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

Report

of the

Auditor-General

Annual Report

for the

year ended 30 June 2008

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Part C: State Finances and Related Matters

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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 2008-09 Budget, supplemented with information provided by the Department of Treasury and Finance (DTF).

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 2007-08. 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. Budget Papers explain structural breaks in time series.

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 June 2008. The Government's fiscal strategy seeks to ensure that risks to the State finances are managed prudently, to maintain a triple-A rating.

For 2008-09, the Government's fiscal targets are unchanged from the previous Budget. The Government's primary fiscal targets are to achieve:

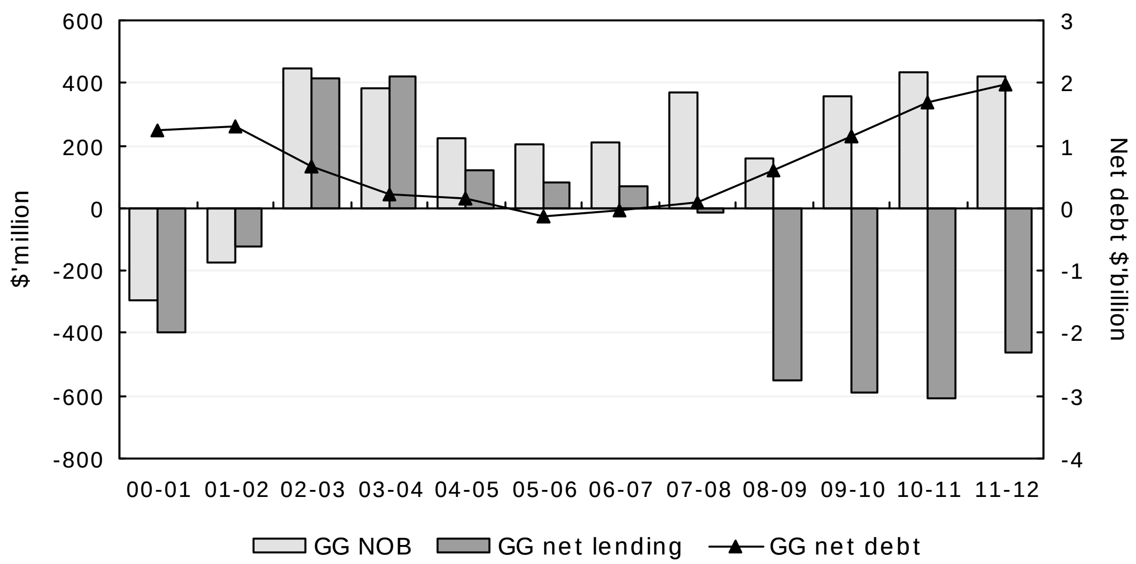
- at least a net operating balance in the general government sector in every year. Up to the 2005-06 Budget, the Government sought balanced budgets in net lending terms which also took into account net capital investment. The change in strategy allows the Government to borrow to fund proposed capital investment each year

- 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 2011-12 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. Since the 2006-07 Budget, the strategy of net operating balance surpluses and net borrowing (lending deficits, to finance higher capital spending) is also evident. Net borrowing, in turn, leads to rising net debt.

2.4 OPERATING STATEMENT

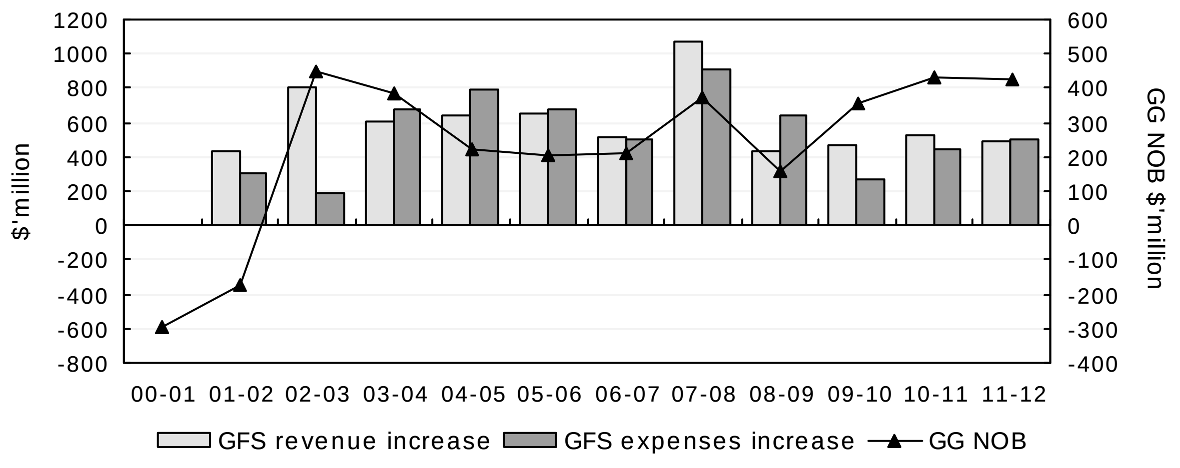
2.4.1 Estimated Results for 2007-08

The 2008-09 Budget Papers show that the Government financial operations for 2007-08 are on target for a higher than budgeted net operating balance surplus. The estimated result is a surplus of $373 million (budget $30 million). Revenues grew strongly and are expected to well exceed budget and to exceed unbudgeted growth in expenses. Net borrowing is estimated to be $15 million, much lower than the budget of $428 million.

2.4.2 Budget Forecasts 2008-09 to 2011-12

The following chart shows some of the 2008-09 Budget targets against past experience.

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



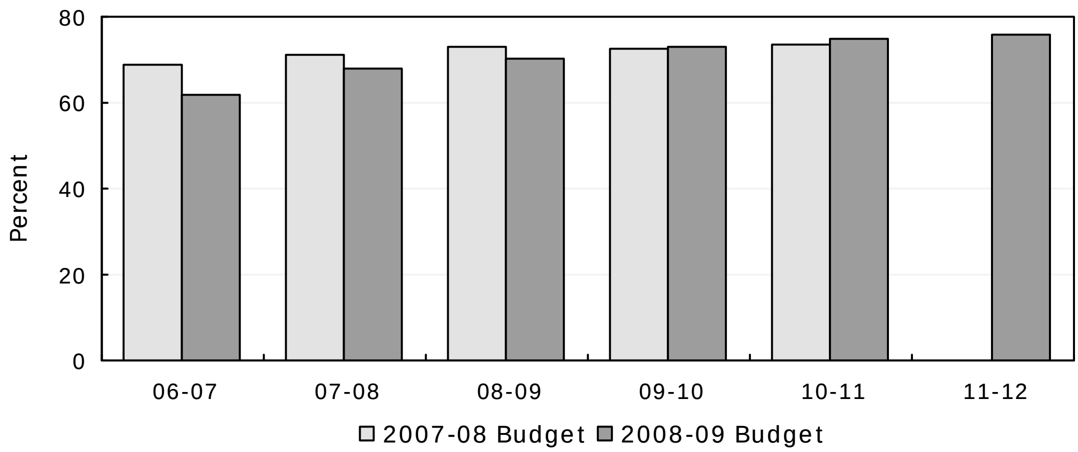
As shown, between 2002-03 and 2006-07, annual expenses growth generally outstripped revenue growth with the natural consequence that the net operating balance trends down. Both revenues and expenses grew significantly in 2007-08 and the estimated result for the net operating balance in 2007-08 is higher. The net operating balance is projected to fall in 2008-09 and then rising again to 2010-11 provided that expense growth is constrained and in 2009-10, is limited to half or less than that experienced or expected in the six prior years.

