from the estimated result.
- Classification changes occur from year to year in revenue and expense definitions that can affect the comparability of individual items across the time series. Such changes do not generally affect the net lending (borrowing) result.

Notwithstanding, in Audit's view, these limitations are reasonable and do not invalidate the overall trend analysis from the Budget data.

2 OVERVIEW OF STATE FINANCES

2.1 OVERVIEW

This Section provides a broad overview of matters that are, in my opinion, currently relevant to the State's public finances. Further commentary follows in later sections. Readers will observe that specific terms are used in reporting on public finances. The main terms and their meanings are provided in sections 3 and 4 of this Report.

2.2 FISCAL STRATEGY

South Australia has had a triple-A credit rating since September 2004. The rating was affirmed in August 2007.

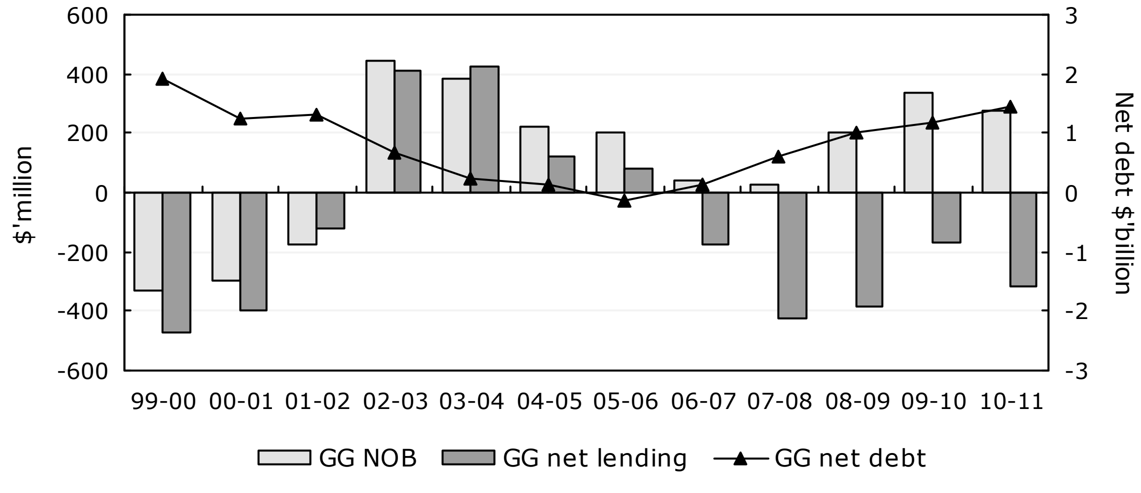
In the 2005-06 Budget, the Government amended its budgetary strategy. It now aims to achieve a net operating balance (revenues equal or exceed expenses) in every year. Previously, it sought balanced budgets in net lending terms which also took into account net capital investment. This meant net capital investment was met by the excess of revenues over expenses. The change in strategy allows the Government to borrow to fund proposed capital investment each year.

For 2007-08, the Government's fiscal targets are unchanged from the previous Budget. They include ensuring that risks to the State finances are managed prudently, to maintain a triple-A rating. A primary fiscal target is to achieve net lending outcomes that ensure the ratio of net financial liabilities[1] to revenue continues to decline towards that of other triple-A rated States.

2.3 CHANGING FINANCIAL POSITION

The following chart shows changes occurring or anticipated in some of the key financial indicators over a 12 year period to 2010-11 for the general government sector.

Chart 2.1 — GFS - General Government Sector Net Operating Balance (NOB), Net Lending and Net Debt



1 See section 4.1.2 of this Report.

The chart highlights the very large surpluses in 2002-03 and 2003-04 that changed the previous trend of deficits. Revenue from distributions from public financial corporations of $332 million was central to the 2002-03 results compared to other years. Also shown is the very large reduction in net debt until 2005-06, due firstly to sales of electricity assets and then from surpluses, particularly in 2002-03 and 2003-04.

The chart clearly displays the effect of changes in fiscal targets over the years reviewed.

Prior to 2002-03, government fiscal targets were substantially different, focussing on cash results for the then defined, non-commercial sector. The net operating and lending outcomes for those years were not the focus of budget management and reporting at the time. They are included in the chart to demonstrate how circumstances have changed over time.

From 2002-03 to 2005-06, Budget strategy was to achieve balanced budgets in net lending terms. The chart shows this was achieved.   The 2006-07 and 2007-08 Budget strategy of net operating balance surpluses and net borrowing (lending deficits) across the forward estimates, which in turn leads to rising net debt, is also evident.

2.4 OPERATING STATEMENT

2.4.1 Estimated Results for 2006-07

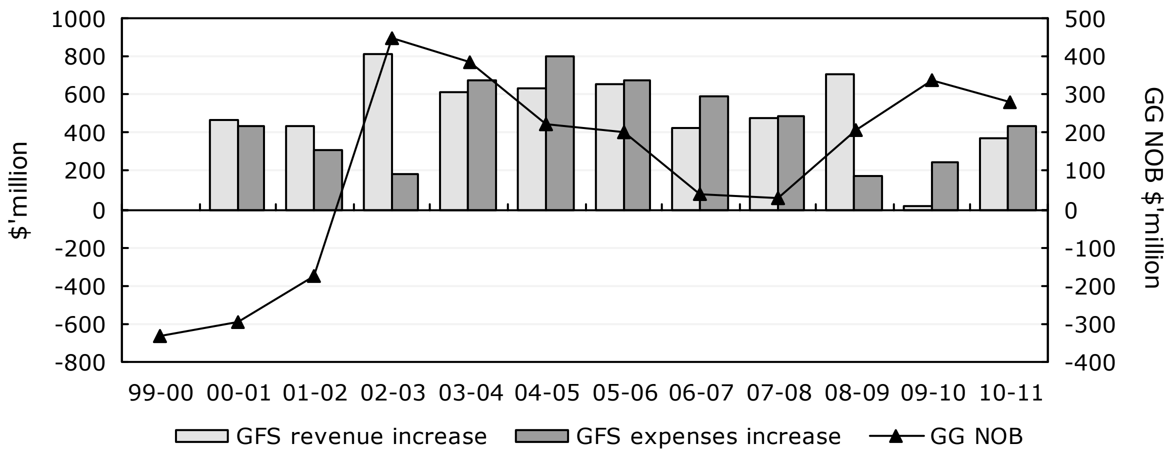
The 2007-08 Budget Papers show that the Government financial operations for 2006-07 are on target for a budgeted net operating balance surplus, although lower than was budgeted. The estimated result is a surplus of $38 million (budget $91 million). Solid growth in revenues that exceeded budget were, however, exceeded by increases in expenses. Net borrowing is estimated to be $176 million (budget $118 million).

2.4.2 Budget Forecasts 2007-08 to 2010-11

Chart 2.1 shows the projected outcomes for the four years to 2010-11 as set out in the 2007-08 Budget.

The following chart shows some of the 2007-08 Budget targets against past experience.

Chart 2.2 — GFS – Annual Change in General Government Sector Revenue, Expenses and Net Operating Balance (NOB)



As shown, after 2002-03, annual expenses growth outstrips revenue growth up to 2007-08 with the natural consequence that the net operating balance trends down after 2002-03.

The 2007-08 Budget projects that this trend will reverse in 2008-09 and 2009-10 but decline again in 2010-11.

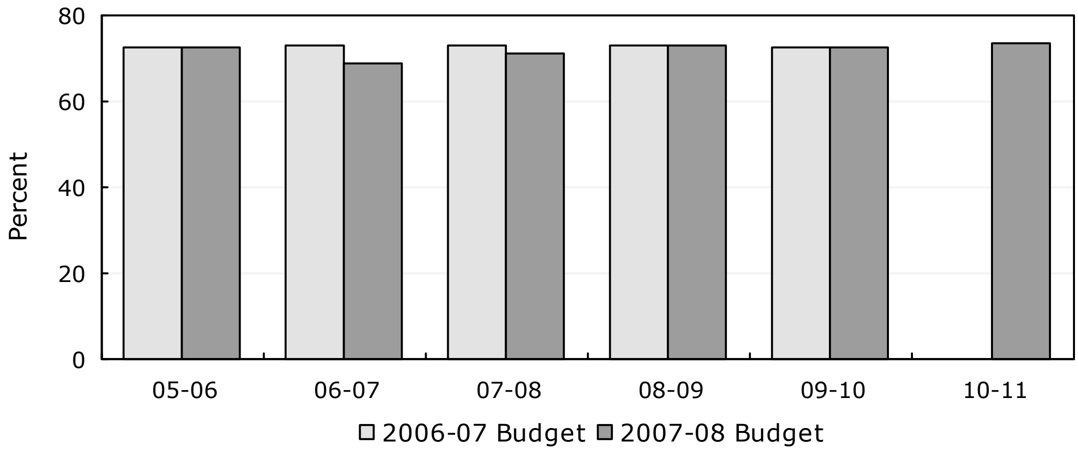
This will depend on achieving revenue budgets and limiting expense growth in 2008-09 and 2009-10 to half or less than that experienced or expected in the five years to 2007-08.

2.4.3 General Government Net Financial Liabilities to Revenue Ratio

As noted, a primary fiscal target is to achieve net lending outcomes that ensure the ratio of net financial liabilities to revenue continues to decline towards that of other triple-A rated States.

Chart 2.3 shows the estimated outcomes for this ratio as set out in the 2006-07 and 2007-08 Budgets.

Chart 2.3 — Net Financial Liabilities to Revenue Ratio – Budget Comparison



The chart highlights the effect on the ratio of the 2007-08 Budget compared to the previous Budget. In the 2006-07 Budget, the ratio was projected to be stable and then reduce slightly in 2009-10, in line with the fiscal target of continuing to decline towards that of other triple-A rated States. The 2007-08 Budget settings result in the ratio essentially rising until 2010-11. This is not consistent with the fiscal target. Chart 10.3 in section 10 of this Report sets out the five year trend to 2010-11 for most other States. It is evident that a similar situation exists for Victoria and Queensland and that South Australia's relative standing against most other triple-A rated States remains similar.

2.4.4 Interstate Comparison

The 2007-08 Budget compares key budget aggregates across jurisdictions. In 2007-08, most jurisdictions are forecasting general government net operating balance surpluses and net borrowing (lending deficits). Most jurisdictions are investing significant funds into infrastructure projects.

2.5 NON-FINANCIAL SECTOR BALANCE SHEET[2]

The State's balance sheet is expected to strengthen over the four years of the 2007-08 Budget as measured by net worth. Net financial worth, however, declines due to the growth of financial liabilities. Both these trends are consistent with borrowing to build infrastructure.

2.5.1 Estimated Position for 2006-07 and Forward Years

The State has a substantial asset base. Assets are estimated to increase by over $500 million in 2006-07 to $34 billion, due mainly to revaluation increases for non-financial assets. Rising property values have had a marked positive influence on the balance sheet. Growth in the value of rental properties of the South Australian Housing Trust alone has contributed $2.4 billion over the four years to 2006-07. Total assets are expected to rise to $38.8 billion by 2010-11.

The major component of liabilities is unfunded superannuation liabilities that are estimated to decrease $405 million to $5.7 billion as at 30 June 2007. The decrease was due principally to the strong investment performance from equity markets.

Net debt was estimated to rise $477 million to $2.3 billion at 30 June 2007. Net debt is estimated to rise to $3.4 billion by 2010-11. The general government sector net debt increased to $151 million at 30 June 2007.

Net worth, comprising total assets less total liabilities, is estimated to rise $862 million to $20.6 billion at 30 June 2007 and to $23.1 billion by 2010-11.

2.6 RISKS AND MANAGEMENT TASKS FOR THE 2007-08 BUDGET

Maintaining forecast net operating balance surpluses represents overall good financial planning, providing some flexibility and buffer against unfavourable influences and events that may affect Budget outcomes.

The projections for 2007-08 forecast a small reduction in the net operating balance from the estimated result in 2006-07.

The improved results for 2008-09 and 2009-10, however, are based on reducing expenditure trends that have not been, or estimated to be, experienced for five years and are therefore considered more uncertain.

The net borrowing (lending deficit) outcomes are due to higher spending on non-financial assets (infrastructure).

2.6.1 Managing Performance

2.6.1.1 Net Operating Balance

Each budget since the 2002-03 Budget has projected restraint in relation to expenses across the forward estimates. The 2006-07 Budget estimated that expenses would fall in real terms by 1 percent for 2006-07. The estimated result shows real terms growth

2 Balance Sheet data is for the non-financial public sector unless otherwise stated due to the high value of non-financial assets in public non-financial corporations.

for expenses in 2006-07 of nearly 3 percent – an overall 4 percent variation on the year's $11 billion[3] expenses.

The 2007-08 Budget, plans real terms growth in expenses of nearly 2 percent for 2007-08 but real terms fall for the next two years to 2009-10.

Chart 2.2 shows that experience for the four years to 2006-07 is that spending has increased annually beyond that projected for the four years to 2010-11 in the 2007-08 Budget. This implies a need for very strong control and reporting over future spending.

Audit review in 2006-07 confirmed that the Government has a range of budget monitoring and reporting procedures in place, a summary of which is included in this Report.

Even so, in the last four years there were substantial expenditure pressures and initiatives, beyond original budgets, especially in health and family and community support. These have annually added hundreds of millions to expenses. Net operating balance surpluses were achieved after revenue windfalls (unbudgeted) allowed for funding of initiatives and expenditure pressures to be addressed.

The 2007-08 Budget is constructed on steady own source revenue forecasts having regard to payroll tax relief measures, the phasing out of various duties and other effects. There is, however, strong growth in Commonwealth GST revenue grants. The Budget records that the State is receiving a net benefit from the national tax reform package.[4] Recent years show that revenues have tended to be underestimated.

Some identified risk factors were realised in 2006-07 and continue into the 2007-08 Budget. Most particularly the Government has participated in a range of support actions to those suffering the adverse effects of a severe drought. State sourced assistance (exclusive of Commonwealth aid) is estimated to be $18 million in 2007-08 apart from other effects that may flow through to the Budget. There is also a risk of further rising interest rates. These and other factors lead to a continually testing environment for expenditure control.

The Budget also has an underlying premise of achieving identified savings initiatives. The 2007-08 Budget identifies operating savings over four years of $202 million additional to the $695 million of savings over four years under the 2006-07 Budget. To recap, the 2006-07 Budget savings initiatives include the development of shared services and the Future ICT arrangements. There are considerable risks to manage as certain savings initiatives advance. For example, the development of shared services creates a new entity and all its attendant requirements. These include consolidating and rationalising systems and service support, implementing new or revised control environments, while at the same time, maintaining efficiency of service outcomes.

The Department of Treasury and Finance have advised that the majority of savings initiatives are on track for 2007-08 and forward years. Tranche 1 of Future ICT was completed and general government sector savings assigned to agency budgets in early

---

3 The estimated result for revenues and expenses in 2006-07 include a grossing up effect in the order of $100 million from accounting reclassifications.

4 Budget Statement 2007-08, Budget Paper 3, Table 4.3.

2007-08. Expected savings from structural changes, printing and publications, motor vehicles (in support of local industry) and office accommodation were not achieved and/or proceeding.[5]

The new 2007-08 savings are mainly in the health portfolio and involve operational savings and service delivery changes. The health sector has constantly experienced expenditure pressure over the years and received substantial additional resources in 2006-07.[6]

As noted in past Auditor-General's Reports, it is important to emphasise that:

- when implementing savings initiatives, it is necessary for agencies to fully understand and fulfil their legislative responsibilities;
- where seeking savings through shared services, such arrangements need careful planning and risk analysis to be successful in both efficiency of costs and effectiveness for controlling and managing operations. Roles and responsibilities of all parties need to be clearly set out in well constructed service level agreements. Audit experience has shown that lack of clarity in roles leads to failure in control systems.

2.6.1.2 Net Lending

The 2006-07 Budget estimated higher total net acquisition of non-financial assets (capital spending) than past years. The 2007-08 Budget elevates those estimates higher again.

There may be a heightened risk to the proper control and management of those outlays. Major projects carry high inherent risks including cost estimating, escalations and timeliness of completion. Sustained higher capital outlays than have be made in past years, need to be supported by appropriate project management expertise, information systems and controls.

2.6.1.3 Public Private Partnership Projects

A feature of the 2006-07 Budget was the announcement of substantial public private partnership (PPP) projects for the provision of correctional and educational infrastructure for use by the public sector. Private sector capital expenditure for the projects is estimated to be nearly $700 million, well beyond recent PPP projects.

In 2006-07, expenses for these initiatives were limited to the costs of PPP consultants. Whether PPPs are off-Balance Sheet and how the transactions will be represented in the various financial reports will be a matter to resolve when contractual arrangements are established. A significant consideration before a PPP procurement is initiated is whether the Government is satisfied that a PPP provides a net benefit to the public compared to conventional public sector procurement.

---

5 See also Budget Statement 2007-08, Budget Paper 3, p 2.2 which notes savings reversed or delayed.

6 See for example additional resources of $59 million in 2006-07, Budget Statement 2007-08, Budget Paper 3, Table 2.21.

2.7 CONCLUDING OBSERVATIONS

The 2007-08 Budget has been prepared on a consistent basis to past years in that revenue predictions allow for anticipated trends and policy changes, and expense projections are restrained. Experience of the past five years is that the State has benefited from sustained strength in both the local and national economy with resultant unbudgeted revenue gains covering expenditure increases.

The Budget indicates that savings initiatives, higher capital outlays and the use of PPPs continue to be significant elements of the Budget strategy. As mentioned in last year's Report, new and large scale initiatives commence with a higher inherent risk while experience is gathered.

The Budget is to operate over a period that will see the likelihood of pressures being realised in the economy through, for example, interest rate rises, drought and more recently, volatility in equity markets.

There remains a range of risks to be managed to facilitate successful budget outcomes. As always, strong and effective controls based on sound information systems, reporting integrity and effective monitoring, will be needed to support achievement of the Budget targets. Audit review in 2006-07 indicated a need for focus on the improvement of data quality in some areas and for most agencies. This was reflected by the degree of change in projected budget positions during the year and the variation between month to date data and projected end of year data. Information quality for the majority of agencies was consistently rated by the Department of Treasury and Finance as medium and low on a high to low scale.

It would be appropriate for the factors that contribute to the quality of reported data to be reviewed with a view to achieving improvements where practical and beneficial. Audit has noted that improvements in information systems used in agencies is likely to be an area that would assist this aim.

Finally, the 2007-08 Budget shows that infrastructure investment is a major priority for the State, to support long term service delivery and economic development, as it is in other jurisdictions. To meet this need the Government is, on current estimates, unable to achieve one of its primary fiscal targets, the continuing decline in the ratio of net financial liabilities to revenue towards that of other triple-A rated States. Notably, since the Budget, the Government has announced the likelihood that both a desalination plant and a doubling of our water storage capacity in the Mt Lofty ranges will be built to guarantee South Australia's long-term water security. These could amount to an investment of more than $2.5 billion. This represents an investment greatly exceeding the entire proposed capital investment program for 2007-08. A natural conclusion is that should it occur, there is likely to be attendant implications for net lending outcomes, debt and related fiscal measures and targets. Any effect will depend on how these initiatives are delivered, including water pricing.