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 2007-08 and 2008-09 Budgets.

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



The chart shows that the 2008-09 Budget settings continue the expectations of the previous Budget, with the ratio rising over the forward estimates. The Government has acknowledged this is not consistent with the fiscal target, stating that the increase in the ratio reflects the Government's major infrastructure program.

Chart 10.3 in section 10 of this Report sets out the five year trend to 2011-12 for most other States. It is evident that a similar situation exists for Victoria and Queensland.

2.4.4 Interstate Comparison

The 2008-09 Budget compares key budget aggregates across jurisdictions. In 2008-09, most jurisdictions are forecasting general government net operating balance surpluses and net borrowing (lending deficits). Most jurisdictions are budgeting to invest significant funds into infrastructure projects.

2.5 NON-FINANCIAL PUBLIC SECTOR BALANCE SHEET[2]

The State's balance sheet is expected to strengthen over the four years of the 2008-09 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.

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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.

2.5.1 Estimated Position for 2007-08 and Forward Years

Assets are estimated to increase by over $1.5 billion in 2007-08 to $36.6 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 2007-08. Total assets are expected to rise to $45.5 billion by 2011-12.

From 2007-08, the majority of the Government's financial assets are managed by the Superannuation Funds Management Corporation (Funds SA). Funds SA incurred a net loss for assets under management in 2007-08 0f $1478 million due to the significant decline experienced in the financial markets during the year. One impact of the negative market returns was a deterioration in the Motor Accident Commission's solvency level, which while still positive, was at a level where there is little margin for further negative investment performance without risking not meeting the solvency requirements.

The major component of liabilities is unfunded superannuation liabilities that are estimated to increase $1.8 billion to $6.9 billion for the year to 30 June 2008. The increase is due principally to adopting changes recommended as a result of the 2007 independent actuarial triennial review. Economic and demographic factors are estimated to add $792 million and $268 million respectively to the estimated liability. A further $708 million was added by an estimated earnings rate of negative 4 percent in 2007-08 reflecting the negative movements of investment markets for the year. The effect of the increase in liabilities is to add about $90 million per year to the related nominal superannuation interest expense.

Net debt is estimated to rise $40 million to $2 billion at 30 June 2008 and to $5.2 billion by 2011-12. The Government states that net debt remains at responsible levels over the forward estimate period. The general government sector net debt increased to $82 million at 30 June 2008.

Net worth, comprising total assets less total liabilities, is estimated to decrease $446 million to $21.7 billion at 30 June 2008 due to the increase in the unfunded superannuation liability. It is then estimated to rise by $3.7 billion to $25.4 billion by 2011-12 with the growth of assets.

2.6 RISKS AND MANAGEMENT TASKS FOR THE 2008-09 BUDGET

The 2008-09 Budget projects net operating balance surpluses over the four years to 2011-12 and a strengthening balance sheet even though high levels of net lending are also forecast together with growing net debt. To achieve the projections, many budget risks need to be monitored and managed. These are detailed in the Budget Papers[3]. I believe that prevailing economic events and the nature of some aspects of recent budgets elevate some of the risks to the 2008-09 Budget and beyond. Accordingly, these risks warrant the highest attention for monitoring, reporting and management of budget spending and revenues.

2.6.1 Net Operating Balance

As I indicated last year, 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.

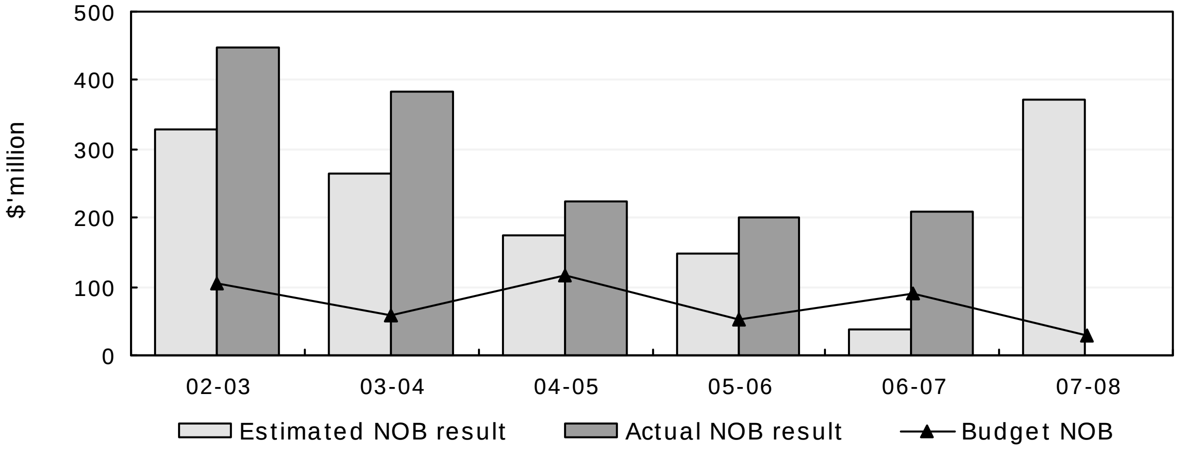
[3] Budget Statement 2008-09, Budget Paper 3, Chapter 7.

Chart 2.1 shows that, consistent with fiscal targets, net operating balance surpluses have been achieved for six consecutive years. While achieving these targets, over that time the State has received very large amounts of unbudgeted revenues that have enabled these results while also funding significant spending initiatives and pressures.

The total amount of revenue that now comes into the budget has grown from $9.3 billion in 2002-03 to $12.8 billion in 2007-08, an increase of $3.5 billion or 37 percent in five years. Over this period, the net operating balance surpluses are, on average only three percent of total revenues, a very small part of total activity. The budgeted net operating balance surpluses have been lower.

Chart 2.4 shows the budget, estimated and actual result for the net operating balance since 2002-03.

Chart 2.4 — Net Operating Results Comparisons



The chart demonstrates how consistently and to what degree, the budget and estimated and actual results have varied each year. It is also evident that the variance of the estimated result from budget in 2007-08 is larger than the previous five years.

I note that the 2008-09 Budget forecasts higher net operating balance surpluses than any of the previous six budgets, improving the buffer against unfavourable variations.

2.6.2 Operating Expense Variations

As mentioned earlier and shown in chart 2.4, the State has a consistent record of net operating balance surpluses. A possible risk attaching to that record is that the State may have developed a culture of expecting growing revenues to continue to support increasing expenses. This may prove to be the case, but the recent economic events in Australia and internationally, manifest in the global credit crunch, escalating inflation and the extraordinary volatility of financial markets, certainly give reason to pause and consider this likelihood.

Recent years have seen hundreds of millions added annually to expenditure from parameter effects and policy measures. In 2007-08, estimated expenses are $342 million higher than budgeted.

Parameter effects, mainly salary and wage increases, are a substantial proportion of this. In the forward years, parameter effects identified in 2007-08 add expenditure in the order of $600 million each year. I note that DTF estimate that an increase of one percent per annum in public sector wide wage outcomes above the amounts factored into the Budget, would have an adverse impact of approximately $200 million in 2011-12.