3 REPORTING FRAMEWORK

3.1 INTRODUCTION

There are three reporting frameworks that are now used for reporting on the State's finances, namely the:

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

To allow for the analysis of (1) the financial performance, and (2) the financial position of the State, it is necessary to understand the nature and the application of each framework.

The UPF framework is based on the reporting standards of the Australian Bureau of Statistics' (ABS's) accrual-based framework.

The major proportion of the discussion and analysis in this Report is directed at reviewing information that is reported on the UPF basis for the Budget. Reference to other reporting framework based information is included as may be relevant.

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

3.2 UNIFORM PRESENTATION FRAMEWORK (UPF)

3.2.1 Background

The UPF is a reporting standard based on the ABS's accrual-based Government Financial Statistics (GFS) framework.[7] The UPF has been adopted by all Australian Government jurisdictions for the preparation and presentation of supplementary information reported in Budget and Budget Result documents prepared by each jurisdiction.

In South Australia, the Budget is prepared using the GFS framework.

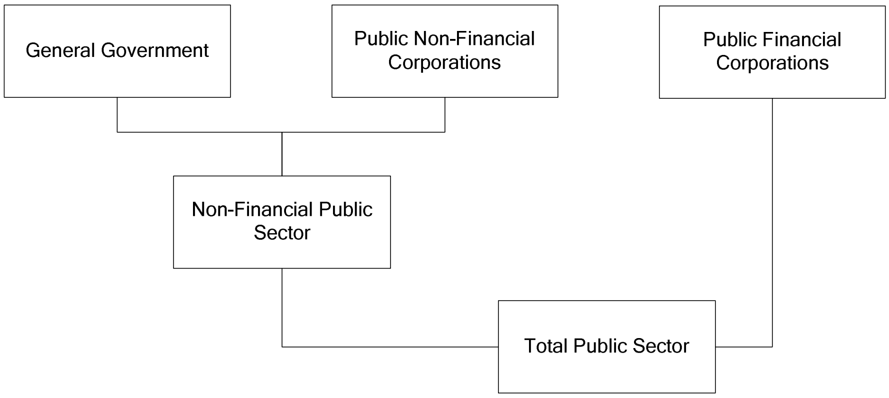
The GFS accrual reporting has many similarities to that under the AAS framework. There are, however, significant differences such as the GFS framework excludes revaluations from the GFS Operating Statement, as they are not transactions for the purposes of the GFS framework.

Notwithstanding these differences, the main statements emanating from GFS financial reporting are the (1) Operating Statement, (2) Balance Sheet and (3) Cash Flow Statement.

Another key aspect of the GFS framework is the identification of different sectors, recognising that state government responsibilities cover a wide range of activities.

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

Three sectors (which are then consolidated into two additional sectors) of government activity are identified in the following chart:



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

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

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

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

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

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

Cash Flow Statements are also published for these sectors.

The public financial corporations sector data is not published in the Budget Papers. Although data is produced and published for this sector by the ABS, it is not available until some months after the collation of the Budget Papers.

Key GFS Headline Amounts

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

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

- ***GFS Net Lending/Borrowing*** — the net operating balance less net acquisition of non-financial assets. It indicates the extent to which accruing operating expenses and net capital investment expenditure is funded by revenues.

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

- ***Net Debt*** — comprises certain financial liabilities less financial assets. The items included in this measure are discussed in depth in the Budget Papers.[8]

3.2.2 Scope of Audit Review of GFS Financial Statements

This Report primarily covers commentary on GFS based information. Although Audit seeks to have a comprehensive understanding of the budget preparation process, the data and assumptions are not subject to audit.

Work performed on the 2007-08 Budget year's GFS data has included some analytical procedures to ensure that the amounts presented are reasonably supported and where trends in data materially differ, that they can be adequately explained.

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

3.3 AUSTRALIAN ACCOUNTING STANDARDS (AAS)

The AAS framework is the basis for agency (budget and actual) and whole-of-government (actuals only) reporting.

3.3.1 Agency Financial Reports

The statutory financial reports that are prepared by individual agencies and subject to audit are compiled using Australian Accounting Standards. Australian Accounting Standards are now based on International Financial Reporting Standards as subsequently amended.

3.3.2 AAS Whole-of-Government Financial Statements

Whole-of-government financial reports for South Australia are prepared by the Department of Treasury and Finance pursuant to Accounting Standard AAS 31 'Financial Reporting by Governments'.

A summary of information prepared on this basis is provided in section 12 of this Report.

3.3.3 Review of Government Accounting Standards

The Australian Accounting Standards Board (AASB) issued Exposure Draft 156 (ED 156) 'Proposals Arising from the Short-term Review of the Requirements in AAS 27, AAS 29 and AAS 31' in June 2007.

---

8 Net debt equals the sum of deposits held, advances received and borrowing, minus the sum of cash and deposits, advances paid, and investments, loans and placements as defined in the GFS framework.

The AASB considered it timely to review the requirements in AASs 27, 29 and 31 which are based on the Australian Accounting Standards that were current at the date of their issue. Since their issue, the AASB has issued Australian Accounting Standards that are based on International Financial Reporting Standards.

The stated short-term focus of ED 156 is on relocating the requirements of these AASs, substantively unamended (with some exceptions), into topic-based transaction neutral Standards. In the longer term the focus is on improving the requirements for each topic-based issue where necessary.

3.3.4 Convergence of GFS and Australian Accounting Standards

The AASB issued Australian Accounting Standard AASB 1049 *Financial Reporting of General Government Sectors by Governments* in September 2006.

AASB 1049 specifies requirements for general government sector financial reports of each government. These requirements are in addition to requirements for whole-of-government financial reports of each government. The Standard requires disclosure of additional information such as reconciliations to key fiscal aggregates determined in accordance with the ABS GFS Manual.

AASB 1049 applies to annual reporting periods beginning on or after 1 July 2008.

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

The Treasurer's Statements are prepared pursuant to the requirements of the *Public Finance and Audit Act 1987* (the Act) and reported as an Appendix to the Auditor-General's Report to Parliament.

A summary of information prepared on this basis is provided in section 11 of this Report.

4 SUMMARY OF KEY FISCAL MEASURES AND TARGETS

4.1 SOUTH AUSTRALIAN FISCAL TARGETS

The 2007-08 Budget Papers[9] indicate that the Government is committed to the following fiscal targets:

Net operating balance	*to achieve at least a net operating balance in the general government sector in every year.*
Net lending	*to achieve net lending outcomes that ensure the ratio of net financial liabilities to revenue continues to decline towards that of other triple-A rated states.*
Taxes	*to ensure the State has an effective tax regime having regard to the Government's social and economic objectives.*
Services	*to provide value for money community services and economic infrastructure within available means.*
Superannuation	*to fully fund accruing superannuation liabilities and progressively fund past service superannuation liabilities.*
Risk	*to ensure that risks to State finances are managed prudently, to maintain a triple-A rating.*
PNFCs borrowing	*to ensure public non-financial corporations (PNFCs) will only be able to borrow where they can demonstrate that investment programs are consistent with commercial returns (including budget funding).*

4.1.1 General Government Net Operating Balance

One of the Government's primary fiscal targets is the achievement of net operating balances every year. This means that revenues are covering expenses, including interest and depreciation.

4.1.2 General Government Ratio of Net Financial Liabilities to Revenue

The second of the Government's primary fiscal targets is the achievement of net lending outcomes that ensure the ratio of net financial liabilities to revenue continues to decline towards that of other triple-A rated states. Net financial liabilities is calculated as total liabilities less financial assets (excluding equity held in PNFCs and PFCs), such as cash, advances and investments. This measure is broader than net debt as it includes significant liabilities other than borrowings, such as unfunded superannuation and long service leave entitlements.

4.2 FISCAL MEASURES IN OTHER JURISDICTIONS

In considering the State's fiscal strategy, it is useful to note what is current practice across Australian jurisdictions.

9 Budget Statement 2007-08, Budget Paper 3, p 1.5.

The following table summarises the current budget targets for each jurisdiction.

Jurisdiction	Budget Fiscal Objective/Strategy (a) (b)
Commonwealth	Maintain budget balance on average over the economic cycle (Fiscal Balance = 0). Maintaining surpluses over the forward estimates period while economic growth prospects remain sound.
NSW	Reduce the level of general government net financial liabilities as a share of GSP to 7.5 percent or less by 30 June 2010. Maintain general government underlying net debt as a share of GSP at or below its level as at 30 June 2005.
Victoria	Short Term: Target Operating Surplus of at least $100 million for the general government sector (measured on A-IFRS net result from transactions basis). Long Term: Maintain a substantial budget operating surplus.
Queensland	The Government will ensure that its level of service provision is sustainable by maintaining an overall general government operating surplus.
WA	Achieve operating surpluses for the general government sector.
Tasmania	Achieve, on average, a Net Operating Surplus for the General Government Sector. Maintain, on average, a Fiscal Surplus for the General Government Sector.
ACT	Achieve a General Government Sector Net Operating Surplus. Maintain Operating Cash Surpluses.
NT	To achieve a positive GFS operating balance in the general government sector by 2012-13.

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

4.3 SOME AUDIT OBSERVATIONS ON THE FISCAL MEASURES

There has been no change in other state's fiscal targets from the previous year. While it is evident that there is some variation between the jurisdictions, the most prevalent position is to target net operating surpluses in the general government sector, based on the GFS accrual method as is the position in this State.

NSW is the only other state to give specific focus to net financial liabilities.

5 BUDGET 2006-07 – ESTIMATED RESULT

5.1 OVERVIEW

The following section summarises the estimated GFS operating results for 2006-07.

5.2 ESTIMATED RESULT FOR 2006-07

5.2.1 General Government Sector

The estimated result for the year was a GFS net operating balance of $38 million (budget $91 million) and net borrowing result of $176 million (budget $118 million).

The following table shows 2005-06 financial year data and differences between the estimated result and budget for 2006-07.

Table 5.1 — GFS - General Government Budget Comparisons 2005-06 to 2006-07

	2005-06 Actual $'million	**2006-07 Budget $'million**	**2006-07 Estimated Result $'million**	Difference to Budget $'million	Difference to Budget Percent
GFS Revenue					
Taxation revenue	2 979	3 086	3 215	129	4
Current grants	5 556	5 572	5 684	112	2
Capital grants	221	220	242	22	10
Sales of goods and services	1 333	1 322	1 439	117	9
Interest income	147	171	176	5	3
Distributions from PFCs	116	29	31	2	7
Distributions from PNFCs	459	457	431	(26)	(6)
Other	431	407	447	40	10
Total Revenue	11 242	11 264	11 665	401	4
Less: **GFS Expenses**					
Gross operating expenses					
Employee expenses	5 124	5 215	5 409	194	4
Depreciation	454	481	498	17	4
Other operating expenses	2 808	2 948	3 065	117	4
Nominal superannuation interest expense	344	316	315	(1)	-
Other interest expense	223	204	213	9	4
Current transfers	1 975	1 897	2 019	122	6
Capital transfers	112	112	107	(5)	(4)
Total Expenses	11 040	11 173	11 627	454	4
GFS Net Operating Balance	202	91	38	(53)	(58)
Less: **Net Acquisition of Non-Financial Assets**					
Purchases of non-financial assets	717	780	811	31	4
Less: Sales of non-financial assets	144	90	99	9	10
Less: Depreciation	454	481	498	17	4
Total net acquisition of non-financial assets	119	209	214	5	2
GFS Net Lending (Borrowing)	83	(118)	(176)	(58)	49

Note: Totals may not add due to rounding.

As shown in the table, when compared to 2005-06, the 2006-07 Budget anticipated a reduction of the net operating balance from higher growth in expenses than the minimal expected change in revenue, and higher purchases of non-financial assets leading to net borrowing. The estimated result for 2006-07 shows substantial growth in both revenue and expenses, and consequently a lower than budgeted net operating balance and higher net borrowing.

The primary reasons for the changes from the original 2006-07 budget are as follows:

- ***Taxation Revenue*** — property taxes are expected to exceed budget by $114 million (10 percent) as property market conditions have remained robust.
- ***Current Grants*** — the increase relates primarily to better than expected receipts of GST revenue grants (up $15 million) and specific purpose payments (up $89 million) from the Commonwealth.
- ***Sales of Goods and Services*** — the increase is due to classification/reporting changes ($80 million and offset by related reclassification of operating expenses) and additional revenue ($37 million), mainly relating to higher than expected revenue from regulatory fees (in particular, land transfer fees) and Commonwealth contributions.
- ***Expenses*** — up $454 million on budget, of which $194 million was employee expenses.

5.2.1.1 Net Acquisition of Non-Financial Assets

The 2006-07 estimated result for purchases of non-financial assets is expected to slightly exceed budget, up $31 million. The 2006-07 budget of $780 million for purchases of non-financial assets, included a slippage allowance of $90 million to allow for likely project delays. Table 5.2 shows the estimated result is influenced by the reduction of the slippage allowance (reflecting the reduced uncertainty of projections) whereas gross purchases are estimated to be $24 million lower than budget.

Table 5.2 — GFS – Purchases of Non-Financial Assets Budget to Estimated Result Comparisons 2006-07

	2006-07 Budget $'million	**2006-07 Estimated Result $'million**	Difference to Budget $'million
Gross purchases of non-financial assets	870	846	(24)
Less: Slippage	90	35	55
	780	811	31

The Budget Papers[10] show the estimated result for most portfolios was lower than budgeted. At the time of the Budget, $55 million[11] of underspending had been carried forward into the forward estimates consistent with past practice.

[10] Budget Statement 2007-08, Budget Paper 3, Table 2.19.

[11] Budget Statement 2007-08, Budget Paper 3, Table 1.9.

5.2.2 Non-Financial Public Sector

The non-financial public sector (consolidating the general government and public non-financial corporations sectors) estimated result for the year was a GFS net borrowing result of $313 million, which is $91 million over budget for the year.

The estimated result was $432 million lower than the previous year's result due to significantly higher estimated total expenses in 2006-07 compared to 2005-06.

The following table summarises the position.

Table 5.3 — GFS - NFPS Budget Comparisons 2005-06 to 2006-07

	2005-06 Actual $'million	**2006-07 Budget $'million**	**2006-07 Estimated Result $'million**	Difference to Budget $'million	Difference to Budget Percent
GFS Revenue	11 807	11 727	12 155	428	4
Less: **GFS Expenses**	11 634	11 687	12 231	544	5
GFS Net Operating Balance	173	40	(76)	(116)	(290)
Less: **Net Acquisition of Non-Financial Assets**	53	262	237	(25)	(10)
GFS Net Lending (Borrowing)	120	(222)	(313)	(91)	41

Note: Totals may not add due to rounding.

The key differences for the net operating balances are similar to those as explained for the general government sector, namely increases in taxation, current grants, sales of goods and services and spending on employee expenses, other operating expenses and current transfers.

6 BUDGET 2007-08 OVERVIEW

6.1 OVERVIEW

The following focuses on the trends arising from the 2007-08 Budget tabled in Parliament in June 2007. It provides an overview of:

- the Budget for 2007-08 having regard to the estimated result for 2006-07;
- a longer term view of the forecast results going forward to 2010-11.

The analysis deals only with the accrual-based GFS framework.

6.1.1 Matters of Significance to the 2007-08 Budget

Some matters of significance to the 2007-08 Budget estimates years, are:

- new operating and investing initiatives totalling $1.7 billion over the next four years;[12]
- targeted savings and revenue offsets totalling $224 million over four years;[13]
- reform of payroll taxation is expected to reduce payroll tax receipts by $337 million over four years;
- expenditure restraint compared to revenue growth is projected to lift the net operating balance to $278 million by 2010-11;
- higher capital investment leads to net debt increasing by $1.3 billion by June 2011.

Total revenues and expenses for 2007-08 are higher than was budgeted in 2006-07.

Total revenue for 2007-08 is now budgeted at $12.1 billion, $504 million or 4.3 percent more than was estimated for 2007-08 in the previous, 2006-07 Budget. Expenses for 2007-08 are now budgeted at $12.1 billion, $637 million or 5.6 percent higher than was estimated at the time of the 2006-07 Budget.

As a consequence of these changes, the net operating balance is now budgeted at $30 million, down from the estimated $162 million 2007-08 result in the 2006-07 Budget but still achieving the fiscal objective of at least a net operating balance for the general government sector.

---

[12] Budget Statement 2007-08, Budget Paper 3, Table 2.1.

[13] Budget Statement 2007-08, Budget Paper 3, Table 2.1.

6.2 GENERAL GOVERNMENT SECTOR – OPERATING STATEMENT

Table 6.1 sets out the differences between the 2007-08 Budget and the estimated results for 2006-07.

Table 6.1 — GFS - General Government Sector Budget Comparison of 2006-07 Estimate Results and 2007-08 Budget

	2006-07 Estimated Result $'million	2007-08 Budget $'million	Difference $'million	Difference Percent
GFS Revenue				
Taxation revenue	3 215	3 243	28	0.9
Current grants	5 684	6 089	405	7.1
Capital grants	242	298	56	23.1
Sales of goods and services	1 439	1 505	66	4.6
Interest income	176	170	(6)	(3.4)
Distributions from PFCs	31	22	(9)	(29.0)
Distributions from PNFCs	431	365	(66)	(15.3)
Other	447	448	1	0.2
Total Revenue	11 665	12 140	475	4.1
Less: **GFS Expenses**				
Gross operating expenses				
Employee expenses	5 409	5 702	293	5.4
Depreciation	498	497	(1)	(0.2)
Other operating expenses	3 065	3 107	42	1.4
Nominal superannuation interest expense	315	282	(33)	(10.5)
Other interest expense	213	214	1	0.5
Current transfers	2 019	2 216	197	9.8
Capital transfers	107	92	(15)	(14.0)
Total Expenses	11 627	12 110	483	4.2
GFS Net Operating Balance	38	30	(8)	(21.1)
Less: **Net Acquisition of Non-Financial Assets**				
Purchases of non-financial assets	811	1 021	210	25.9
Less: Sales of non-financial assets	99	66	(33)	(33.3)
Less: Depreciation	498	497	(1)	(0.2)
Total Net Acquisition of Non-Financial Assets	214	458	244	114.0
GFS Net Lending (Borrowing)	(176)	(428)	(252)	143.2

Note: Totals may not add due to rounding.

As shown, the differences for the 2007-08 year are due mainly to:

- current revenue grants rising at a much greater rate than inflation (CPI is forecast to be 2.5 percent for South Australia in 2007-08);[14]
- revenue from distributions by PNFCs reducing to $365 million, from $431 million;
- employee expenses rising by twice the rate of inflation;

14 Budget Statement 2007-08, Budget Paper 3, Table 8.1.

- an increase in total net acquisition of non-financial assets of $244 million, noting that purchases of non-financial assets for 2007-08 is $210 million higher than 2006-07 after allowing for capital slippage provisions of $35 million in 2006-07 and $90 million in 2007-08.

More detail of the factors influencing the 2007-08 Budget is considered in the context of the longer-term trends discussed later in this Report.

6.2.1 Reconciliation of Variations since 2006-07 Budget

Each year a reconciliation is provided in the Budget Papers of the current budget estimates with the corresponding estimates for the previous year. This allows the reader to understand differences between budgets arising from what the Government categorise as parameter and policy changes.

'Parameter changes' are those that flow from other than policy choices. Revenue includes taxation changes from economic activity and Commonwealth revenue. Expenses include carry overs between years from timing effects, reclassifications and corrections.

'Policy changes' are the decisions made by the Government to increase or decrease taxation and spending.

The following table summarises all parameter and policy changes made since the 2006-07 Budget that affect the net operating balance.[15]

Table 6.2 — Reconciliation of General Government Sector Net Operating Balance

	2006-07 Estimated Result $'million	2007-08 Budget $'million	2008-09 Estimate $'million	2009-10 Estimate $'million
2006-07 Budget	**91**	**162**	**188**	**208**
Parameter and other variations				
Revenue - taxation	130	103	115	118
Revenue - other	232	304	377	471
Operating expenses	(332)	(293)	(239)	(253)
Net Effect of Parameter and Other Variations	**30**	**114**	**253**	**336**
Policy measures				
Revenue - taxation	(2)	(39)	(85)	(94)
Revenue - other	35	64	32	13
Revenue offsets	6	71	97	9
Operating expenses	(163)	(372)	(305)	(160)
Net Effect of Policy Measures	**(124)**	**(276)**	**(261)**	**(232)**
Use of Provisions Set Aside in the 2006-07 Budget and the 2006-07 MYBR				
Operating expenses	41	28	23	24
2007-08 Budget	**38**	**30**	**205**	**336**

Note: Totals may not add due to rounding.

15 Budget Statement 2007-08, Budget Paper 3, Table 1.7.

Revenues

The table shows that revenue changes since the 2006-07 Budget are almost entirely due to parameter changes.

The following table shows the components of revenue parameter changes.[16]

Table 6.3 — Revenue Parameter Changes

	2006-07 Estimated Result $'million	**2007-08 Budget $'million**	**2008-09 Estimate $'million**	**2009-10 Estimate $'million**
Property related taxes	115	100	110	110
GST revenue grants	15	85	150	197
Health – recognition of unbudgeted revenue	70	72	74	75
Commonwealth SPP's	64	108	45	41
Royalties	20	6	20	41
Distributions from PNFCs and PFCs	(13)	(42)	(30)	(7)
Other	91	78	123	132
Total	**362**	**407**	**492**	**589**

Operating Expenses

Table 6.2 shows that parameter effects are estimated to add operating expenses of $1.1 billion over the four years to 2009-10.

Policy spending decisions have the lesser effect on estimated results, adding $1 billion to operating expenses over the four year period.[17]

Some of these increases are offset by the use of provisions set aside in the 2006-07 Budget and mid-year Budget review.

6.3 PUBLIC NON-FINANCIAL CORPORATION SECTOR – OPERATING STATEMENT

The 2007-08 Budget projects a deficit in 2007-08 of $12 million ($79 million 2006-07) for the net operating balance and a net borrowing result for the public non-financial corporation (public trading enterprises) of $75 million ($137 million 2006-07). Both are lower than the estimated results for 2006-07 due mainly to increases in budgeted GFS revenue.

[16] Budget Statement 2007-08, Budget Paper 3, Table 1.9 and 2006-07 Mid Year Budget Review, Table 1.6.

[17] Policy details are in Budget Statement 2007-08, Budget Paper 3, Tables 2.3-2.14.

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

Table 6.4 — GFS - PNFC Budget Comparison 2006-07 and 2007-08

	2006-07 Estimated Result $'million	2007-08 Budget $'million	Difference $'million	Difference Percent
GFS Revenue				
Sales of goods and services	1 304	1 336	32	2.5
Other	638	671	33	5.2
Total Revenue	1 941	2 007	66	3.4
Less: **GFS Expenses**				
Gross operating expenses	1 326	1 373	47	3.5
Other expenses	694	647	(47)	(6.8)
Total Expenses	2 020	2 019	-	-
GFS Net Operating Balance	(79)	(12)	67	(84.8)
Less: **Net Acquisition of Non-Financial Assets**				
Purchases of non-financial assets	434	497	63	14.5
Less: Sales and depreciation	376	434	58	15.4
Total Net Acquisition of Non-Financial Assets	58	63	5	8.6
GFS Net Lending (Borrowing)	(137)	(75)	62	(45.3)

Note: Totals may not add due to rounding.

6.4 NON-FINANCIAL PUBLIC SECTOR – OPERATING STATEMENT

The result for the non-financial public sector reflects the combination of the general government and public non-financial corporation sectors. The budgeted result for the non-financial public sector is net borrowing of $503 million, that is a deterioration of $190 million from the 2006-07 estimated result as previously explained.

6.5 A LONGER TERM PERSPECTIVE OF FINANCIAL PERFORMANCE

The following sections provide additional details on individual elements of the GFS general government sector Operating Statement in a historical perspective.

6.5.1 General Government Sector Operating Statement Time Series

Table 6.5 provides a 10 year time series for those individual elements that contribute to the budget result.[18]

[18] Time series data for all sectors are available in the Appendices to the Budget Statement 2007-08, Budget Paper 3.

Table 6.5 — GFS - General Government Sector Operating Statement - Time Series

	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11
						Estimated				
	Actual	Actual	Actual	Actual	Actual	Result	Budget	Estimate	Estimate	Estimate
GFS Revenue	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**
Taxation revenue	2 193	2 431	2 806	2 941	2 979	3 215	3 243	3 324	3 435	3 559
Current grants	4 485	4 638	4 906	5 206	5 556	5 684	6 089	6 294	6 436	6 643
Capital grants [(a)]	228	209	191	212	221	242	298	257	302	245
Sales of goods and services	902	997	1 165	1 244	1 333	1 439	1 505	1 563	1 621	1 685
Interest income	131	146	172	161	147	176	170	168	174	184
Distributions from PFCs	50	332	96	125	116	31	22	22	24	24
Distributions from PNFCs	241	300	373	322	459	431	365	399	392	423
Other	308	293	246	382	431	447	448	462	484	476
Total Revenue	8 538	9 346	9 955	10 592	11 242	11 665	12 140	12 489	12 868	13 240
***Less:* GFS Expenses**										
Gross operating expenses										
Employee expenses	3 828	3 997	4 313	4 649	5 124	5 409	5 702	5 845	6 016	6 187
Depreciation	390	401	435	453	454	498	497	543	575	604
Other operating expenses	2 270	2 126	2 305	2 805	2 808	3 065	3 107	3 079	3 195	3 362
Nominal superannuation interest expense	244	299	354	351	344	315	282	282	282	281
Other interest expense	272	297	253	248	223	213	214	231	253	268
Current transfers	1 663	1 724	1 894	1 824	1 975	2 019	2 216	2 217	2 122	2 171
Capital transfers	44	54	16	38	112	107	92	87	89	89
Total Expenses	8 713	8 898	9 570	10 368	11 040	11 627	12 110	12 284	12 532	12 962
GFS Net Operating Balance	(174)	448	385	224	202	38	30	205	336	278
***Less:* Net Acquisition of Non-Financial Assets**										
Purchases of non-financial assets	508	474	530	695	717	811	1 021	1 197	1 168	1 265
Less: Sales of non-financial assets	171	41	124	119	144	99	66	66	91	69
Less: Depreciation	390	401	435	453	454	498	497	543	575	604
Add: Change in inventories	3	2	(10)	(18)						
Total net acquisition of non-financial assets	(50)	34	(38)	105	119	214	458	588	502	592
GFS Net Lending/(Borrowing)	(124)	414	424	119	83	(176)	(428)	(383)	(167)	(314)

Note - Totals may not add due to rounding.

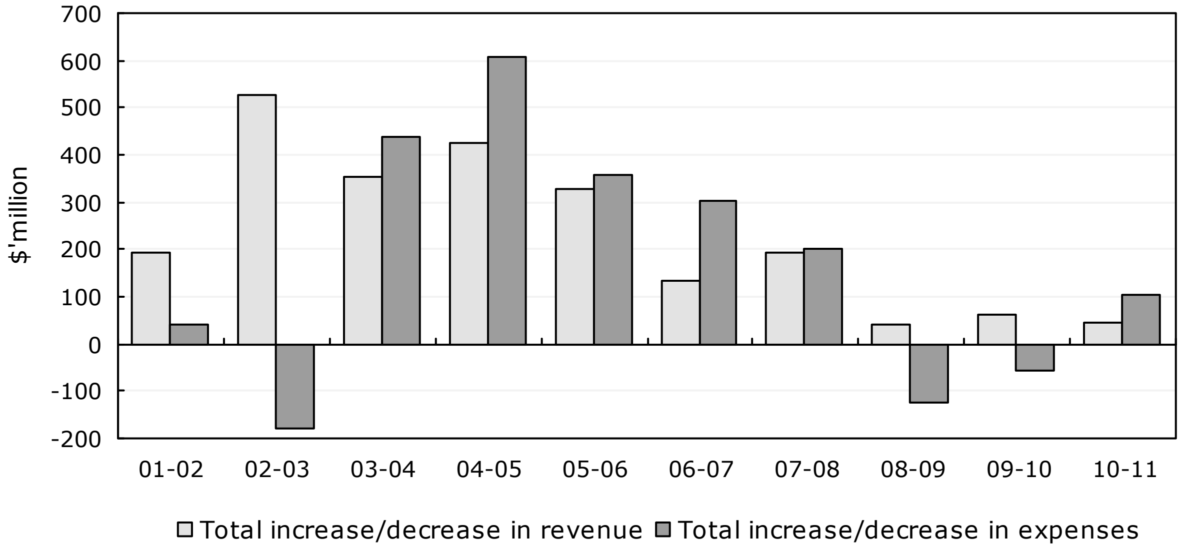
(a) Capital grants prior to 2002-03 are reported separately for the first time.

6.5.2 Net Operating Balance Influences

Net operating balances are a primary fiscal target. It is important to consider how the net operating balance, determined by GFS revenues less GFS expenses, is proposed to be achieved.

The following chart shows the increase or decrease, in real terms, of total revenue and total expenses to the previous year for the 10 years to 2010-11.

Chart 6.1 — Increase/Decrease of Total Revenue and Total Expenses to Previous Year [(a)]



(a) Estimated June 2007 values.

It can be seen that total revenues increased or are estimated to increase in real terms by varying amounts in every year over the period, although at much lower levels in the forward estimate years than earlier years.

In the six years to 2006-07, only in 2002-03 is there a decrease in expenditure in real terms. The 2007-08 Budget projects decreases in real terms in expenses in 2008-09 of $124 million and $56 million in 2009-10 before increasing by $105 million in 2010-11.

The projected current operating surplus for the four years of the 2007-08 Budget is therefore subject to highly constrained expenditure. This was the case in the past two budgets which forecast real terms decreases in expenses for those budget years but was not achieved.

The chart shows that low growth or reductions in expenses have not been achieved since 2002-03 and indeed that growth in revenues has reduced the risk of expenditure increases to the budget bottom line.

7 REVENUE

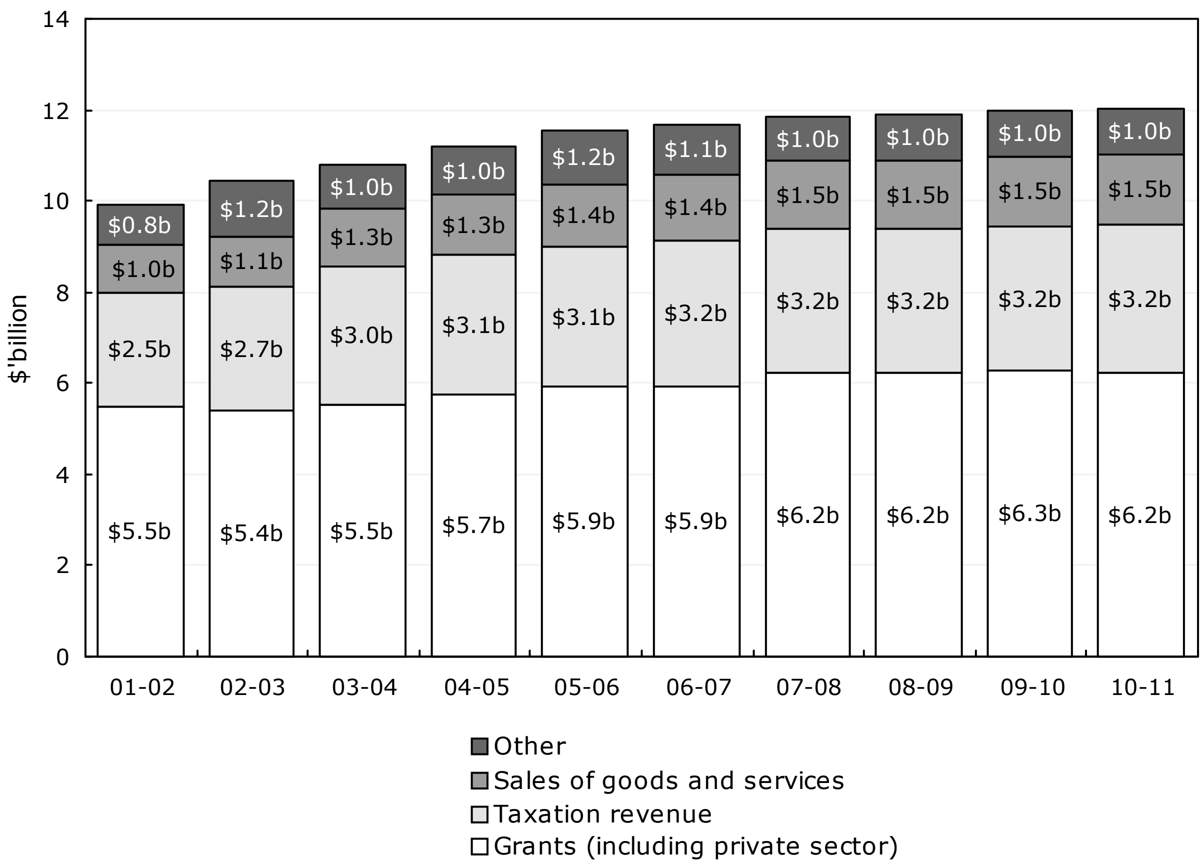
7.1 REVENUE OVERVIEW

Total general government sector GFS revenues are estimated to be $12.1 billion in 2007-08, an increase of $475 million (4.1 percent) over the previous year's estimated result.

General government sector GFS revenues are estimated to rise to $13.2 billion in 2010-11.

The makeup of GFS revenue and trends in real terms are illustrated in the following chart.

Chart 7.1 — General Government Sector GFS Revenues (Real)[(a)]



(a) Estimated June 2007 values.

Notable trends for revenue are:

- There were very significant changes to the composition and amount of revenue in the period up to 2004-05 due mainly to national tax reform.
- As from 2004-05 to the end of the forward estimate period in 2010-11 the level and composition of GFS revenue is projected to remain fairly stable in real terms.
- The State is reliant on Commonwealth grants. They represent 51 percent of total revenue.

The following commentary provides some additional analysis of the main revenue areas. Detailed commentary is provided in Chapter 3 of Budget Statement 2007-08.

7.1.1 Commonwealth Grants

From 1 July 2000, foremost in the changes in the composition of revenue was the effects of the national tax reform and revised Commonwealth-State funding arrangements. Under these arrangements some State taxes have been abolished or reduced. These losses to the State are compensated by Commonwealth funding in the form of GST revenue grants and, up to 2002-03, transitional grants.

GST revenues are expected to be a growth tax. This has proven to be the case and national tax reform is estimated to provide revenue benefits to the State.[19]

Total estimated Commonwealth funding to the State for 2007-08 is $6.3 billion. Funding in 2010-11 is expected to grow to $6.8 billion, (51 percent of GFS revenues) a real increase of $335 million over 2006-07.

While Commonwealth funding is the foundation of State finances, it is not controllable by the State.

7.1.1.1 General Purpose Payments

General purpose payments (GPPs) are GST revenue grants. GPPs are distributed according to the principle of horizontal fiscal equalisation (HFE). The principle of HFE is based on Australia's commitment to ensuring that each State has the capacity to provide public services at a similar standard and level of efficiency as the other States for a comparable revenue-raising effort.

Over the forward estimates, GPPs are expected to grow from $3.9 billion in 2007-08 to $4.5 billion in 2010-11, a real increase of $454 million from 2006-07.

7.1.1.2 Specific Purpose Payments

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

Over the forward estimates, SPPs are expected to reduce from $2.4 billion in 2007-08 to $2.3 billion in 2010-11, a real decrease of $119 million from 2006-07. The Commonwealth committed to not cutting aggregate SPPs as part of the national tax reform arrangements. The Budget Papers show that this commitment is being met in real per capita terms.[20]

7.1.2 Taxation Revenue

Taxation revenue is the second largest source of revenue to the State and represents approximately 28 percent of GFS revenues in 2006-07. Taxation revenue comprises collections from a diverse range of activities, including payroll, property, motor vehicles and gambling activities.

---

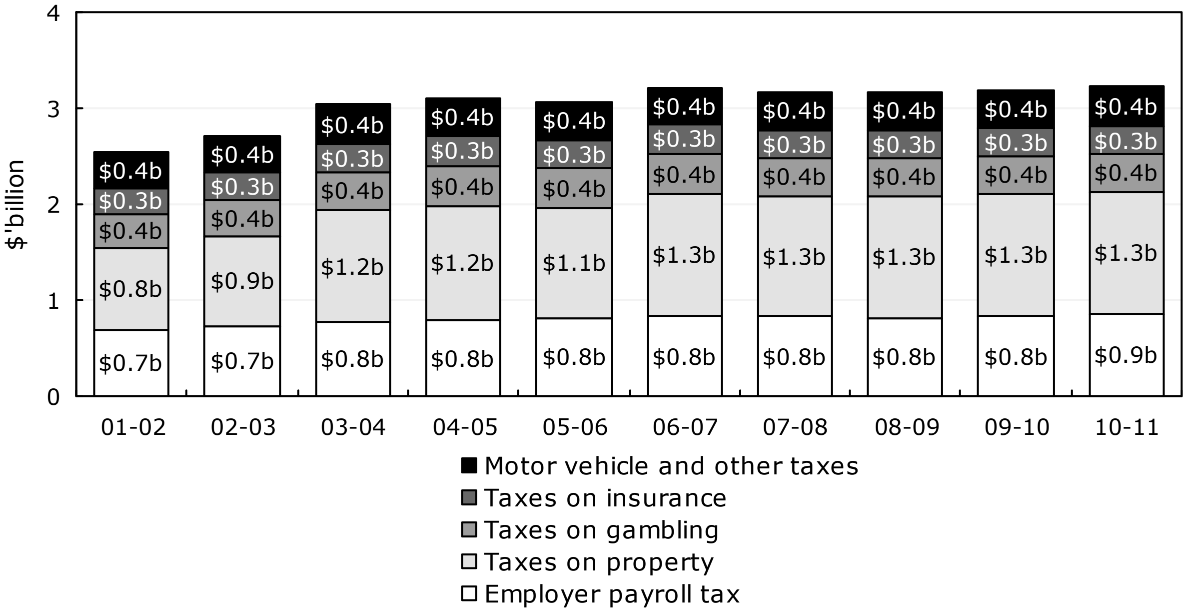
[19] Budget Statement 2007-08, Table 4.3

[20] Budget Statement 2007-08, p 4.10

The Government has a fiscal strategy to ensure the State has an effective tax regime having regard to the Government's social and economic objectives. Considerations in relation to the State's capacity to raise taxation revenue include the capacity of taxpayers to pay and the State's relative tax effort compared to other states and territories.[21]

The following chart examines the trend in the components of taxation receipts (in real terms) over the ten year period to 2010-11.