Policy measures are the other contributor to increased expenses. In 2007-08 these measures included some $100 million in discretionary spending allowed because of unbudgeted revenues and underspending in other areas. This included $50 million to the Adelaide Entertainment Centre (AEC) to enhance facilities that was held in AEC investments as at 30 June 2008. In effect, while reducing the net operating balance for 2007-08, this represented a transfer to the public non-financial corporations sector.

The 2008-09 Budget Papers acknowledge that as well as budgeted expenses, further expenditure, both operating and investing, will be required in future years to support major mining developments, including Olympic Dam at Roxby Downs. These expenditures are not included in the 2008-09 Budget because considerable uncertainty exists about both the amount and timing of expenditure.

2.6.3 Operating Revenues

The 2008-09 Budget is constructed on steady revenue forecasts having regard to property and gambling tax changes and other effects. Overall revenues are budgeted to fall in real terms in 2008-09.

Commonwealth revenues include payments to the State for specific purposes including transport and infrastructure. A major initiative receiving Commonwealth contributions is the AusLink program to improve the transport network. A large part of these revenues are specific purpose grants included in the net operating balance but to cover capital spending. Essentially, in my view, the net operating balance should not be less than AusLink revenue received in any year. I note that the expected AusLink capital grant revenues in the 2008-09 Budget are equal to the budgeted net operating balance in 2008-09 and represent a significant proportion of the net operating balance in each of the forward years to 2011 12.

2.6.4 Savings Initiatives

Setting large value savings targets to fund new spending initiatives is a feature of the past three Budgets. The 2008-09 Budget identifies operating savings over four years of $290 million. These come on top of the 2006-07 and 2007-08 Budget savings identified by agencies, based on either achieving efficiency or reducing particular services. A relatively small proportion of 2006-07 savings initiatives were reversed or delayed.

DTF is reporting that a high proportion of the value of targeted savings is being achieved. I note that after adjustments, the savings target for 2008-09 is in the order of $270 million, in excess of $100 million more than was sought in 2007-08. I also note that as was the case last year, in the forward years, the health portfolio is expected to contribute significant savings to assist funding new initiatives, up to $48.6 million in 2011-12. The health sector has constantly experienced expenditure pressure over the years and received substantial additional resources in 2007-08.[4]

2.6.4.1 Shared Services

The shared services initiative was projected to be a significant contributor to the total savings targets presented in the 2006-07 Budget reaching $45 million by 2008-09 and $60 million each year by 2009-10. I note that staff and service transfers to shared services commenced in early 2008-09, some months after the original target timeframe.

[4] See for example additional resources of $70 million in 2007-08, Budget Statement 2008-09, Budget Paper 3, Table 2.22.

This delay and costs for accommodation are putting pressure on the likelihood of the initiative meeting its savings targets, at least in the original timeframes.

The shared services initiative is discussed in Part A of this Report.

2.6.5 Net Lending

The 2007-08 Budget estimated higher total net acquisition of non-financial assets (capital spending) than past years. The 2008-09 Budget elevates those estimates higher again. General government sector purchase of non-financial assets is budgeted to increase $389 million to $1.4 billion and for the total non-financial public sector is budgeted to increase by $686 million to $2.2 billion.

Last year I noted there may be a heightened risk to the proper management and control of those outlays. Major projects carry high inherent risks including cost estimating, escalations and timeliness of completion. Sustained higher capital outlays than have been made in past years, need to be supported by appropriate project management expertise, information systems and controls. I note that carryovers for investment spending are higher this year than last year showing that achievement of the very large capital program is difficult in the planned timeframes.

2.6.5.1 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 the public sector. I noted last year that private sector capital expenditure for the projects is estimated to be in the order of $700 million, well beyond recent PPP projects.

In 2007-08, these PPPs advanced to the request for proposal stage of the procurement process. In December 2007, the Government announced that the new Marjorie Jackson-Nelson Hospital would be delivered under a public private partnership procurement model.

Most importantly, the nature of these transactions is they involve private sector financing. The credit market crunch experienced in 2007-08 and continuing at the time of this Report, raise the credit and financing risk for the PPPs. In such extraordinary circumstances, progress of these transactions should be done with high degree of caution and may indeed need review of assumptions and information used to date. This may be a significant risk to the fundamental premise of whether a PPP provides a net benefit to the public compared to conventional public sector procurement.

2.6.6 Budget Monitoring

Past Audit Reports have consistently emphasised the need for strong monitoring of budget progress. Audit review in 2007-08 confirmed that the Government has a range of budget monitoring and reporting procedures in place, a summary of which is included in this Report. Indeed, it is evident that in the early part of 2008-09, more stringent management of out of budget spending requests is operating.

2.7 CONCLUDING OBSERVATIONS

The 2008-09 Budget has been prepared on a consistent basis to past years. The revenue predictions allow for anticipated trends and policy changes, and expense projections are restrained. The State, over the past six years has benefited from sustained strength in both the local and national economy with resultant unbudgeted revenue gains.

The global credit crunch, extraordinary volatility of financial markets and escalating inflation mean the 2008-09 Budget will be tested by a more difficult economic environment than any of the previous six years.

The Budget is also consistent with the past two years with a reliance on savings initiatives and increasing capital outlays, including expanding projects under PPP arrangements. As mentioned in last year's Report, new and large scale initiatives commence with a higher inherent risk while experience is gathered.

As always, strong and effective controls based on sound information systems, reporting integrity and effective monitoring, will be needed to support achieving the Budget targets. Audit review indicated a continued 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 DTF as medium and low on a high to low scale.

I note additional processes have been introduced to strengthen review and approval processes for spending decisions. These rely on centralised review of submission recommendations and costings by DTF.

I remain of the view that it would be appropriate for the factors that contribute to the quality of monthly and quarterly reported data to be reviewed with a view to achieving improvements where practical and beneficial. Audit has previously noted that improvements in information systems used in agencies would assist this aim.

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.[5] 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.

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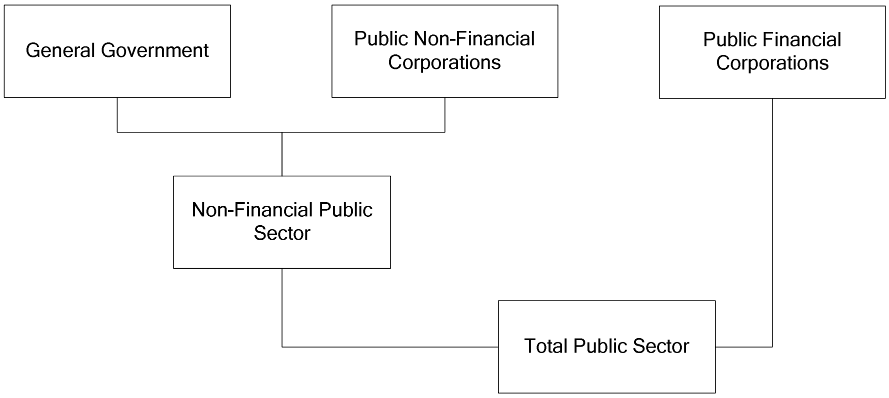
[5] To avoid confusion and ensure consistency, Audit has used the term GFS throughout this Report to refer to the accrual-based Government Financial Statistics (GFS) framework adopted under the Uniform Presentation Framework (UPF).