Chart 7.2 — Taxation Revenue (Real) [(a)]



(a) Estimated June 2007 values.

The chart demonstrates that up to 2005-06 variations in taxation revenue were primarily due to property taxes. Total taxes, in real terms, fall in 2007-08 and rise slightly over the remaining forward estimates period.

Taxation receipts for 2007-08 are estimated to be $3.2 billion, a nominal increase of $28 million over the estimated result for 2006-07.

Taxation revenue is expected to be $3.6 billion in 2010-11, a real increase of only $12 million compared to $3.2 billion in 2006-07.

7.1.2.1 Property Taxes

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

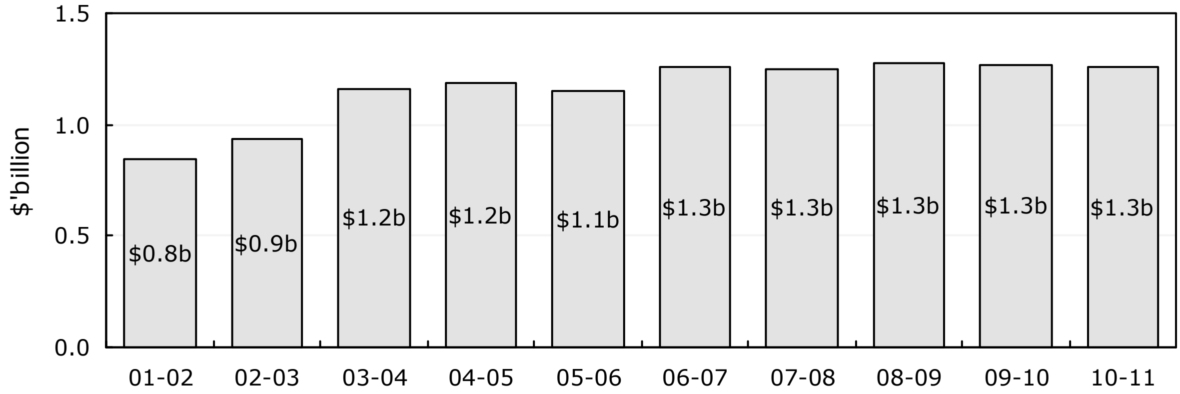
Property taxes for 2007-08 are estimated to be $1.3 billion, a real decrease of $10 million from the estimated result for 2006-07, reflecting allowance for modest growth in property prices and the number of property sales, offset by negative compositional effects in the non-residential sector of the property market.

Property taxation revenue is expected to be $1.4 billion in 2010-11, a real decrease of $3 million compared to 2006-07.

[21] Budget Statement 2007-08, pp 3.16-3.18 discusses South Australia's relative taxation effort.

The following chart shows the trend in property taxes (in real terms).

Chart 7.3 — Taxes on Property (Real) [(a)]



(a) Estimated June 2007 values

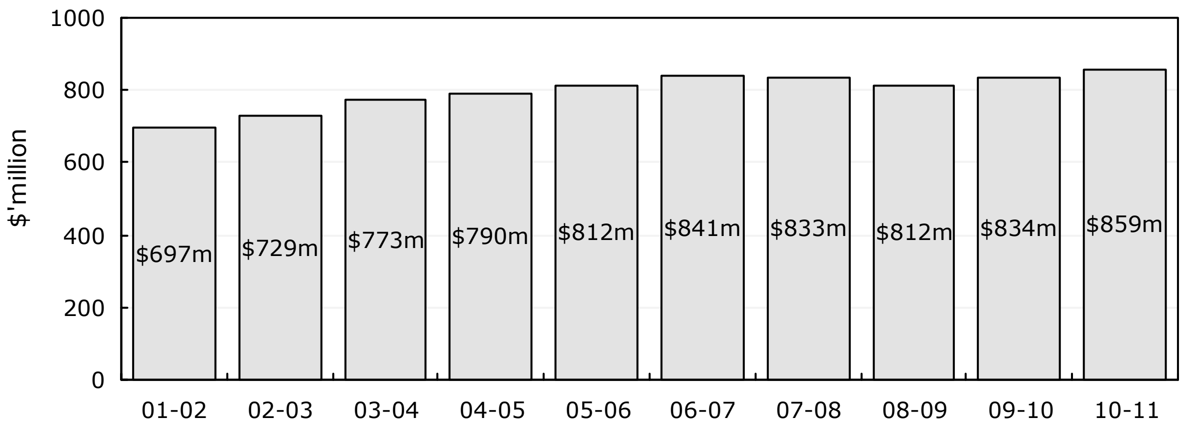
The chart shows the resilience in property taxes, in real terms.

The trend in the forward estimates period reflects an expectation of modest price growth and that turnover will grow more strongly in 2008-09 and 2009-10 before returning to growth consistent with the long–term trend.

7.1.2.2 Payroll Tax

Payroll tax continues to be a principal source of taxation revenue. Chart 7.4 shows payroll tax revenue is anticipated to increase in real terms over the forward estimates.

Chart 7.4 — Employer Payroll Tax (Real) [(a)]



(a) Estimated June 2007 values

Payroll taxes for 2007-08 are estimated to be $853 million, a real decrease of $8 million from the estimated result for 2006-07. The payroll tax rate will be reduced from 5.5 percent to 5.25 percent from 1 July 2007 and reduced further to 5 percent from 1 July 2008. In addition, payroll tax reforms will be introduced from 1 July 2008 to harmonise legislative and administrative arrangements with other jurisdictions.

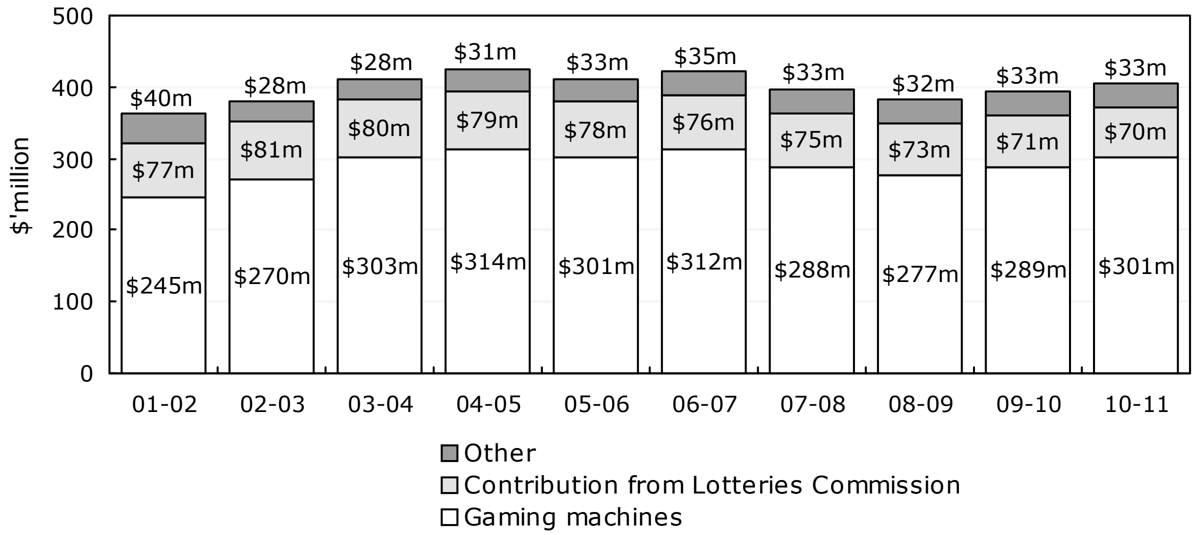
Payroll taxes are expected to be $947 million in 2010-11, a real increase of $18 million compared to 2006-07.

7.1.2.3 Gambling Taxes

Gambling taxes for 2007-08 are estimated to be $405 million, a real decrease of $27 million from the estimated result for 2006-07. Gambling taxes are expected to be $445 million in 2010-11, a real decrease of $20 million compared to 2006-07.

The following chart shows the trend in gambling taxes (in real terms).

Chart 7.5 — Gambling Taxes (Real) [(a)]



(a) Estimated June 2007 values

Gaming machine revenues, which account for 74 percent of 2006-07 gambling taxes, are expected to decline in 2007-08 and 2008-09 reflecting the expected impact of 100 percent smoking bans in gaming venues from 31 October 2007.

7.1.3 Sales of Goods and Services

Revenue from sales of goods and services represented about 12 percent of estimated GFS revenues in 2006-07. Sales of goods and services by the general government sector include Government fees and charges which are projected to grow at rates ranging from 3.7 percent to 4.6 percent per annum, reflecting the annual indexation of fees and underlying volume growth.

Revenue from sales of goods and services is fairly stable over the forward estimates period (increasing from $1.47 billion in 2007-08 to $1.53 billion in 2010-11 (real terms).

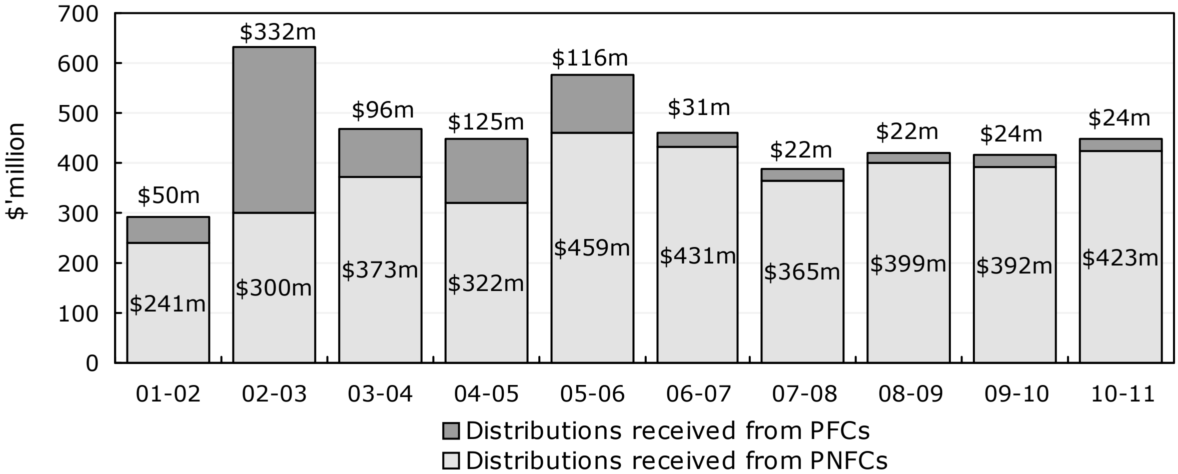
7.1.4 Other Revenue

The more significant components of Other revenue are the distributions received from public non-financial corporations (PNFCs) and, in recent years, public financial corporations (PFCs), which comprise essentially tax equivalent payments, dividends and returns of accumulated capital. Distributions from PNFCs and PFCs, are significant not only in terms of their size, but because in past years they provided an opportunity for the Government to 'manage' the bottom line given their discretionary nature. This flexibility is limited essentially only by amounts available.

As the distributions come from two other GFS sectors, on a consolidated financial reporting basis, these distributions are internal transfers and have no effect on an annual consolidated operating result. On the GFS sector basis, transfers are recorded as revenue in the general government sector.

Chart 7.6 shows the trend in distributions received from PNFCs and PFCs for the 10 years to 2010-11.

Chart 7.6 — Distributions Received by the General Government Sector (Nominal)



The chart highlights the variability of revenue from PNFC and PFC distributions over the period.

7.1.4.1 Public Non-Financial Corporations

In 2006-07, distributions received from PNFCs are estimated to amount to $431 million, a decrease of $28 million (6 percent) from the previous year's result and $26 million (6 percent) under budget. The decrease mainly reflects lower dividend payments from South Australian Water Corporation and Land Management Corporation.

The decreased distribution from South Australian Water Corporation reflected the impact of the drought. The decreased distribution from Land Management Corporation reflected lower joint venture distributions and a lower volume of land sales to the Port Adelaide Maritime Corporation.

7.1.4.2 Public Financial Corporations

Up to 2006-07, the main source of revenue from PFCs was from the SAAMC and SAFA.

As seen in Chart 7.6, distributions from PFCs have varied greatly from year to year entirely at the discretion of the Government of the day. As noted in past Reports, after large distributions up to 2005-06 reduced their capital and reserves, budgeted PFC distributions are now at low levels.

Distributions from PFCs are budgeted to be $21.7 million in 2007-08[22] and around $23 million thereafter.

As at 30 June 2007 SAFA's capital and reserves totalled $272 million (including $90 million from amalgamation of the former SA Government Captive Insurance Corporation) and SAAMC's capital and reserves was $65 million.

After distributions, SAFA's total capital and reserves are estimated to increase to $297 million, and increase SAAMC's capital and reserves to around $76 million.

[22] Budget Statement 2007-08, Budget Paper 3, Table 3.18.

7.2 RISKS TO REVENUE

The Budget Statement 2007-08 provides quite detailed consideration of various risks to the amount and the flexibility of the revenue budget. Included in the risk analysis is:

- ***Taxation and Royalties*** — a variance of 1 percent in taxation and royalty revenue equates to about $34 million per annum.
- ***Commonwealth General Purpose Grants*** — A variance of 1 percent in GST revenue growth has a revenue impact of $36 million per annum.

  Commonwealth GPPs are the vehicle for horizontal fiscal equalisation (HFE). The methodology and data underlying the HFE process is determined by the Commonwealth Grants Commission. Methodology changes may impact on the State, either positively or adversely.

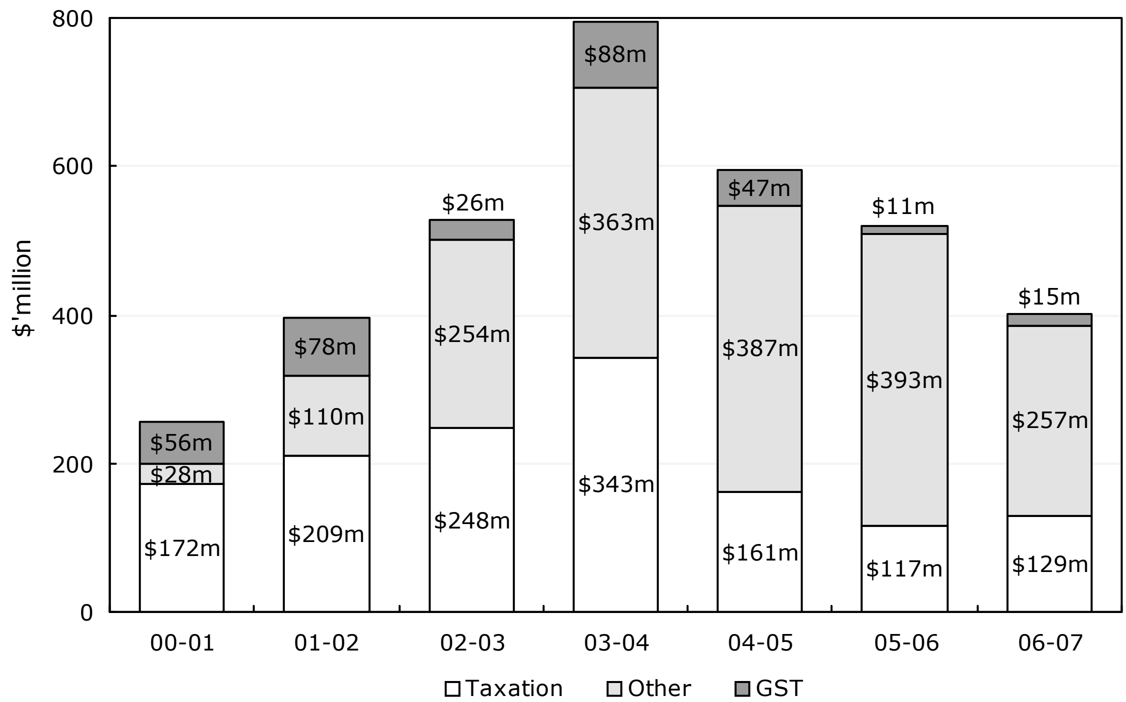
  A 0.01 change in South Australia's GST relativity results in a change in GST revenue grants of $34 million.
- ***Commonwealth Specific Purpose Grants*** — Funding levels of SPPs are exposed to the risk of variability in the parameters that determine funding levels and variability in Commonwealth policy settings.

Readers are referred to the Budget Statement 2007-08, Budget Paper 3, Chapter 7 for the full details.

7.2.1 Past Revenue Outcomes

Notwithstanding the risks to the revenue budget, to provide a recent historic context, the following chart shows the difference between budgeted and actual GFS revenue for the past six years.

Chart 7.7 — GFS - Difference Between Budget and Actual Revenues*



* 2006-07 estimated result

The chart highlights the very large favourable variations from budget that have been enjoyed up to 2006-07.

8 EXPENSES

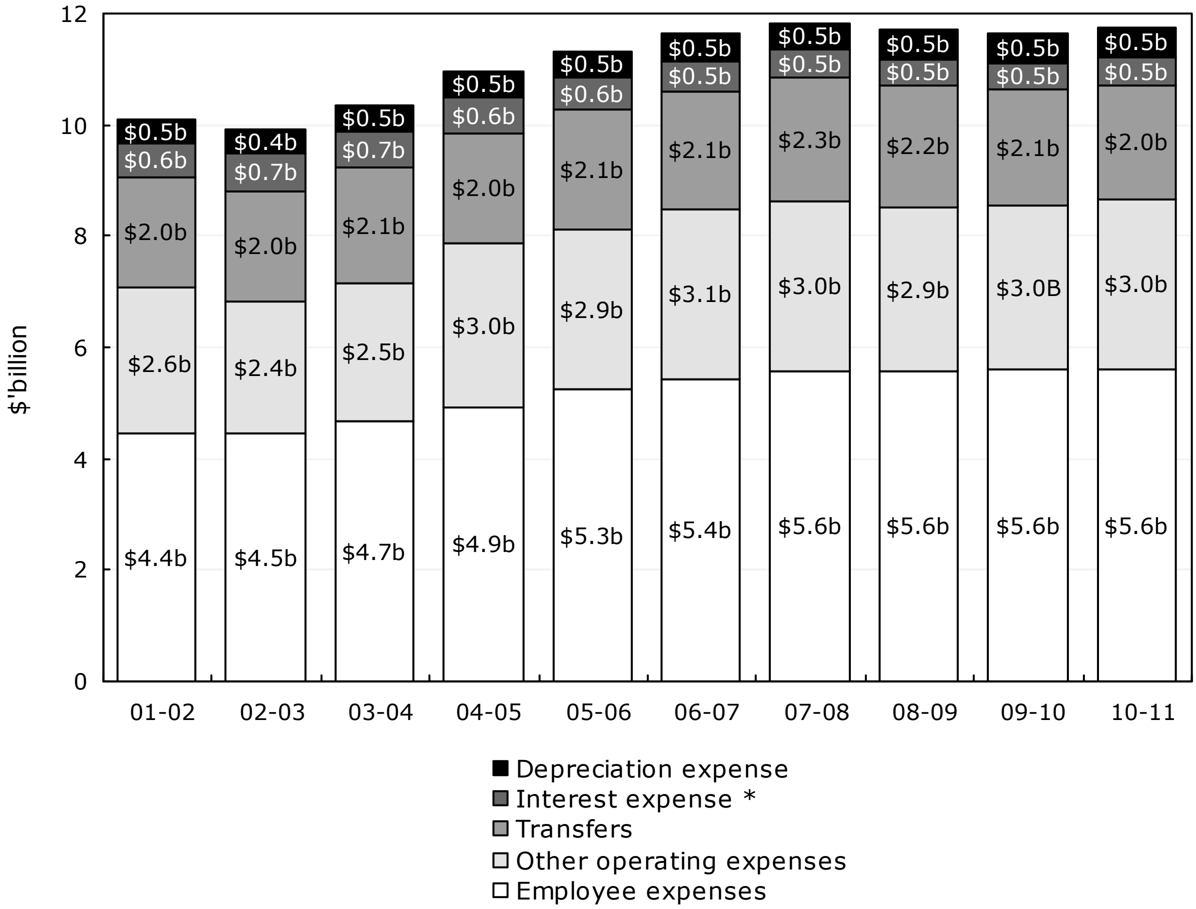
8.1 EXPENSES OVERVIEW

For 2006-07 estimated GFS expenses total $11.6 billion and exceed budget by $454 million or 4.1 percent.

Total GFS expenses for 2007-08 are budgeted to be $12.1 billion, $483 million or 4.2 percent higher than 2006-07 and grow to $13 billion in 2010-11, a real increase of 1.1 percent from 2006-07.

The following chart highlights the trends in GFS expenses (in real terms) that have emerged since 2001-02.

Chart 8.1 — GFS - General Government Sector - Expenses (Real) [(a)]



(a) Estimated June 2007 values.
* Includes nominal superannuation interest expense.

The chart shows GFS expenses (in real terms) grew annually from 2002-03 to 2006-07 but are projected to remain relatively stable over the forward estimate period.

The following discussion focuses on some of the major components that make up GFS expenses. Detailed comments on expenditure are provided in Budget Statement 2007-08, Budget Paper 3, Chapter 2.

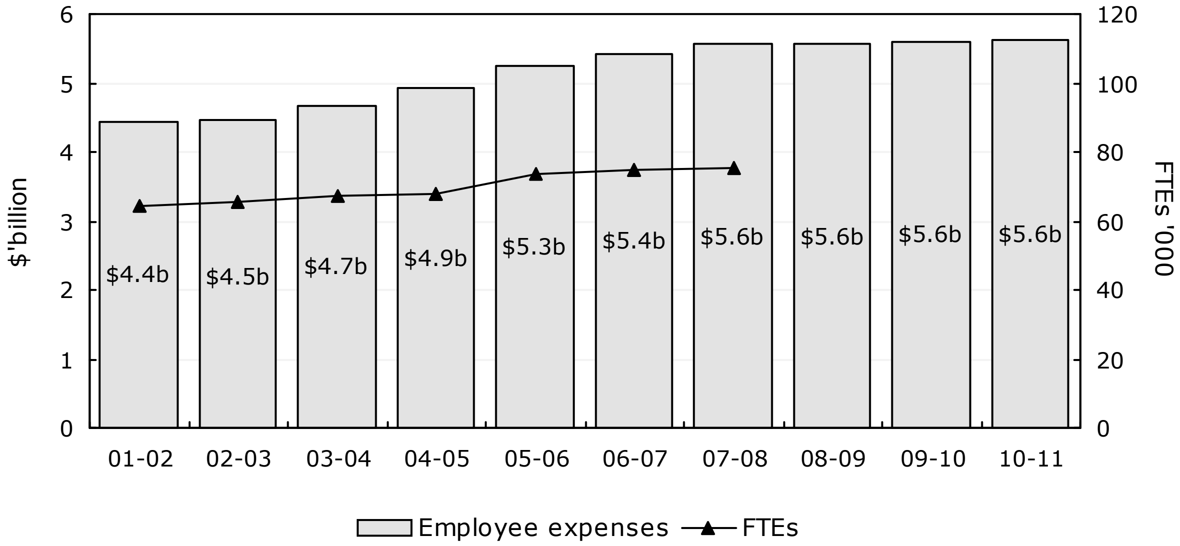
8.2 EXPENSES BY TYPE

8.2.1 Employee Expenses

Employee expenses (an estimated $5.4 billion in 2006-07) represent the highest proportion (46 percent) of GFS expenses. They are estimated to increase by 5.4 percent in 2007-08 and about 2.8 percent per year to 2010-11.

The following chart shows employee expenses in real terms and available full time equivalent (FTE) data from the Office of Public Employment (OPE) and Department of Treasury and Finance estimates.

Chart 8.2 — GFS - General Government Sector – Employee Expenses (Real) and FTEs[(a)]



(a) 2006-07 and 2007-08 are Department of Treasury and Finance estimates. OPE data is derived for the sector and is the best available information for the periods shown.

The chart highlights the real terms growth in employee expenses right across the period charted. This growth is consistent with FTE numbers up to 2007-08.

Real terms growth in employee expenses is a combination of any award increases above CPI and the increase in FTEs.

In the four years to 2006-07 employee expenses grew by an average of 7.9 percent per year. The 2007-08 Budget projects employee expenses to grow in real terms on an average of 1 percent, a much lower rate than in prior years.

The 2007-08 Budget provides for anticipated public sector wage increases over the forward estimates period, both in individual agency budgets, and as a contingency item in the 'Administered Items for Department of Treasury and Finance' to cover future enterprise agreement outcomes. The 2007-08 Budget includes contingency amounts of $16 million for employee entitlements, $4 million less than was included in the 2006-07 Budget. The reduction is partly explained by the settlement of number of enterprise agreement outcomes during 2006-07 (wages parity salaried and weekly paid groups). Contingency funds may also be transferred from other lines where available (see following section on operating expenses) if necessary. The inclusion of contingencies is a consistent approach to previous Budgets.

The major risk to the Budget and, in particular the forward estimates, is the outcomes from enterprise agreements and control of FTE numbers. The main enterprise agreements to be renegotiated in 2007-08 are for:

- South Australian Ambulance Service
- nurses
- police
- salaried medical officer
- executives
- metal and building trades employees.

8.2.2 Other Operating Expenses

Other operating expenses include general purchases of goods and services.

These expenses are estimated to be $3.1 billion for 2007-08, an increase of $42 million or 1.4 percent in nominal terms from 2006-07.

The projection for the forward years to 2010-11 is for no real growth in other operating expenses.

Contingency amounts have also been incorporated into the budget to provide some flexibility if additional expenditure is required to be made by the Government. The 2007-08 Budget includes contingency amounts of $83 million for supplies and services, $20 million less than was included in the 2006-07 Budget.

Under revised forward estimates indexation policy, agencies are required to absorb within their existing budget allocations, any cost increases above the standard 2.5 percent indexation, unless the increase has a material effect on the agency budget. The materiality test is where a price change altered the overall agency price indexation by more than 0.5 percentage points above or below the standard 2.5 percent indexation. Given the revised treatment of inflationary impacts on agencies, there would be no budget impact from consumer price movements other than additional agency expenditure arising from large one-off inflationary impacts for particular expenditure items.

8.2.3 Transfer Payments

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

- grants to non-government schools, local government and industry;

- appropriations for the South Australian Housing Trust; and

- community service obligation (CSO) payments to the South Australian Water Corporation and Forestry SA.

Transfer payments are estimated to be $2.1 billion for 2006-07, that is, $117 million or 6 percent above budget.

Current transfers are estimated to increase in 2007-08 ($197 million) largely due to payments to be made under the joint Commonwealth/State Exceptional Circumstances drought relief program.

8.2.4 Interest Expense

Estimated interest expense in 2006-07 was $213 million and is projected to increase by 26 percent to $268 million in 2010-11 as a result of projected net lending deficits, to fund capital programs.

Further discussion in relation to debt movements is provided in section '9.6 Net Debt' of this Report.

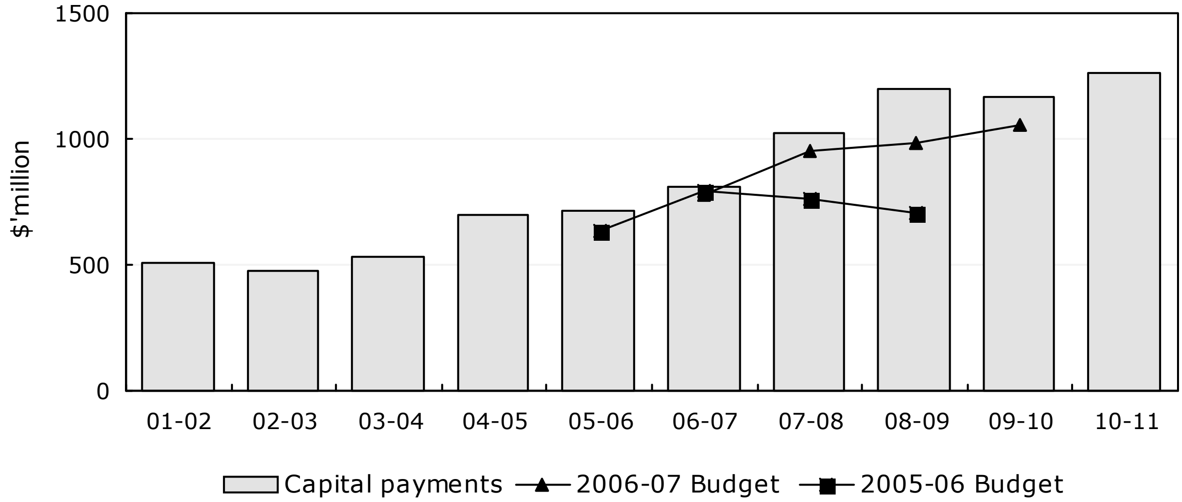
8.2.5 Capital Payments

Capital payments are represented by the value of purchases of non-financial assets in the GFS - General Government Sector Operating Statement.

Purchases of non-financial assets are estimated to be $811 million in 2006-07, increase to $1 billion in 2007-08 and be $1.3 billion in 2010-11.

The following chart shows purchase of non-financial assets over the 10 year period to 2010-11, overlayed with budgeted purchases from the 2005-06 and 2006-07 Budgets.

Chart 8.3 — GFS - General Government Sector Purchase of Non-Financial Assets (Nominal)



The chart shows the variability of the expenditure, both historically and in the forward estimates and the large increases projected for the 2007-08 Budget, particularly compared to that estimated for the 2005-06 Budget which expected capital payments to trend down to 2008-09.

Although there will be components of future expenditure that have effectively been committed, the forward years contain funds contingent on future approvals of between $36 million (in 2007-08) and $441 million (in 2010-11).

Capital payments exclude private sector capital expenditure for public purposes discussed in the next section.

8.2.5.1 Infrastructure Planning

Past Reports have commented that proper infrastructure planning is fundamental to the efficient and effective use of public resources.

The 2007-08 Budget reports that it includes expenditure on major infrastructure projects which form part of the Strategic Infrastructure Plan including:

- major infrastructure development by the Port Adelaide Maritime Corporation to support the Air Warfare Destroyer program;
- development of the Marion Interchange;
- the Northern Expressway;
- the South Road upgrade program.[23]

The Strategic Infrastructure Plan for South Australia, released on 6 April 2005, is currently under mid term review by the Department for Transport, Energy and Infrastructure for the Major Proposals Review Cabinet Committee.

8.2.6 Public Private Partnerships (PPP)

In the 2006-07 Budget, the Government announced substantial PPP projects for the provision of correctional and educational infrastructure for use by the public sector. Work commenced on procuring education (lead agency Department of Education and Children's Services), prison (lead agency Department for Correctional Services) and youth detention infrastructure (lead agency Department for Families and Communities) in 2006-07.

Funds of $1.5 million for the costs of PPP consultants were released from contingency provisions in the Administered Items for the Department of Treasury and Finance during 2006-07.

The 2007-08 Budget reports that Education Works will result in the private sector delivering six new schools in Playford North and the inner north and west areas of metropolitan Adelaide at a cost of around $134 million. The PPP for the construction of new men's and women's prisons at Mobilong, near Murray Bridge, a new secure care facility for youth together with a new pre-release centre at Cavan is a capital investment of around $500 million.

Under current timeframes Expressions of Interest to gauge private sector market interest will be sought in 2007.

The 2007-08 Budget announced the construction of the new $1.7 billion Marjorie Jackson-Nelson Hospital. The Government is considering if this project can be delivered as a PPP. Budgeted expenditure for this project, $212.8 million, is currently showing as investing expenditure.

8.2.6.1 Financial Reporting of PPPs

The use of PPPs alters the financial reporting of costs associated with the construction and operation of relevant infrastructure.

PPPs may, under current accounting standards, be excluded from state Balance Sheets (may be off-Balance Sheet) through their contractual arrangements and assignment of

---

[23] Capital Investment Statement 2007-08, Budget Paper 5, p 3.

risks and benefits. The 2007-08 Budget Papers indicate the possible timing and value of capital expenditure on PPP projects.[24] The main outlays occur in the three years to 2010-11, about $600 million overall. As PPPs, this is capital expenditure incurred by the private sector not the Government. The Government will pay annual service payments for the period of any PPP contracts that will smooth the otherwise lumpy capital payments over many years.

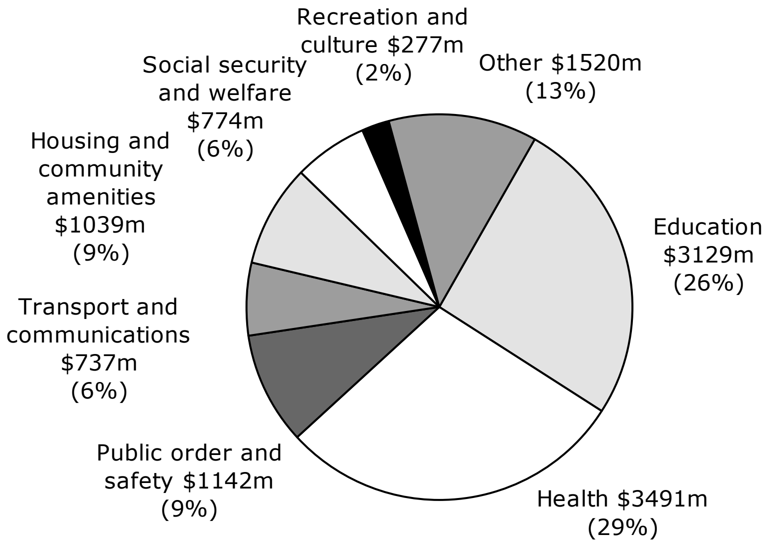
PPP service payments are to recoup the service provider for the provision of accommodation and operational services. Service payments will cover all construction, financing and other operating costs (eg utilities, facilities management and maintenance) and profit margins, and are included in GFS expenses. This means that payments relating to construction costs would be met from GFS revenues under the current policy of achieving at least a net operating balance each year.

Whether PPPs are off-Balance Sheet and how the transactions will be represented in the various financial reports will be a matter to resolve when contractual arrangements are established. A significant consideration of Government in initiating a PPP procurement is whether the PPP provides a net benefit to the public compared to conventional public sector procurement.

8.3 EXPENSES BY FUNCTION

The GFS reporting framework also provides information on expenditure (excluding capital payments) by its function for the General Government Sector. The following charts the 2007-08 Budget expenses and demonstrates the extent to which the health and education sectors dominate the overall expenditure by the State.

Chart 8.4 — GFS - General Government Sector Expenses by Function[25] ($'million)



---

24 Budget Statement 2007-08, Budget Paper 3, Figure 1.3.

25 Budget Statement 2007-08, Budget Paper 3, Table 2.17.

8.4 RISKS TO EXPENSES

8.4.1 Overview

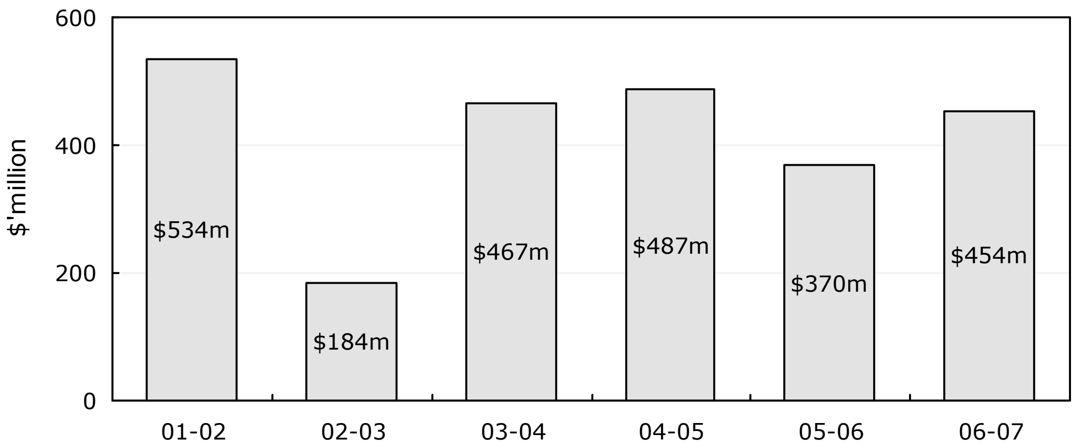
As with revenue, the Budget Statement 2007-08 provides detailed consideration of various risks to the expenditure budget and acknowledges the management task for achieving budgeted outcomes.[26]

Some of the key risks reported are:

- ***Change in service needs*** — demand for services may change as a result of numerous factors including age demographics. A variance of 1 percent in hospital activity increases expenditure by approximately $13 million per year.
- ***Wages and salaries*** — An increase of 1 percent per annum above the amounts factored into the Budget would have an adverse impact of approximately $190 million in 2010-11.
- ***Capital Investment Pressures*** — A number of departments including Health and Transport, Energy and Infrastructure have large capital investment programs over the forward estimates period. Historically there has been considerable cost escalation compared with original projections. As raw material prices increase and all states embark on significant infrastructure programs this risk increases. If cost escalations exceed the amounts included in the capital investment program, annual net lending outcomes will be impacted.