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.[6]

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 2008-09 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 AAS.

3.3.2 AAS Whole-of-Government Financial Report

Whole-of-government financial reports for South Australia are prepared by DTF 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

On 21 December 2007, the Australian Accounting Standards Board announced that it had completed its review of AAS 27, 29 and 31 and that these standards were to be withdrawn. The requirements of these standards were relocated into existing Australian Accounting Standards or included in new accounting standards operating from 1 July 2008. The new standards include:

- 1050 Administered Items
- 1051 Land Under Roads
- 1052 Disaggregated Disclosures.

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6 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.

Government agencies were advised that DTF will be considering the impact of the withdrawal of AAS 29 (it is the foundation for aspects of the current reporting format and content) and would advise agencies of the impacts and any proposed changes to accounting policy statements.

3.3.4 Convergence of GFS and Australian Accounting Standards

The AASB issued AASB 1049 'Whole of Government and General Government Sector Financial Reporting' in October 2007.

AASB 1049 specifies requirements for whole of government financial reports and General Government Sector (GGS) financial reports of each government. The Standard requires compliance with other applicable AAS except as specified in the Standard. It also requires disclosure of additional information such as reconciliations to key fiscal aggregates determined in accordance with the ABS GFS Manual and, for the whole of government, sector information (GGS, Public Non-Financial Corporations (PNFC) sector and Public Financial Corporations (PFC) sector).

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 2008-09 Budget Papers[7] 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.

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7 Budget Statement 2008-09, Budget Paper 3, p 1.4.

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

Jurisdiction	Budget Fiscal Objective / Strategy [(a)] [(b)]
Commonwealth	Achieving a budget surplus of at least 1.5 percent of GDP.
	Achieving a budget surplus, on average, over the medium term.
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 1 percent of revenue in each year.
	Long Term: Maintain a substantial budget operating surplus that allows for the delivery of the Government's infrastructure objectives.
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

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.

New South Wales is the only other state to give specific focus to net financial liabilities.

5 ESTIMATED RESULT FOR 2007-08

5.1 OVERVIEW

The following section summarises the estimated GFS operating results for 2007-08.

5.2 ESTIMATED RESULT FOR 2007-08

5.2.1 General Government Sector

The estimated result for the year was a GFS net operating balance of $373 million (budget $30 million) and net borrowing result of $15 million (budget $428 million).

The following table shows 2006-07 financial year data and differences between the estimated result and budget for 2007-08.

Table 5.1 — GFS - General Government Budget Comparisons 2006-07 to 2007-08

	2006-07 Actual $'million	**2007-08 Budget $'million**	**2007-08 Estimated Result $'million**	Difference to Budget $'million	Difference to Budget Percent
GFS Revenue					
Taxation revenue	3 250	3 243	3 566	323	10
Current grants	5 714	6 089	6 258	169	3
Capital grants	271	298	314	16	5
Sales of goods and services	1 464	1 505	1 561	56	4
Interest income	167	170	201	31	18
Distributions from PFCs	29	22	23	1	5
Distributions from PNFCs	422	365	407	42	12
Other	438	448	495	47	10
Total Revenue	11 757	12 140	12 825	685	6
Less: **GFS Expenses**					
Gross operating expenses:					
Employee expenses	5 439	5 702	5 861	159	3
Depreciation	498	497	531	34	7
Other operating expenses	2 959	3 107	3 142	35	1
Nominal superannuation interest expense	316	282	276	(6)	(2)
Other interest expense	204	214	225	11	5
Current transfers	1 991	2 216	2 293	77	3
Capital transfers	140	92	126	34	37
Total Expenses	11 547	12 110	12 452	342	3
GFS Net Operating Balance	209	30	373	343	-
Less: **Net Acquisition of Non-Financial Assets**					
Purchases of non-financial assets	771	1 021	1 007	(14)	(1)
Less: Sales of non-financial assets	134	66	88	22	33
Less: Depreciation	498	497	531	34	7
Total net acquisition of non-financial assets	139	458	388	(70)	(15)
GFS Net Lending (Borrowing)	71	(428)	(15)	413	(96)

Note: Totals may not add due to rounding.

As shown in the table, when compared to 2006-07, the 2007-08 Budget anticipated a reduction of the net operating balance from higher growth in expenses than in revenue, and higher purchases of non-financial assets leading to net borrowing.

The estimated result for 2007-08 shows a much stronger than budgeted result. This is essentially from continued substantial growth in revenue.

The primary reasons for the changes from the original 2007-08 budget are as follows:

- ***Taxation Revenue*** — property taxes are expected to exceed budget by $260 million (20 percent) as property market conditions exceeded expectations.
- ***Current Grants*** — better than expected receipts of GST revenue grants (up $91 million) and specific purpose payments (up $78 million) from the Commonwealth.
- ***Expenses*** — up $342 million on budget, of which $159 million was employee expenses.

5.2.1.1 Expenses

As shown in table 5.1, expenses are estimated to total $12.5 billion for 2007-08, up $342 million on budget and $905 million or 7.8 percent higher than 2006-07. The increase from Budget comprised parameter variations of $187 million and policy variations of $274 million. A proportion of each of these is offset by use of provisions of $119 million.

Notably during 2007-08 and particularly in the course of setting the 2008-09 Budget, the receipt of unbudgeted revenues and under expenditure in originally budgeted expenses during the year, allowed the Government to take a range of one-off (not affecting forward estimates) policy spending decisions. The more significant of these, totalling $99.7 million, were:

- $50 million to the Adelaide Entertainment Centre (AEC) to enhance facilities. These funds were held in AEC investments as at 30 June 2008
- $18.9 million to the Royal Zoological Society of SA to redevelop facilities
- $8 million to the Royal Agricultural and Horticultural Society to facilitate the installation of solar power as part of the Goyder Pavilion at the Wayville Showground
- $6.8 million for homelessness initiatives including $4 million for the Foyer Plus Partnership Project in Metropolitan Adelaide and $2.8 million to facilitate the Port Augusta Regional Common Ground Project
- $6 million to Thoroughbred Racing SA to redevelop the Gawler racetrack and $5 million to the South Australian Jockey Club to develop a second track at Morphettville racecourse
- $5 million by equal grants of $2.5 million to each of the Adelaide Football Club and the Port Adelaide Football Club to redevelop sporting facilities.

5.2.1.2 Net Acquisition of Non-Financial Assets

The 2007-08 estimated result for purchases of non-financial assets is slightly less than budget, down $14 million. The 2007-08 budget of $1021 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 $104 million lower than budget.

Table 5.2 — GFS – Purchases of Non-Financial Assets Budget to Estimated Result Comparisons 2007-08

	2007-08 Budget $'million	**2007-08 Estimated Result $'million**	Difference to Budget $'million
Gross purchases of non-financial assets	1 111	1 007	104
Less: Slippage	90	-	90
	1 021	1 007	14

The Budget Papers[8] show the estimated result for most portfolios was lower than budgeted. The majority of under expenditure qualifies for carry over into future budgets. Investing carryovers from 2007-08 to 2008-09 and future years are $154 million[9] ($74 million), in part reflecting the size of the capital program.