To provide a recent historic context, the following chart shows actual outcomes against estimates for GFS expenses for the past six years.

Chart 8.5 — Difference between Budget and Actual GFS Expenses [(a)]



(a) 2006-07 is the difference between budget and the estimated result.

The chart highlights that, notwithstanding classification changes, expenses have consistently exceeded original budget GFS expense targets in the last five years.

8.4.2 Savings

The 2007-08 Budget identifies operating savings over four years of $202 million and revenue offsets of $22 million. These come on top of 2006-07 Budget savings identified

[26] Budget Statement 2007-08, Budget Paper 3, p 7.6

by agencies, based on either achieving efficiency or reducing particular services, totalling $695 million over four years to 2009-10. A summary of the total savings initiatives for all departmental portfolios for the three years to 2009-10[27] is as follows:

Table 8.2 — Summary of Budget Savings

	2007-08 $'million	2008-09 $'million	2009-10 $'million
Total Savings 2006-07 Budget	148	223	277
Total Savings 2007-08 Budget	10	45	64
Total Savings	158	268	341

The savings in Table 8.2 are in addition to the $58 million savings initiatives included in the 2005-06 Budget for the 2006-07 to 2008-09 forward years.

8.4.3 Nature of Savings Initiatives

The 2006-07 Budget provided a thorough account of proposed savings and revenue initiatives allowing any reader a detailed knowledge of the description of these initiatives.

The major savings initiatives included:

- the implementation of shared services arrangements which aim to save $130 million over four years (including savings from Future ICT and associated changes) but involve implementation costs of $60 million;
- savings from an efficiency dividend which are designed to save $128 million over the forward estimates period;
- departmental efficiencies with combined savings of $47 million over four years; and,
- identified savings as a result of proposed structural changes to government totalling $40 million over four years.

The 2007-08 Budget operating savings essentially arise in health and family and community services.

8.4.4 Savings Initiatives – DAIS

The 2006-07 Budget noted 'A significant savings measure arising from the Review of Priorities is the proposed abolition of the Department for Administrative and Information Services' (DAIS).

The activities of DAIS were transferred to four recipient agencies, mainly the Department for Transport, Energy and Infrastructure and the Department of Treasury and Finance as of 1 January 2007. Comments on structural reform savings follow below.

[27] Note, as mentioned in subsection 2.6.1.1 of this Report, some 2006-07 savings initiatives were reversed or delayed.

8.4.5 Savings Initiatives – Shared Services

The shared services initiatives are estimated to add net savings of $70 million, after implementation costs, over four years.

The Shared Services Reform Office (SSRO) was established in 2006-07 to develop and implement shared services across government. The estimated cost of the program for 2006-07 was $3.8 million at the time of the 2007-08 Budget. Budgeted expenses for the Office in 2007-08 are $28 million.

SSRO has identified five planning phases - information gathering, strategy development, detailed design and development, implement and migrate, operate and improve.

The SSRO is concurrently working on the information gathering and strategy development phases, which include developing the initial scope of services, program feasibility, a high level operating model, transition and workforce strategy.

The shared services initiative is a complex project. Significant elements to its success are the governance arrangements established for implementation; identifying, assessing and managing implementation risks; planning, having or developing skilled resources and appropriate support systems; procurement management; communication processes; and implementing new or revised control environments while at the same time maintaining efficiency in service outcomes.

In view of the early stage of implementation of the project, Audit plans to undertake the review of aspects of the progress of this initiative during 2007-08.

8.4.6 Budget Monitoring and Reporting

Monitoring of progress against Budget targets to enable a timely response to any significant issues arising, is a vital element in managing budget risk.

In 2006-07, in response to an audit inquiry on budget monitoring processes, the Department of Treasury and Finance (DTF) advised that a number of strategies are undertaken to control and monitor agency budgets. They include:

- monthly reporting by agencies of year to date budget outcomes and revisions to expected end of year outcomes allowing monitoring and action on over and underspending by DTF, the Treasurer and the Expenditure Review and Budget Cabinet Committee (ERBCC);

- quarterly reporting of progress of achieving budget initiatives through DTF to ERBCC. Specific reporting whereby portfolios will classify each amount in relation to whether the Budget initiative is proceeding or whether the initiative is at risk;

- reporting by agencies on the status of their Capital Investment Program at the project level as at the end of October, December and February through DTF to ERBCC;

- a carry over policy to identify under expenditure by agencies allowing Cabinet to approve carryovers or redirect funds. The carry over system categorises carry over requests as not approved, approved or conditional;

- a cash alignment policy to ensure agencies do not build up excessive cash balances to fund unauthorised expenditures (see section 11 in this Part of the Report);

- an end of year process where agencies and DTF meet to discuss financial performance and identify improvements as necessary.

Budgets can only be changed with appropriate approval. Changes to budget results are approved by the Treasurer, ERBCC or Cabinet.

8.4.7 Audit Review of Budget Monitoring and Reporting

Audit reviewed aspects of the DTF and ERBCC budget monitoring process for 2006-07. The following summarises processes observed and/or advised. The audit review focussed on the processes and evidence of completion of the process. It did not address the reliability of reported data. Agency audits in 2006-07 identified certain agency specific issues with budgetary management where improvement was needed. Agency reports in Part B of this Report includes comments, where applicable, on these matters.

Review of the DTF and ERBCC budget monitoring process highlighted the following:

- Reporting on operating and capital budget positions and 2006-07 budget initiatives was in place.

- Monthly monitoring reports were prepared for departments summarising the year to date and end of year estimated positions with commentary on key points on the projected positions and main points influencing the projections.

  A summary report was prepared for the ERBCC consolidating year to date and projected year end for all portfolios.

- Agencies were required to submit a quarterly 'Monitoring of Budget Initiatives' return certified by a responsible officer eg senior financial officer. Initiatives were classified eg at risk/delayed or expected success and comments provided.

  A detailed consolidated report was prepared as at December 2006 and March 2007 for each initiative within classifications of complete, expected success, at risk/delayed, not proceeding. As at May 2007 – reporting on the year to March 2007 - no initiatives were categorised as not proceeding.

It was evident from the summaries to March 2007 that there was a need for improvement of data quality in some areas. This was reflected by the degree of change in projected budget positions during the year and the variation between month to date data and projected end of year data. Information quality for the majority of agencies was consistently rated by DTF as medium and low on a high to low scale.

The overall end of year projections for 2006-07 were mainly affected by two agencies being Department of Health and Department for Families and Communities. This is consistent with appropriation variations for cost pressures experienced in those agencies. See section 11 in this Part of the Report.

Reporting was to be provided to ERBCC for the completed year. The report is prepared from completed agency financial reports for the financial year. At the time of this Report that information was not available.

As part of the Audit review process, some further specific inquiries were made in July 2007. The topics and responses from the Under Treasurer follow:

- Agency under expenditures and carry overs for 2006-07 – Cabinet approved two changes to the carry over policy in 2006-07.

  Firstly, carry overs that meet one of four specific categories are now automatically approved. Documentation of requests demonstrating compliance with criteria and expenditure authority records must be maintained. Secondly, agencies were to be permitted to carry over, for one year only, any net under expenditure after approved carryovers. The impact of carryovers for 2006-07, after reversing slippage allowances, was $23.6 million unfavourable for net operating balance and $23.1 million unfavourable for net lending.

- Sufficiency of contingency provisions for salaries and wages in 2006-07 – the provision was initially estimated to be under by $9 million and was therefore revised upward. In the event $3 million was not required.

- Monitoring system – status of initiatives/implementations costs – the majority of savings initiatives are on track for 2007-08 and forward years. Tranche 1 of Future ICT was complete and savings of $25 million per annum were assigned as adjustments to the general government sector agency budgets in early 2007-08. $4.5 million of structural savings were not achieved due to delays but 2007-08 and forward year savings were expected and had been allocated to agencies. Savings from printing and publications, motor vehicles and office accommodation were not achieved and/or proceeding. For motor vehicles this was to support local industry. Accommodation savings would be pursued as opportunities arise.

- Monitoring system changes – only slight amendments of variance and initiative monitoring would occur to ensure appropriate explanations were provided and ongoing measures included. FTE monitoring had been recently introduced. FTE and FTE cap variances are required from agencies by the 5th of each month.

As noted, final 2006-07 data was not available at the time of this report. That data and the advised amendments to monitoring processes will be considered in the course of 2007-08, together with agency processes, as necessary, for audit purposes.

9 BALANCE SHEET

9.1 INTRODUCTION

The Balance Sheet sets out the assets, liabilities and net worth (difference between assets and liabilities) of the State. This section provides some commentary of trends and influences in the State public sector financial position.

The information relates to GFS data for both the general government sector and also the non-financial public sector, which consolidates the general government and public non-financial corporations (including the South Australian Water Corporation, Forestry SA and TransAdelaide).[28]

9.2 OVERVIEW OF THE STATE'S FINANCIAL POSITION

The following summarises the GFS financial position information for South Australia for the general government and public non-financial corporation (PNFC) sectors.

9.2.1 GFS - General Government Sector Financial Position

The following table provides time series data for the general government sector.

Table 9.1 — GFS - General Government Sector Financial Position (Nominal Terms)

	2003-04 Actual $'million	2004-05 Actual $'million	2005-06 Actual $'million	2006-07 Estimated Result $'million	2007-08 Estimate $'million	2008-09 Estimate $'million	2009-10 Estimate $'million	2010-11 Estimate $'million
Financial assets	15 661	16 915	17 979	18 304	18 173	18 640	19 223	19 863
Non-financial assets	11 917	12 505	13 857	13 857	14 992	15 626	16 169	16 803
Total assets	27 579	29 420	31 836	32 161	33 165	34 265	35 393	36 665
Total liabilities	11 819	13 061	12 133	11 596	12 091	12 633	12 994	13 567
Net worth	15 760	16 359	19 703	20 565	21 073	21 632	22 399	23 098
Net financial worth	3 842	3 853	5 846	6 708	6 081	6 007	6 229	6 295
Net debt	224	144	(119)	151	618	1 011	1 165	1 443

Note: Totals may not add due to rounding.

Of note is the expectation that:

- financial assets increase across the forward estimates. This is essentially due to equity in PNFCs;
- non-financial assets increase over the period 2003-04 to 2010-11. This is mainly from asset revaluations of the State's land and buildings assets. Net acquisitions (gross fixed capital formation less depreciation), account for the majority of other movements from year to year;

[28] Budget Statement 2007-08, Budget Paper 3, Appendix D details agencies within the respective sectors.

- net worth (assets less liabilities) increases across the forward estimates. This is due to asset growth and a reduction in unfunded superannuation liabilities in 2005-06 from a valuation adjustment;
- net debt increased across the forward estimates to $1.4 billion in 2010-11.

9.2.2 GFS - Non-Financial Public Sector Financial Position

The following table provides time series data for the non-financial public sector.

Table 9.2 — GFS - Non-Financial Public Sector Financial Position (Nominal Terms)

	2003-04 Actual $'million	2004-05 Actual $'million	2005-06 Actual $'million	2006-07 Estimated Result $'million	2007-08 Estimate $'million	2008-09 Estimate $'million	2009-10 Estimate $'million	2010-11 Estimate $'million
Financial assets	3 574	3 450	3 902	3 756	3 864	4 083	4 400	4 876
Non-financial assets	25 309	27 363	29 592	30 250	31 214	32 129	33 026	33 916
Total assets	28 883	30 813	33 494	34 006	35 078	36 212	37 426	38 793
Total liabilities	13 124	14 454	13 790	13 441	14 005	14 580	15 027	15 695
Net worth	15 760	16 359	19 703	20 565	21 073	21 632	22 399	23 098
Net financial worth	(9 550)	(11 004)	(9 889)	(9 685)	(10 140)	(10 496)	(10 627)	(10 818)
Net debt	2 285	2 126	1 786	2 263	2 701	3 073	3 215	3 361

Note: Totals may not add due to rounding.

This table highlights that:

- non-financial assets dominate the financial position;
- the value of non-financial assets are estimated to increase by $700 million in 2006-07 to $30.3 billion, and a further $3.7 billion by 2010-11 to $33.9 billion. The main increases in 2006-07 are revaluations of South Australian Housing Trust rental assets, estimated to increase by $324 million in 2006-07;
- net financial worth is negative as financial liabilities exceed financial assets and is estimated to deteriorate over the forward estimates period;
- net debt is estimated to increase over the forward estimates period.

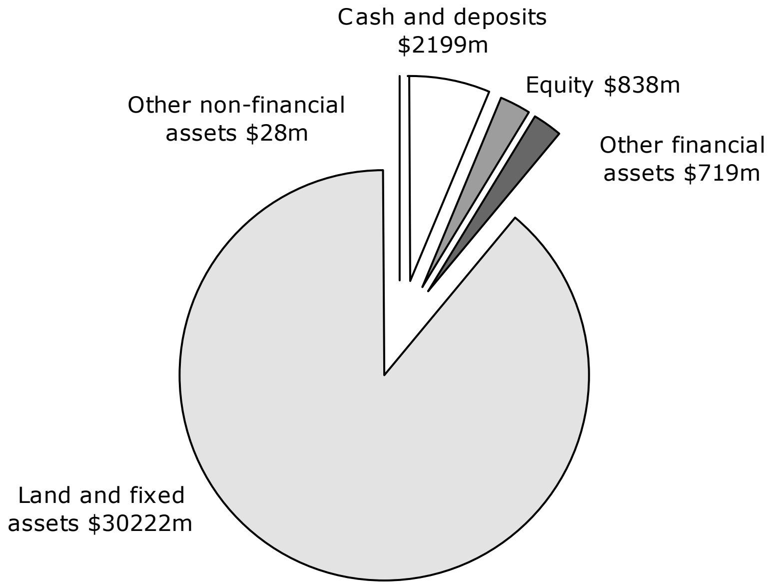
9.3 ASSETS

Historic information shows that the State's financial position does not materially vary from year to year in the absence of major asset disposals or revaluations. This position is similar to interstate jurisdictions, where similar trends are noted.

9.3.1 GFS - Non-Financial Public Sector Assets

The following chart shows the estimated composition of assets under the control of the State as at 30 June 2007 for the non-financial public sector.

Chart 9.1 — GFS - Non-Financial Public Sector Assets at 30 June 2007 ($'million)



Non-financial assets clearly represent the vast majority of State assets being 89 percent of the total. The State's non-financial or physical assets comprise mainly plant, equipment and infrastructure (including roads and water infrastructure) and land and improvements. These assets are divided between the general government and public non-financial corporations sectors. Assets in the general government sector tend not to be used for revenue raising purposes.

In accordance with the Treasurer's Accounting Policy Statements, major assets are subject to regular revaluation. Valuation of public sector assets, particularly general government sector assets, is a subjective process. Valuations will reflect the specific circumstances of individual government entity operations. The general purpose is to provide users of financial reports with an understanding of the extent of assets employed by government agencies in their operations. Most assets are not realisable.

9.3.1.1 Revaluation of Non-Financial Assets

Revaluations of non-financial assets will generally have the most influence in the improvement of the State's net worth. To illustrate, the following chart summarises asset value changes over the four year period 2003-04 to 2006-07 for the major agencies in the general government and public non-financial corporations sectors.

Table 9.3 — Revaluation of Non-Financial Assets

	2003-04 $'million	**2004-05 $'million**	**2005-06 $'million**	**2006-07 $'million**	**Total $'million**
General government	113	421	866	22	1 422
Public non-financial corporations	870	1 363	725	970	3 928
Total	983	1 784	1 591	992	5 350

Revaluation of the assets of the major agencies added $5.4 billion to the total value of non-financial assets over the four year period to 2006-07.

The rental properties of the South Australian Housing Trust alone contributed $2.4 billion of this as the value of housing stock rose from $3.5 billion as at 30 June 2003 to $5.9 billion as at 30 June 2007.

9.3.2 Public Financial Corporations Financial Assets

The majority of the Government's financial assets are held by agencies mainly classified as financial institutions (ie public financial corporations). The gross value of those financial assets is not directly evident in the general government sector financial statements.

The following table shows the major holdings of investment assets as at 30 June 2007 for public financial corporations:

Table 9.4 — Investments held by Public Financial Corporations[(a)] [(b)]

	Domestic Equities $'million	International Equities $'million	Fixed Interest $'million	Other Investments $'million	Total 30 June 2007 $'million	Total 30 June 2006 $'million
Funds SA [(c)]	4 280	3 928	930	3 438	12 576	10 323
MAC	392	200	1 236	254	2 082	1 893
SAICORP [(d)]	-	-	-	-	-	227
SAFA [(d)]	-	-	3 212	-	3 212	2 516
Total	4 672	4 128	5 378	3 692	17 870	14 959

(a) Market values have been used in determining the above amounts and are sourced from their respective financial statements for the year ending 30 June 2007.
(b) Excludes WorkCover.
(c) These amounts relate to superannuation assets set aside for funding future superannuation benefit payments.
(d) SAICORP was dissolved on 1 July 2006 and its assets transferred to SAFA.

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

9.4 LIABILITIES

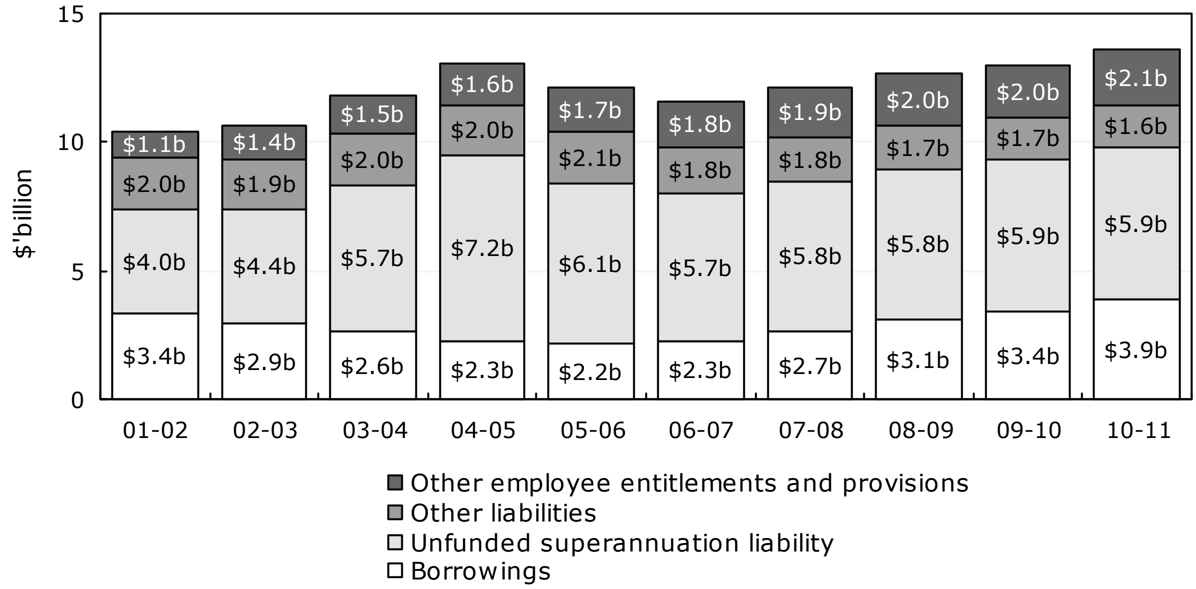
Time series data is presented in the Budget Statement.[29] That data is used as relevant in this section.