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 $17 million, which is $486 million less than budget for the year.

The following table summarises the position.

Table 5.3 — GFS - NFPS Budget Comparisons 2006-07 to 2007-08

	2006-07 Actual $'million	**2007-08 Budget $'million**	**2007-08 Estimated Result $'million**	Difference to Budget $'million	Difference to Budget Percent
GFS Revenue	12 321	12 715	13 464	749	6
Less: **GFS Expenses**	12 175	12 702	13 076	374	3
GFS Net Operating Balance	146	13	388	375	-
Less: **Net Acquisition of Non-Financial Assets**	173	516	405	(111)	(22)
GFS Net Lending (Borrowing)	(26)	(503)	(17)	486	(97)

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 and other operating expenses.

8 Budget Statement 2008-09, Budget Paper 3, Table 2.20.

9 Budget Statement 2008-09, Budget Paper 3, p 1.14.

6 BUDGET 2008-09 OVERVIEW

6.1 OVERVIEW

The following focuses on the trends arising from the 2008-09 Budget tabled in Parliament in June 2008. It provides an overview of:

- the Budget for 2008-09 having regard to the estimated result for 2007-08
- a longer term view of the forecast results going forward to 2011-12.

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

6.1.1 Matters of Significance to the 2008-09 Budget

Some matters of significance to the 2008-09 Budget estimates years, are:

- new operating and investing initiatives totalling $2.85 billion over the next four years[10]
- targeted savings and revenue offsets totalling $737 million over four years[11]
- expenditure restraint compared to revenue growth is projected to lift the net operating balance to $424 million by 2011-12
- higher capital investment leads to general government sector net debt increasing by $1.9 billion to $2 billion by June 2012.

Budgeted total revenues and expenses for 2008-09 are significantly higher than was budgeted in 2007-08.

Total revenue for 2008-09 is now budgeted at $13.3 billion, $766 million or 6.1 percent more than was estimated for 2008-09 in the previous, 2007-08 Budget. Expenses for 2008-09 are now budgeted at $13.1 billion, $810 million or 6.6 percent higher than was estimated at the time of the 2007-08 Budget.

As a consequence of these changes, the net operating balance is now budgeted at $160 million, down from the estimated $205 million 2008-09 result in the 2007-08 Budget but still achieving the fiscal objective of at least a net operating balance for the general government sector.

6.2 GENERAL GOVERNMENT SECTOR – OPERATING STATEMENT

Table 6.1 sets out the differences between the 2008-09 Budget and the estimated results for 2007-08.

Table 6.1 — GFS - General Government Sector Budget Comparison of 2007-08 Estimate Results and 2008-09 Budget

	2007-08 Estimated Result $'million	2008-09 Budget $'million	Difference $'million	Difference Percent
GFS Revenue				
Taxation revenue	3 566	3 615	49	1.4
Current grants	6 258	6 526	268	4.3
Capital grants	314	382	68	21.7
Sales of goods and services	1 561	1 601	40	2.6
Interest income	201	200	(1)	(0.5)

10 Budget Statement 2008-09, Budget Paper 3, Table 2.1.

11 Budget Statement 2008-09, Budget Paper 3, Table 2.1.

Table 6.1 (continued)	2007-08 Estimated Result $'million	2008-09 Budget $'million	Difference $'million	Difference Percent
GFS Revenue (continued)				
Distributions from PFCs	407	421	14	3.4
Distributions from PNFCs	23	23	-	-
Other	495	486	(9)	(1.8)
Total Revenue	12 825	13 255	430	3.4
Less: **GFS Expenses**				
Gross operating expenses:				
Employee expenses	5 861	6 116	255	4.4
Depreciation	531	593	62	11.7
Other operating expenses	3 142	3 281	139	4.4
Nominal superannuation interest expense	276	370	94	34.1
Other interest expense	225	234	9	4.0
Current transfers	2 293	2 372	79	3.4
Capital transfers	126	129	3	2.4
Total Expenses	12 452	13 094	642	5.2
GFS Net Operating Balance	373	160	(213)	(57.1)
Less: **Net Acquisition of Non-Financial Assets**				
Purchases of non-financial assets	1 007	1 396	389	38.6
Less: Sales of non-financial assets	88	94	6	6.8
Less: Depreciation	531	593	62	11.7
Total Net Acquisition of Non-Financial Assets	388	709	321	82.7
GFS Net Lending (Borrowing)	(15)	(548)	(533)	-

Note: Totals may not add due to rounding.

As shown, the differences for the 2008-09 year are due mainly to:

- current revenue grants rising at a greater rate than inflation (CPI is forecast to be 3.75 percent for South Australia in 2008-09)
- increased employee expenses
- increased other operating expenses
- nominal superannuation interest expense rising $94 million or 34 percent
- an increase in total net acquisition of non-financial assets of $321 million, noting that purchases of non-financial assets for 2008-09 is $389 million higher than 2007-08 after allowing for capital slippage provisions of $nil in 2007-08 and $120 million in 2008-09.

More detail of the factors influencing the 2008-09 Budget is considered in the context of the longer-term trends discussed later in this Report.

6.2.1 Reconciliation of Variations since 2007-08 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 carryovers 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 2007-08 Budget that affect the net operating balance and provisions used to offset some of those changes.[12]

Table 6.2 — Reconciliation of General Government Sector Net Operating Balance

	2007-08 Estimated Result $'million	2008-09 Budget $'million	2009-10 Estimate $'million	2010-11 Estimate $'million
2007-08 Budget	**30**	**205**	**336**	**278**
Parameter and other variations				
Revenue - taxation	323	303	289	308
Revenue - other	331	427	506	586
Operating expenses	(187)	(610)	(580)	(668)
Net Effect of Parameter and Other Variations	**467**	**120**	**215**	**226**
Policy measures				
Revenue - Taxation	0	(17)	(35)	(40)
Revenue - Other	2	4	5	5
Revenue offsets - Taxation	1	5	10	12
Revenue offsets - Other	29	43	78	134
Operating expenses	(274)	(337)	(382)	(313)
Net Effect of Policy Measures	**(242)**	**(302)**	**(324)**	**(202)**
Use of Provisions Set Aside in the 2007-08 Budget and the 2007-08 MYBR				
Operating expenses	119	136	128	131
2008-09 Budget	**373**	**160**	**356**	**434**

Note: Totals may not add due to rounding.

6.2.1.1 Revenue Variations

The table shows that revenue changes since the 2007-08 Budget are almost entirely due to parameter changes.

The following table shows the components of revenue parameter changes.[13]

Table 6.3 — Revenue Parameter Changes

	2007-08 Estimated Result $'million	2008-09 Budget $'million	2009-10 Estimate $'million	2010-11 Estimate $'million
Property related taxes	261	234	220	234
Commonwealth SPP's	75	229	264	243
GST revenue grants	91	94	159	170
Payroll tax	40	46	47	53
Royalties	18	30	42	53
Interest income	31	32	24	33
Distributions from PNFCs and PFCs	41	23	(19)	56
Other	97	42	58	52
Total	**654**	**730**	**795**	**894**

[12] Budget Statement 2008-09, Budget Paper 3, Table 1.6.

[13] Budget Statement 2008-09, Budget Paper 3, Table 1.8 and 2007-08 Mid Year Budget Review, Table 1.6.

Consistent with recent years, property related taxes and GST revenue grants account for the major part of higher estimated revenues.

Higher Commonwealth specific purpose grants mainly reflect additional estimated road funding under the AusLink 2 program, recurrent grants for health including Australian Health Care Agreement funding and grants for non-government schools.

Importantly, the Commonwealth AusLink funding is recorded as revenue in the operating statement but a large part of that funding is to support capital expenditure. The following table shows expected AusLink capital grant revenues in the 2008-09 Budget.

Table 6.4 — Commonwealth AusLink Grants

	2008-09 Budget $'million	2009-10 Estimate $'million	2010-11 Estimate $'million	2011-12 Estimate $'million
AusLink roads — Commonwealth contribution	164	232	262	167

This funding arrangement is an example where the budgeted net operating balance includes specific purpose revenues that may only be applied to particular purposes.

6.2.1.2 Operating Expense Variations

Table 6.2 shows that parameter effects are estimated to add operating expenses of $2 billion over the four years to 2010-11.

Policy spending decisions add a further $1.3 billion to operating expenses over the four year period of which $274 million is for 2007-08.[14] It needs to be remembered that these are spending decisions taken after the presentation of the Budget for the year, in this case the 2007-08 Budget. The following table shows the value of policy measures taken after each of the past four Budgets.

Table 6.5 — Policy Spending Decisions

	2004-05 $'million	2005-06 $'million	2006-07 $'million	2007-08 $'million
Policy measure operating expenses	**352**	**217**	**184**	**274**

Table 6.5 shows that over $1 billion was added to spending for the four years. It is evident that there is well established practice of discretionary expenditure decisions being taken after Budgets are announced. While some of these increases are offset by the use of provisions set aside in the respective Budgets and revenues have been available in the immediate years, they frequently flow through to the forward years. This practice and culture adds to the budget management task each year and into future years.

6.3 PUBLIC NON-FINANCIAL CORPORATION SECTOR – OPERATING STATEMENT

The 2008-09 Budget projects a deficit in 2008-09 of $36 million ($31 million surplus 2007-08) for the net operating balance and a net borrowing result for the public

[14] Policy details are in Budget Statement 2008-09, Budget Paper 3, Tables 2.3-2.15.

non-financial corporation (public trading enterprises) of $282 million ($2 million 2007-08). Both are higher than the estimated results for 2007-08 due mainly to increases in budgeted GFS expenditure and net acquisition of non-financial assets.

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

Table 6.6 — GFS - PNFC Budget Comparison 2007-08 and 2008-09

	2007-08 Estimated Result $'million	2008-09 Budget $'million	Difference $'million	Difference Percent
GFS Revenue				
Sales of goods and services	1 418	1 527	109	7.7
Other	727	668	(59)	(8.1)
Total Revenue	2 145	2 196	51	2.4
Less: **GFS Expenses**				
Gross operating expenses	1 441	1 501	60	4.2
Other expenses	672	731	59	5.6
Total Expenses	2 114	2 232	119	5.6
GFS Net Operating Balance	31	(36)	(67)	-
Less: **Net Acquisition of Non-Financial Assets**				
Purchases of non-financial assets	507	788	281	55.4
Less:Sales and depreciation	474	541	67	14.1
Total Net Acquisition of Non-Financial Assets	33	247	214	-
GFS Net Lending (Borrowing)	(2)	(282)	(280)	-

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 $830 million, a deterioration of $813 million from the 2007-08 estimated result.

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 6.7 provides a 10 year time series for those individual elements that contribute to the budget result.[15]

[15] Time series data for all sectors are available in the Appendices to the Budget Statement 2008-09, Budget Paper 3.

Table 6.7 — GFS - General Government Sector Operating Statement - Time Series

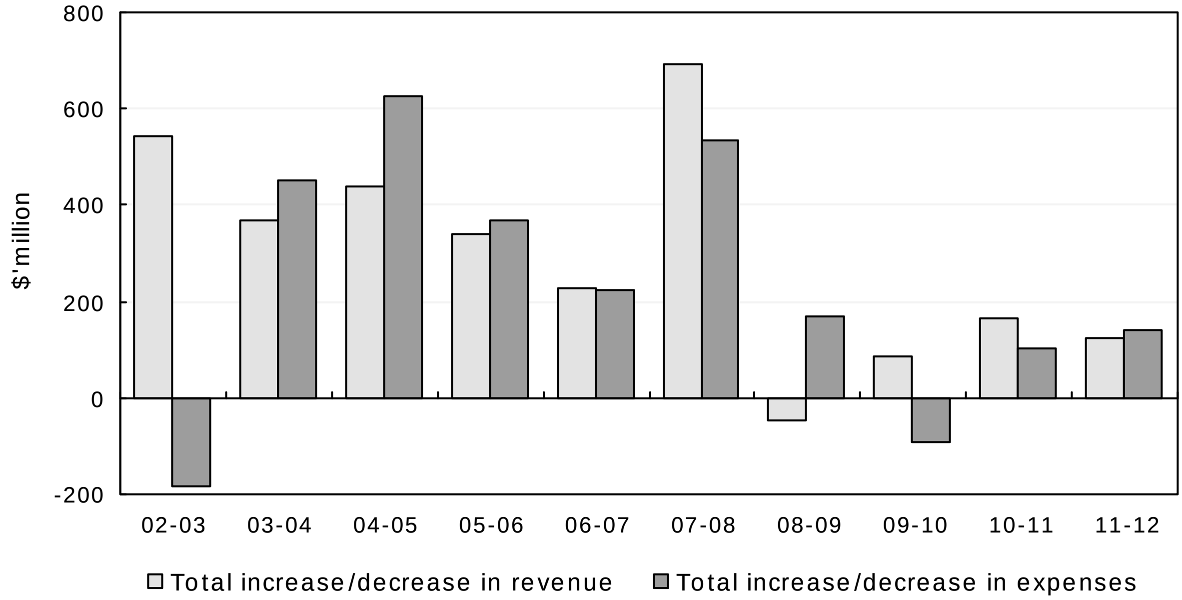
	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12
						Estimated				
	Actual	Actual	Actual	Actual	Actual	Result	Budget	Estimate	Estimate	Estimate
GFS Revenue	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**
Taxation revenue	2 431	2 806	2 941	2 979	3 250	3 566	3 615	3 699	3 839	4 026
Current grants	4 638	4 906	5 206	5 556	5 714	6 258	6 526	6 763	7 017	7 350
Capital grants	209	191	212	221	271	314	382	482	411	311
Sales of goods and services	997	1 165	1 244	1 333	1 464	1 561	1 601	1 660	1 729	1 798
Interest income	146	172	161	147	167	201	200	198	217	233
Distributions from PFCs	332	96	125	116	29	23	23	23	73	62
Distributions from PNFCs	300	373	322	459	422	407	421	374	430	407
Other	293	246	382	431	438	495	486	523	529	553
Total Revenue	9 346	9 955	10 592	11 242	11 757	12 825	13 255	13 722	14 246	14 741
Less: **GFS Expenses**										
Gross operating expenses										
Employee expenses	3 997	4 313	4 649	5 124	5 439	5 861	6 116	6 320	6 496	6 671
Depreciation	401	435	453	454	498	531	593	637	678	725
Other operating expenses	2 126	2 305	2 805	2 808	2 959	3 142	3 281	3 348	3 538	3 718
Nominal superannuation interest expense	299	354	351	344	316	276	370	371	372	372
Other interest expense	297	253	248	223	204	225	234	265	314	382
Current transfers	1 724	1 894	1 824	1 975	1 991	2 293	2 372	2 295	2 282	2 317
Capital transfers	54	16	38	112	140	126	129	130	131	132
Total Expenses	8 898	9 570	10 368	11 040	11 547	12 452	13 094	13 366	13 812	14 317
GFS Net Operating Balance	448	385	224	202	209	373	160	356	434	424
Less: **Net Acquisition of Non-Financial Assets**										
Purchases of non-financial assets	474	530	695	717	771	1 007	1 396	1 694	1 860	1 730
Less: Sales of non-financial assets	41	124	119	144	134	88	94	113	137	121
Less: Depreciation	401	435	453	454	498	531	593	637	678	725
Add: Change in inventories	2	(10)	(18)	-	-	-	-	-	-	-
Total net acquisition of non-financial assets	34	(38)	105	119	139	388	709	945	1 045	884
GFS Net Lending (Borrowing)	414	424	119	83	71	(15)	(548)	(589)	(611)	(460)