[29] Budget Statement 2007-08, Budget Paper 3, Chapter 5 and Appendix B.

9.4.1 GFS - General Government Sector Liabilities

The following chart shows trends in the main elements of total liabilities for the 10 years to 2010-11.

Chart 9.2 — GFS - General Government Sector Liabilities (Nominal Terms)



Total liabilities are estimated to decrease by $537 million or 4.4 percent to $11.6 billion in 2006-07. This is due mainly to a decrease in the unfunded superannuation liability. The variability in the unfunded superannuation liability in the four years to 2006-07 is due to movements in earnings and the discount rate used to estimate the value of the liability.

Total liabilities are expected to increase $2 billion or 17 percent to $13.6 billion over the period of the forward estimates. This is due mainly to increases in borrowings, up $1.6 billion, superannuation liability, up $140 million and other employee entitlements and provisions, up $360 million, offset by decreases in other liabilities, down $147 million, over the four years to 2010-11.

9.4.2 GFS - Non-Financial Public Sector Liabilities

The trends and composition of liabilities for the non-financial public sector are consistent with those of the general government sector.

Total liabilities are expected to increase $2.3 billion or 16.8 percent to $15.7 billion over the period of the forward estimates. A $349 million or 2.5 percent decrease in total liabilities in 2006-07 is due to a decrease in superannuation liabilities, down $405 million or 6.6 percent and other liabilities, down $239 million or 10.5 percent, offset by an increase in borrowings, up $218 million or 6.1 percent and increase in other employee entitlements and provisions, up $77 million or 4.3 percent.

9.5 UNFUNDED SUPERANNUATION

9.5.1 Background to Unfunded Superannuation Liabilities

Superannuation liabilities are regarded as unfunded when specific assets have not been set aside to meet the estimated value of accrued superannuation liabilities.

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

In estimating the liabilities, a range of variable factors and assumptions are taken into account. Also important are the scheduled past service contributions by the 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. This is an accepted fact for this type of liability.

9.5.2 Estimated Unfunded Superannuation Liability at 30 June 2007

The following table sets out the major elements that comprise the movement from the actual unfunded superannuation liabilities at 30 June 2006 to the 30 June 2007 estimated liability.

Table 9.5 — Estimated Unfunded Superannuation Liabilities as at 30 June 2007

		$'million	$'million
Actual 30 June 2006			6 147
Add:	Nominal interest	315	
	Past service payments	(252)	
	Higher earnings against assumed	(537)	
	Variation between actual and expected experience	92	
	Other	(24)	
	Total changes		(405)
Estimated Closing Balance June 2007			5 741

9.5.2.1 Superannuation Funding

In 2007-08, total superannuation funding is budgeted to be $795 million, a significant part of cash outlays. Payments comprise amounts paid from agencies as contributions with respect to current employment new service and contributions reflecting lack of funding for current employment in previous years ('past service' contributions) prior to the full funding policy.

The past service superannuation liability cash payments are affected by the long-term earning rate on superannuation assets. Where investment performance exceeds the assumed rate, it is possible to reduce the level of past service payments required to fully fund superannuation liabilities by 2034. Equally, additional funding contributions are required, however, to compensate for reduced earnings to remain on target.

The past service superannuation liability cash payment for 2007-08 is estimated to be $235 million.[30] This is $27 million lower than was estimated in the 2006-07 Budget.

[30] Budget Statement 2007-08, Budget Paper 3, Table 5.6

9.5.2.2 Earnings

Funds SA is responsible for managing the investment of superannuation assets. Investment earnings on superannuation assets are very much susceptible to economic conditions, financial markets and Funds SA's investment strategy. Further detail on investment performance is provided under 'Superannuation Funds Management' (Funds SA) in Part B of the Auditor-General's Report for the year ended 30 June 2007 to Parliament.

Higher earnings were estimated to be achieved against the assumed investment earnings. In the 2007-08 Budget an earnings rate of 17.2 percent was estimated for 2006-07. This rate is substantially higher than the long-termed assumed earnings rate of 7 percent.

9.5.3 Long-Term Funding of Superannuation Liabilities

The commitment to fully fund unfunded liabilities was reaffirmed by the Government in the 2007-08 Budget Papers, with the position as at 30 June 2007 remaining consistent with the plan to eliminate unfunded superannuation liabilities by 2034.

On current projections, unfunded liabilities are expected to increase until peaking around the period 2011-12. It is estimated that benefit payments will peak in 2023-24.

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

9.6 NET DEBT

Since the collapse of the State Bank, management of net debt has been a major focus of fiscal strategy. The achievements over a number of years of restructuring the State's finances have reduced net debt to historically low levels and the Government now focuses on total liability data.

9.6.1 Definition of Net Debt

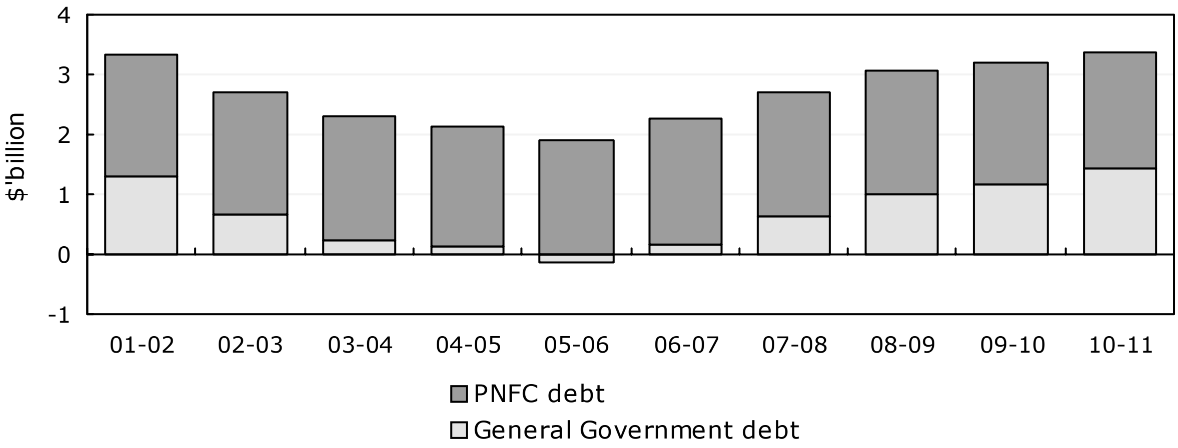
Net debt[31] equals certain financial liabilities (the sum of deposits held, advances received and borrowing) minus financial assets (the sum of cash and deposits, advances paid, and investments, loans and placements) as defined in the GFS framework.

9.6.2 Longer Term Trends in the Level of Debt

The following chart shows data on a long-term basis to the end of the forward estimates. Public sector net debt has reduced by $1.1 billion to $2.3 billion (3.5 percent of South Australia's Gross State Product) in the period 2001-02 to 2006-07. Forward estimates show that net debt is projected to rise to $3.4 billion in 2010-11 (4.1 percent of South Australia's Gross State Product).

[31] The indebtedness of the Treasurer, published in the Treasurer's Statements, represents the amount the Treasurer has borrowed from SAFA. This amount may be linked with the GFS accrual numbers, but a change in the GFS net lending position is not necessarily reflected by a change in the indebtedness of the Treasurer.

Chart 9.3 — GFS - South Australian Public Sector Net Indebtedness 2002 to 2011



In real terms, total net debt is projected to increase over the forward estimate period.

General government sector is estimated to have net debt of $151 million for 2006-07. Over the forward estimates net debt increases in this sector by $1.3 billion to $1.4 billion due to projected budget deficits.

Net debt of the public non-financial corporations decreases by $194 million over the same period to $1.9 billion.

The chart highlights that most debt resides with the public non-financial corporations sector. The main holders of debt in that sector are the South Australian Water Corporation, South Australian Housing Trust and TransAdelaide. Of these the South Australian Water Corporation is a commercial business servicing its debt from business revenues.

9.6.3 Debt Affordability and Servicing

Chart 9.3 clearly highlights the decrease of general government net debt as at 2005-06. This was one of the reasons the Government was able to consider revision of its fiscal targets.

At the end of 2006-07 total public sector net debt is estimated to represent 3.5 percent of gross state product compared to 6.5 percent in 2001-02.

9.6.4 Debt Management Policy

The SAFA has been delegated the responsibility for managing the debt of the South Australian Treasurer.

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

The Treasurer's approved policy for benchmark duration applied during the 2006-07 financial year is between 1 to 1.5 years.

Lower duration benchmarks offer lower average interest costs over the long-term but with possible higher short-term budget volatility.

For further details on the debt management policy, refer to the financial statements of the South Australian Government Financing Authority in Part B of this Report.

9.7 OTHER NON-FINANCIAL PUBLIC SECTOR LIABILITIES

Other liabilities include provisions for other employee entitlements (in particular long service leave provisions), $1.9 billion for 2006-07 and workers compensation and other liabilities of entities including outstanding insurance claims, $2 billion for 2006-07.

By their nature these liabilities tend to increase at a steady but manageable rate.

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

- estimated long service leave provisions amounting to $1.1 billion for 2006-07 and $1.2 billion in 2007-08. Long service leave is calculated by an estimation process in most cases subject to guidelines issued by DTF;
- estimated workers compensation totalling $343 million for 2006-07 and $357 million in 2007-08;
- outstanding claims payable to entities external to SAFA amount to $244 million for 2005-06 and $211 million in 2006-07. These liabilities are funded. Details of SAFA's insurance operations are included in Part B of this Report.[32]

9.8 CONTINGENT LIABILITIES

As reported in the Budget Papers[33] contingent liabilities are those that have not been recognised in the Balance Sheet, but rather in notes to the accounts, for one of the following reasons:

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

Contingent liabilities of the Government can arise from:

- legislative provisions requiring the Government to guarantee the liabilities of public sector organisations eg financial institutions;

32 The South Australian Government Captive Insurance Corporation (SAICORP) was amalgamated into SAFA from 1 July 2006.

33 Budget Statement 2007-08, Budget Paper 3, pp 7.11 – 7.20 provides a detailed summary of contingent liabilities.

- the ordinary activities of the Government might give rise to disputes and litigation that remain unresolved at any given balance date.

Guarantees and contingent liabilities of the Government of South Australia as at 30 June 2006 were valued at $920 million ($950 million as at 30 June 2005). This is at nominal values without adjustment for the probability of actual liabilities occurring.

The $30 million decrease is due mainly to a $36 million reduction in the net present value of operating lease obligations offset by net upward variation in the estimated value of guarantees.

Service Risks and Contingent Liabilities

Agencies must continue to properly manage against incurring long term liabilities arising from the inherent risks in the delivery of public services such as health, welfare, education, corrections, public housing and how duty of care responsibilities are exercised. Matters that have arisen over recent years highlight the importance of public sector entities understanding the nature of risk in their circumstances and having relevant controls and processes in place to mitigate and monitor identified risks.

10 COMPARISON WITH OTHER STATES

10.1 SOME QUALIFYING OBSERVATIONS

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

Across jurisdictions, net worth is influenced by varying valuation approaches between states, differences in the type and level of infrastructure, and be associated with higher debt levels. Infrastructure can also be provided through the private sector and therefore not be included in government data.

Importantly before drawing conclusions, any assessment needs a sound understanding of the specific circumstances prevailing in different states. I have not sought to provide all of the relevant information in this Report. Rather I take the opportunity to show what each State is forecasting through to 2011.

The following table shows 2007-08 budgeted GFS total revenue for each state.

Table 10.1 — 2007-08 Budgeted General Government GFS Total Revenue by State

State	NSW $'million	VIC $'million	QLD $'million	WA $'million	SA $'million	TAS $'million
GFS Total Revenue	47 516	34 269	32 551	17 593	12 140	3 747

Given the relative differences in size and level of financial activity of each State, comparisons that follow are given as proportions of GFS total revenues in each state.

10.2 OPERATING STATEMENT

The following charts compare some trends in the GFS accrual information with most other States using 2007-08 budget data.

Chart 10.1 — General Government Sector Net Operating Balance as a Proportion of GFS Total Revenue

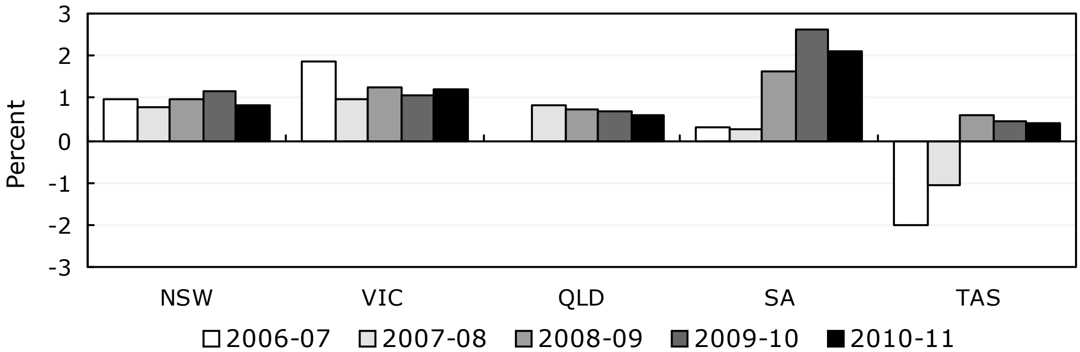
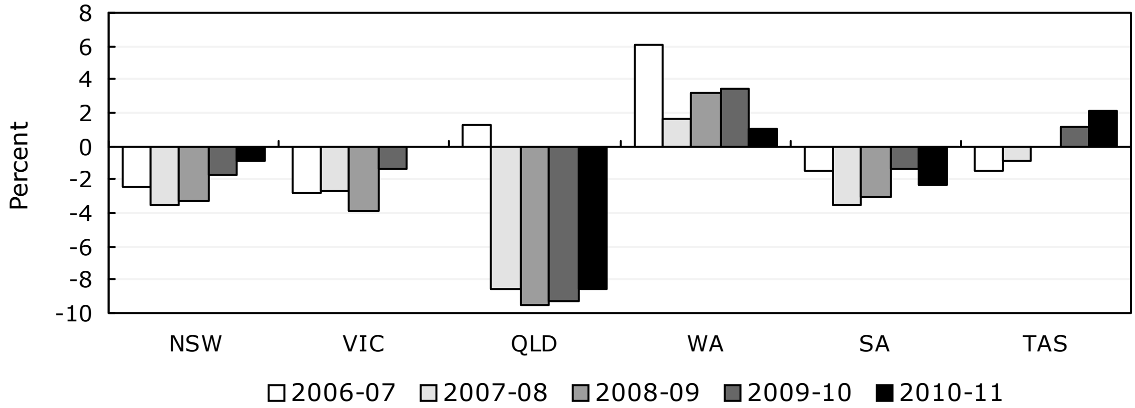


Chart 10.1 shows that South Australia's net operating balance as a ratio to total revenue compares very favourably with most other states. Note that Queensland's ratio for 2006-07 and Western Australia are omitted due to the size of those results to assist legibility.

Chart 10.2 — General Government Sector Net Lending (Borrowing) as a Proportion of GFS Total Revenue



As detailed in chart 10.2, most States are estimating net borrowing (deficit) outcomes for all or most of the four years to 2010-11.

Chart 10.2 shows that South Australia's net borrowing as a proportion of GFS total revenues is lower than most States. Given the net operating balance outcomes in chart 10.1, this indicates South Australia's relative capital payments are lower than the other states.

The reasons for the differences will be varied but are likely to include differing capital policies and needs, reflecting population growth and demand differences and differing needs for renewal of capital assets.

10.3 BALANCE SHEET

10.3.1 Ratio of Net Financial Liabilities to Revenue

The primary fiscal targets include a measure, the ratio of net financial liabilities to revenue. This measure is broader than net debt as it includes significant liabilities other than borrowings, such as unfunded superannuation and long service leave entitlements.

The following chart plots the ratio of net financial liabilities to revenue for each of the states.

Chart 10.3 — Ratio of Net Financial Liabilities to Revenue

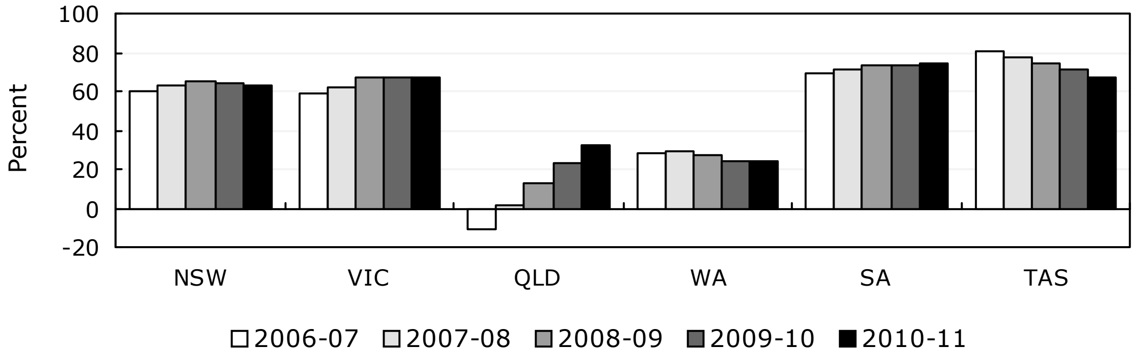


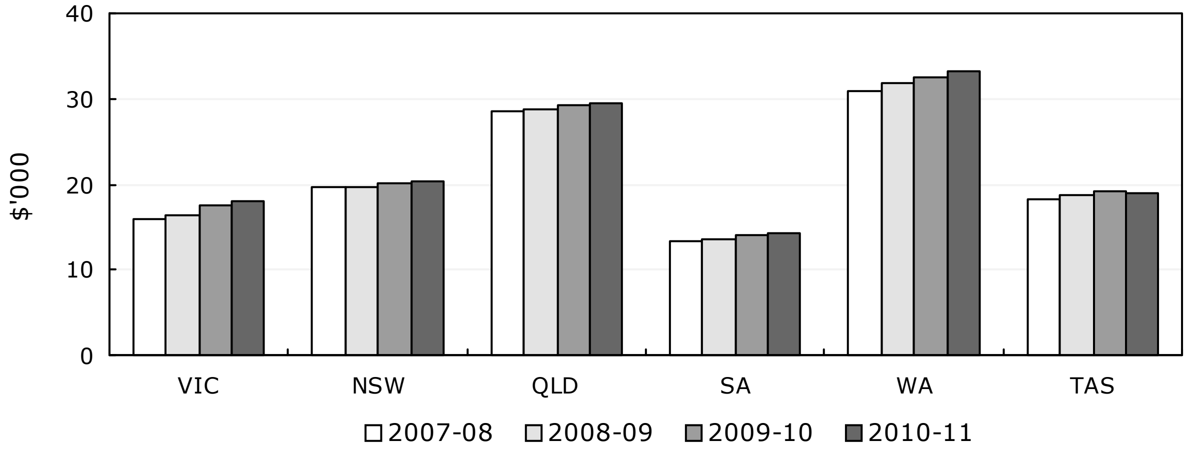
Chart 10.3 shows the 2007-08 Budget settings result in the ratio for South Australia essentially rising until 2010-11. It is evident that a similar situation exists for Victoria and Queensland and NSW rises to 2008-09 before declining. Accordingly, South Australia's relative standing against most other triple-A rated States remains similar. It is not, however, declining towards that of other triple-A rated States as required by the fiscal strategy.