Note - Totals may not add due to rounding.

6.5.2 Net Operating Balance Influences

Net operating balances are a primary fiscal target. 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 2011-12.

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



(a) Estimated June 2008 values.

It can be seen that, except for 2008-09, total revenues increased or are estimated to increase in real terms in every year over the period, although at much lower levels in the forward estimate years than earlier years.

In the six years to 2007-08, only in 2002-03 is there a decrease in expenditure in real terms. The 2008-09 Budget projects decreases in real terms in expenses in 2009-10 of $91 million before increasing by $101 million in 2010-11 and $142 million in 2011-12.

The projected current operating surplus for the four years of the 2008-09 Budget is therefore subject to highly constrained expenditure. This was the case in the past two budgets which forecast, but did not achieve, real terms decreases in expenses for those budget years.

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

7 REVENUE

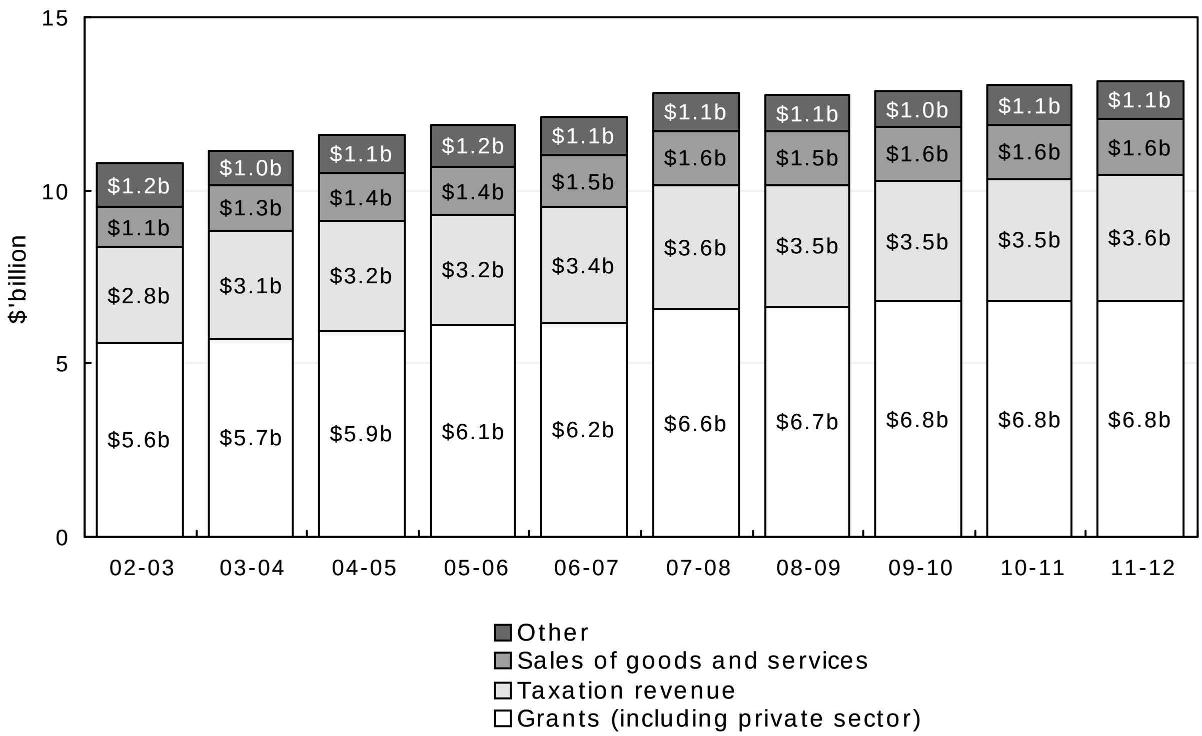
7.1 REVENUE OVERVIEW

Total general government sector GFS revenues are estimated to be $13.3 billion in 2008-09, an increase of $430 million (3.4 percent) over the previous year's estimated result, but a fall in real terms of 0.4 percent.

General government sector GFS revenues are estimated to rise annually (and in real terms) after 2008-09 to $14.7 billion in 2011-12.

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 2008 values.

Notable trends for revenue are:

- as from 2004-05 to the end of the forward estimate period in 2011-12 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 the Budget Statement 2008-09.

7.1.1 Commonwealth Grants

Total estimated Commonwealth funding to the State for 2008-09 is $6.8 billion. Funding in 2011-12 is expected to grow to $7.5 billion, (51 percent of GFS revenues) a real increase of $278 million over 2007-08.

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. GST revenues are expected to be a growth tax. This has proven to be the case and national tax reform is estimated to provide net revenue benefits to the State.[16]

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 $4.2 billion in 2008-09 to $4.9 billion in 2011-12, a real increase of $418 million from 2007-08.

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 increase from $2.6 billion in 2008-09 to $2.7 billion in 2011-12, a real decrease of $140 million from 2007-08. 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.[17]

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 2007-08. Taxation revenue comprises collections from a diverse range of activities, including payroll, property, motor vehicles and gambling activities.