10.3.2 Net Worth Per Capita

General government sector net worth is calculated as total assets (physical and financial) less total liabilities (debt, superannuation, other) and therefore highlights the net change in these items. Changes in net worth arise from transactions, the operating result and from revaluations of assets and liabilities.

The following chart plots the Budget data for all States.

Chart 10.4 — GFS - General Government Sector Net Worth per Capita



The chart shows the increase in net worth in this State through to 2010-11 based on current budget settings. This is consistent with the projections for other states.

The data suggests that states with higher net worth have additional assets for service provision or disposal despite differences that might arise from measurement issues.

11 TREASURER'S STATEMENTS

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

The Treasurer's Financial Statements are prepared pursuant to the *Public Finance and Audit Act 1987* (the Act) to report on transactions and balances in the public accounts.

The main public accounts are the Consolidated Account and special deposit accounts and deposit accounts established pursuant to the Act.

A high proportion, but not all, of public monies are received and expended through the Consolidated Account. The main receipts to the Consolidated Account are State taxation and Commonwealth general purpose grants to the State.

Special deposit accounts and deposit accounts are used by all agencies as their main operating account. The Treasurer's Financial Statements report only the closing balances of these accounts. Detail of agency transactions are in the individual general purpose financial reports of agencies.

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

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

11.2 SCOPE OF AUDIT OF THE TREASURER'S STATEMENTS

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

- testing of appropriations from the Governor's Appropriation Fund, Contingency Funds and other payments;
- establishment and changes to Treasurer's Special Deposit Accounts and Deposit Accounts;
- updating and recording of the Treasurer's Loans;
- maintenance of the Central General Ledger.

11.2.1 Audit Findings and Comments

The results of audit work undertaken indicated that while internal controls were in general operating satisfactorily, there were a number of minor areas where improvements could be made.

In addition to the matters above, observations were also regarding the Accrual Appropriation Excess Fund Account.

Follow-up review findings are discussed in detail under the Audit Findings and Comments heading for the Department of Treasury and Finance in Part B of this Report.

11.3 THE CONSOLIDATED ACCOUNT OUTCOME

The following table sets out total appropriation authority and actual payments for the Consolidated Account in 2006-07.

Table 11.1 — 2006-07 Appropriation Authority and Payments

	Appropriation Authority $ million	Actual Payments $ million
Appropriation Act 2006	7 719	7 665
The Governor's Appropriation Fund	222	198
Specific appropriations authorised in various Acts	126	126
Total	8 067	7 989

The result on the Consolidated Account for 2006-07 was a deficit of $107 million ($24 million surplus in 2005-06) exceeding the budgeted deficit amount by $67 million. The deficit was funded by borrowings from SAFA. This is reflected in an increase in net debt serviced from the Consolidated Account as shown in Statement J of the Treasurer's Statements .

Total receipts of $7.9 billion exceeded budget by $85 million. Total payments exceeded budget by $152 million.

The key differences between actual and budgeted amounts were:

- ***Receipts*** — large increases in stamp duty receipts of $160 million due to higher than expected activity in the property sector.
- ***Payments*** — Higher payments from Administered Items for Department of Treasury and Finance and the Department of Health. The main increases are discussed in the following section on appropriation flexibility.

Details of the budget and actual data are presented in Statement A 'Comparative Statement of the Estimated and Actual Payments from the Consolidated Account of the Government of South Australia'.

11.4 APPROPRIATION FLEXIBILITY

Flexibility in appropriation authority arises from the provision of sources of funds for additional/new initiatives or unforeseen cost pressures that can be used without a requirement to return to Parliament for additional appropriation authority.

This flexibility is provided by a combination of legislative provisions and budget practices.

The following table sets out relevant items for 2006-07.

Table 11.2 — Appropriation Flexibility

	Authority/ Budget $'million	Actual Payments $'million
Governor's Appropriation Fund	222	198
Contingency provisions in Administered Items for DTF	139	88
Total Flexibility	361	286

Use of both the contingency provisions and the Governor's Appropriation Fund requires the Treasurer's approval. Use of contingency provisions does not affect the budget result as they are already figured into that result.

11.4.1 Governor's Appropriation Fund and Contingency Provisions

Section 12 of the *Public Finance and Audit Act 1987* provides for the Governor's Appropriation Fund (GAF).

Details of the purpose of appropriations from the GAF are provided in Statement K - Governor's Appropriation Fund of the Treasurer's Statements. The main items were payments of $79 million to Administered Items for the Department for Treasury and Finance (the main purposes being a payment to SAFA for restructure of government insurance arrangements, $64 million and grants/subsidies to the South Australian National Football League, $9 million and the Royal Zoological Society of SA and Common Ground Adelaide, each $2 million), $49 million to Department of Health (mainly for activity growth/non-wage costs) and $20 million to the Department for Families and Communities (DFC) mainly for additional cash.

11.4.2 Contingency Provisions

Contingency provisions for employee entitlements, supplies and services and plant and equipment are included in the total of the appropriation purpose 'Administered Items for Department of Treasury and Finance' in Statement A of the Treasurer's Statements. These amounts are included within the total appropriation (and budgeted expenses) but may not be committed to a specific purpose at the time of the Budget. They are provided for potential budget impacts or for expenditure that is subject to further Cabinet or Ministerial approval.

Details of payments from the contingency funds are provided in Statement L – Statement of Transfers from Contingency Provisions of the Treasurer's Financial Statements. Payments are transfers of additional funding to agencies. The major items were for payments totalling $21 million to the Department of Health (for agreed Commonwealth of Australian Governments cost sharing obligations and salary agreements settlement), $15 million to the Department of Further Education, Employment, Science and Technology (mainly budget supplementation, $13.3 million) and $12 million to the Department for Transport, Energy and Infrastructure (mainly for Old Stock Exchange building and salary agreements settlement).

11.4.3 Appropriation Transfers

In addition to the preceding provisions, appropriation can be transferred between agencies. Section 13 of the *Public Finance and Audit Act 1987* provides authority where excess funds exist for one agency and are necessary for another. Section 5 of the *Appropriation Act* provides authority where restructuring of an agency occurs so that appropriation related to transferring functions may in turn be transferred. A Section 13 transfer of $15 million from Administered Items for DFC to DFC for maintaining cash requirements occurred in 2006-07 as detailed in Statement K. Section 5 transfers are detailed in Statement A of the Treasurer's Statements.

11.5 SPECIAL DEPOSIT ACCOUNTS AND DEPOSIT ACCOUNTS

Most appropriation from the Consolidated Account is transferred to special deposit accounts and deposit accounts established pursuant to the *Public Finance and Audit*

Act 1987. Under related provisions, monies credited to those accounts can be spent without further appropriation from Parliament. This is of significance in that monies appropriated in one year and transferred to a deposit account need not actually be expended in that year, that is, they may be carried over into the next year unless required by the Treasurer to be paid to the Consolidated Account.[34]

Table 11.3 shows that nearly $2 billion is in special deposit accounts and deposit accounts as at 30 June 2007, up $242 million from the previous year.

Table 11.3 — Special Deposit Accounts and Deposit Accounts

	2005-06 $'million	**2006-07 $'million**	**Increase $'million**
Special Deposit Accounts	1 262	1 447	185
Deposit Accounts	462	519	57
Total	1 724	1 966	242

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

The largest balances at 30 June 2007 were:

- ***Special Deposit Accounts*** — Accrual Appropriation Excess Funds ($398 million), Highways Fund $187 million and Treasury and Finance Administered Items ($73 million).
- ***Deposit Accounts*** — SAFA ($55 million) and South Australian Housing Trust ($55 million).

Account balances are also subject to the Treasurer's Cash Alignment Policy that aims to minimise balances as discussed below.

11.5.1 Accrual Appropriation Excess Funds Account

The approved purpose of the Accrual Appropriation Excess Funds Account (the Account) is to record all receipts and payments associated with surplus cash balances generated in agencies by the shift to accrual appropriations.

Accrual appropriation arrangements were introduced in 1998-99. It resulted in accrual adjustments to annual appropriations for accruing leave liabilities (the value of the leave entitlement accruing to employees for the year rather than just the amount paid to employees taking leave in the year) and depreciation expenses. Previously, agency appropriations were for expected cash outlays for the coming year. These accrual funding amounts were to be deposited into the Account. Administrative arrangements were put in place to control access to these funds. It was intended that the funds be used to meet relevant leave and capital payments. Over a number of years it became

[34] *Public Finance and Audit Act 1987* subsection 8(5) Any surplus of income over expenditure standing to the credit of a special deposit account must, at the direction of the Treasurer, be credited to the Consolidated Account.

evident that there was confusion among agencies as to how the Account was to be used. The balance of the Account grew steadily each year.

At 30 June 1999, the balance of the Account was $75 million. It is now $398 million.

Commentary summarising Audit review of the account over the past three years is included in the section on the Department of Treasury and Finance in Part B of this Report under 'Audit Findings and Comments'.

In June 2007 the Under Treasurer released a new document 'Budgeting for Employee Entitlements Etc' which sets out policy and procedures for budgeting for employee entitlements, depreciation and investments. It provides guidance on maintaining employee entitlement budgets, calculating appropriation amounts and accessing agency balances in the account. The document notes that the Account had not been regularly used as initially intended. It encourages agencies to actively use the Account as a source of cash to reduce employee entitlement liabilities and fund capital expenditure and sets out procedures for accessing the necessary funds. The procedures aim to ensure the use of funds is subject to relevant normal budgetary approval processes.

11.5.2 Cash Alignment Policy

In 2004-05 the Government first applied a cash alignment policy (CAP) with respect to aligning agency cash balances with appropriation and expenditure authority. Pursuant to the policy, payments are required to be made to return surplus cash to the Consolidated Account. The policy supports the Treasurer's discretionary power to require surplus funds in special deposit accounts, to be paid to the Consolidated Account.

Following review of the policy, in May 2006 the Treasurer approved the scope of the policy be broadened to all special deposit accounts with at least an annual review to determine whether there was surplus cash in an account.

A total of $40 million ($49 million in 2005-06) of surplus cash was returned to the Consolidated Account during 2006-07, including return of equity. The main items were $16 million from the Department of Education and Children's Services and $15 million from the Department for Environment and Heritage.

11.5.3 Interest Payments on Operating Accounts

As part of the CAP review, interest payment arrangements for special deposit and deposit accounts was reconsidered. Under current budgetary arrangements, agencies are unable to spend interest earned unless it is included in the agency's expenditure approvals. In May 2006, the Treasurer approved ceasing payment of interest on many special deposit and deposit accounts to discourage the build up of cash and reduce administrative costs. The Treasurer also approved replacing interest receipts with appropriation where necessary.

12 WHOLE-OF-GOVERNMENT FINANCIAL STATEMENTS (AAS 31)

The whole-of-government financial statements present a different view of the State's financial position when compared against the already discussed GFS presentation. The main difference is that data for the public financial corporation sector is included, which, in the case of South Australia, means that superannuation assets and both funded and unfunded superannuation liabilities are reported on the statement of financial position.

Due to the timing of the preparation of the whole-of-government statements, the last completed statements relate to the year ended 30 June 2006, and the following commentary has therefore been kept purposely brief.

12.1 AAS 31 WHOLE-OF-GOVERNMENT FINANCIAL STATEMENTS

Whole-of-government financial reports for South Australia are prepared by the DTF pursuant to AAS 31.

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

12.2 SCOPE OF AUDIT AAS 31 WHOLE-OF-GOVERNMENT FINANCIAL STATEMENTS

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

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

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

- the principles adopted in the definition of the economic entity for whole-of-government purposes;
- controls and procedures within DTF for evaluating the reliability and validity of data forwarded by agencies;
- the adequacy and reliability of the database used for the preparation of the whole-of-government financial statements;

- the preparation of the whole-of-government general purpose financial statements;
- compliance with appropriate legislation and accounting frameworks, in particular Australian Accounting Standards, Urgent Issue Group Consensus Views, Treasurer's Instructions, and other professional reporting requirements in Australia.

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

12.2.1 Audit Findings and Comments

Following the Audit review of the financial statements for 2005-06, a management letter was forwarded to DTF in July 2007 that contained important reporting and operational considerations that would need to be addressed in order to provide an unqualified audit opinion for whole-of-government financial statements. This would, of course, require legislation changes requiring such an opinion to be issued. The Audit management letter was reproduced in full in the whole-of-government financial statements published by DTF.[35]

The matters raised included:

- timeliness issues with the preparation of whole-of-government financial statements. In particular, it was noted that a number of other States had been able to finalise and publish their whole-of-government financial statements many months before South Australia, which did so in July 2007;
- the inclusion of a number of material account balances from government entities that received qualifications;
- recommendations regarding the submission of agency information;
- the reliability of comparative information.

Departmental Response

DTF responded positively to each of the issues raised.

In particular, DTF advised that by 30 June 2006 it had developed and deployed two on-line software products to help achieve a more efficient and timely transfer of relevant information from agencies to DTF. These software products were:

- ***upstream*** — facilitates a rapid and relatively seamless transfer of agencies' general ledger financial data.
- ***year-end notes*** — facilitates the collection of supplementary financial notes information.

[35] Government of South Australia, Consolidated Financial Statements for the year ended 30 June 2006.

As a result of the 2005-06 mapping experience, DTF has now put considerable effort into vetting the agency data during 2006-07, in particular:

- implementing sector specific account validation rules;
- verifying 1 July 2006 opening balances as posted by agencies against the previous year's 30 June audited closing balances;
- analysis of agency data based on a 31 May 2007 upstream submission;
- assisting agencies to improve their mapping techniques and their understanding of the whole-of-government chart of accounts;
- amending Treasurer's Instruction 19 to require that data submitted to DTF is accurate and complies with applicable policies and guidelines;
- at every opportunity emphasising to agencies the critical importance of meeting deadlines.

DTF expects that these targeted efforts will improve the quality of agency data submitted in 2007 and allow DTF to commence its data cleansing and consolidation tasks much sooner than previously and thereby finalise preparation of the whole-of-government financial statements in a more timely manner than in past years.

12.3 AAS 31 FINANCIAL PERFORMANCE

The following briefly discusses the financial result of the AAS 31 statements as at 30 June 2006. As previously discussed, data for the current year (due to the time needed for preparation) is not available at the time of this Report. It is included for reference only. Full details and analysis are published by DTF.[36] This data provides the opportunity to observe the financial result of the Government using a full accrual accounting basis, and the consolidation of all sectors. The consolidation process means that all inter-sector transactions are eliminated.

The following table summarises the financial result for the year ending 30 June 2006, with comparative amounts for the preceding four years.

Table 12.1 — AAS 31 Financial performance (2002-2006)

	2002 $'million	2003 $'million	2004 $'million	2005 $'million	2006 $'million
Revenues					
Taxation	2 037	2 285	2 651	2 760	2 779
Grants	4 807	5 010	5 289	5 589	5 956
Sale of goods and services, fees and levies	2 571	2 898	3 282	3 305	3 517
Investment revenues	811	878	1 757	1 737	2 396
Net revenues from asset disposals	63	28	41	-	33
Other	1 010	893	738	821	450
Total Revenues	11 299	11 992	13 758	14 212	15 131

36 Government of South Australia Consolidated Financial Report for the year ended 30 June 2006.

	2002 $'million	2003 $'million	2004 $'million	2005 $'million	2006 $'million
Expenses					
Employee expenses	4 942	5 032	6 057	6 710	4 570
Supplies and services	2 665	2 713	2 305	2 307	3 359
Grants and subsidies	1 380	1 395	1 466	1 661	1 644
Borrowing cost expenses	757	761	737	688	645
Other	2 581	3 000	3 856	4 324	3 762
Total Expenses	12 325	12 901	14 421	15 690	13 980
Net Surplus (Deficit)	(1 026)	(909)	(663)	(1 478)	1 151

The table highlights significant growth in revenues over the five years to 2006. Up to 2005, this has been exceeded by growth in expenses and deficits have been incurred. The decrease in employee expenses in 2006 resulted in a surplus, reversing the trend of deficits in prior years.

The main variations in expenses in 2005-06 were as follows:

- ***Employee Expenses*** — decreased by $2.1 billion due mainly to:
  - — a $386 million increase in salaries and wages; offset by
  - — a $2.58 billion decrease in superannuation expense due mainly to:
    - ▪ a risk free rate of 5.9 percent being applied in 2005-06 to the superannuation liability compared with 5.2 percent in 2004-05. The effect was to decrease the 2005-06 liability by $1 billion compared to the $1 billion increase in 2004-05.
    - ▪ changes in actuarial assumptions of $388 million in 2005-06 compared to $777 million in 2004-05.
- ***Supplies and Services*** — increased by $1.1 billion due mainly to:
  - — a $1.2 billion increase in other supplies and services, which was principally the result of reclassification of expenses previously reported as other expenses.
- ***Other Expenses*** — decreased by $562 million due mainly to:
  - — a $902 million increase in other expenses, which was principally the result of reclassification of expenses now reported as other supplies and services.

12.4 AAS 31 FINANCIAL POSITION

The following summarises the financial position for the five financial years 2001-02 to 2005-06.

Table 12.2 — AAS 31 (Whole-of-Government Financial Statements) Financial Position Data (Nominal Terms)

	2002 $'million	2003 $'million	2004 $'million	2005 $'million	2006 $'million
Assets					
Cash and investments	4 658	6 289	6 643	6 154	6 099
Superannuation assets	5 057	5 411	6 635	7 934	10 326
Physical assets	22 621	24 234	25 261	28 124	30 414
Other	2 460	2 063	1 869	1 838	2 048
Total Assets	34 796	37 997	40 408	44 050	48 887
Liabilities					
Unfunded superannuation	3 987	4 445	5 668	7 227	6 146
Borrowings	6 754	7 468	6 781	6 607	5 916
Employee entitlements	1 208	1 440	1 595	1 387	1 486
Superannuation liabilities	5 145	5 372	6 599	7 901	10 290
Other	3 774	4 768	4 710	5 295	5 884
Total Liabilities	20 868	23 493	25 353	28 4417	29 722
Net Assets	13 928	14 504	15 055	15 633	19 165

The $3.5 billion increase in net assets for 2005-06 was due mainly to an increase in Superannuation Assets ($2.4 billion) and Physical Assets ($2.3 billion) and decrease in Unfunded Superannuation Liabilities ($1.1 billion), offset by an increase in Superannuation Liabilities ($2.4 billion).