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.[18]

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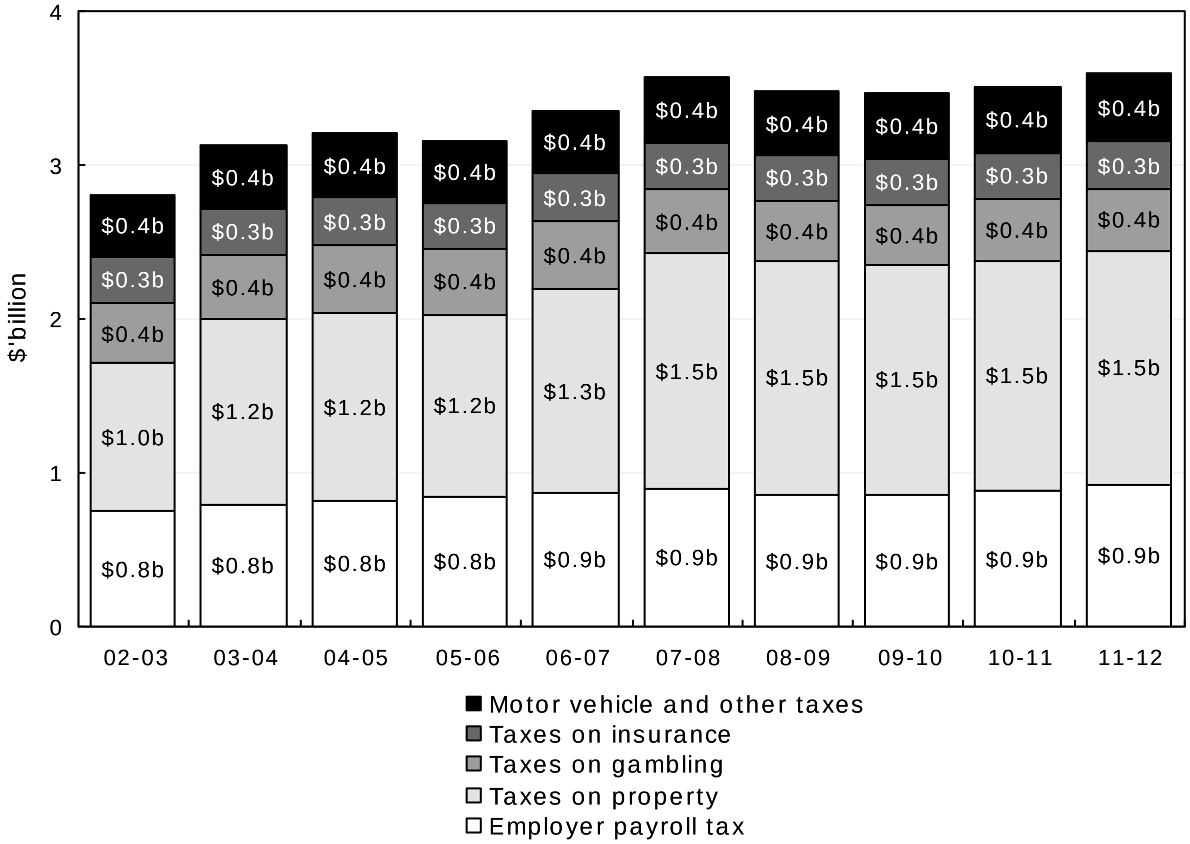
16 Budget Statement 2008-09, p 4.6

17 Budget Statement 2008-09, p 4.7

18 Budget Statement 2008-09, pp 3.18-3.19 discusses South Australia's relative taxation effort.

The following chart examines the trend in the components of taxation receipts (in real terms) over the 10 year period to 2011-12.

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



(a) Estimated June 2008 values.

The chart demonstrates that up to 2007-08 variations in taxation revenue were primarily due to property taxes. Total taxes, in real terms, fall in 2008-09 and rise slightly over the remaining forward estimates period.

Taxation receipts for 2008-09 are estimated to be $3.6 billion, a nominal increase of $49 million over the estimated result for 2007-08.

Taxation revenue is expected to be $4 billion in 2011-12, a real increase of only $27 million compared to $3.6 billion in 2007-08.

7.1.2.1 Property Taxes

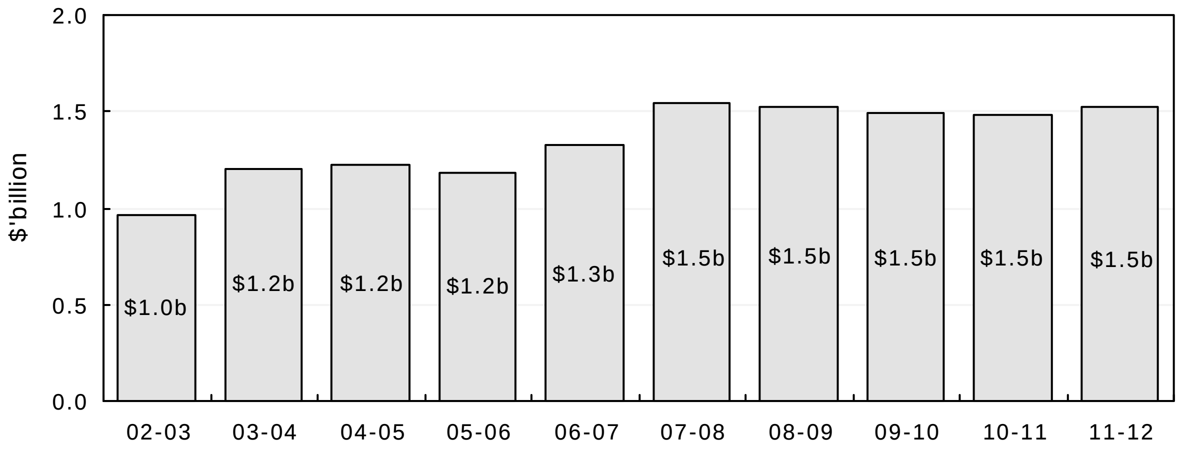
Property taxes include land tax, stamp duty on conveyances, mortgages, shares, rental, emergency services levy (ESL) on fixed property and water catchment levies.

Property taxes for 2008-09 are estimated to be $1.6 billion, a real decrease of $20 million from the estimated result for 2007-08.

Property taxation revenue is expected to be $1.7 billion in 2011-12, a real decrease of $21 million compared to 2007-08.

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

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



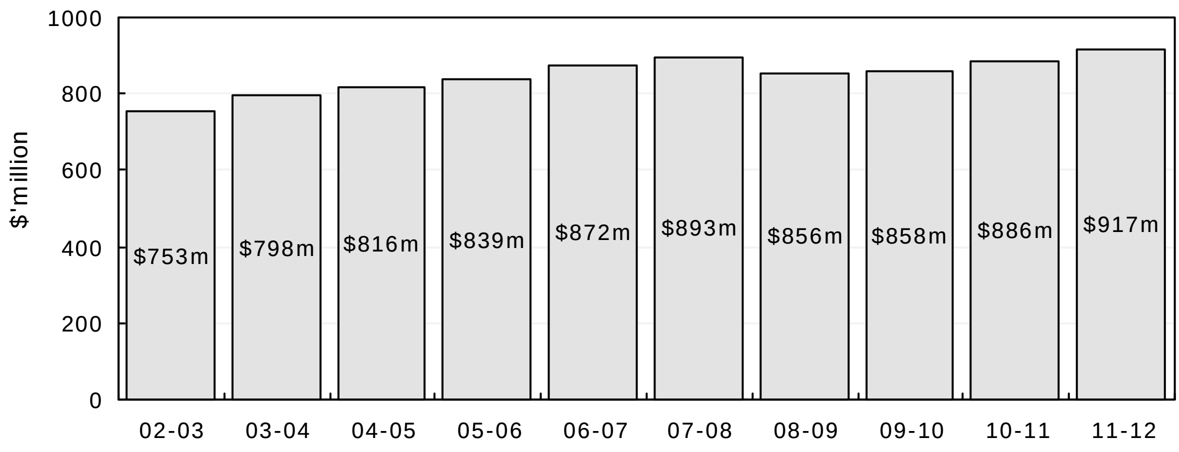
(a) Estimated June 2008 values

The Budget Papers note that property tax revenues are affected by IGA tax policy reforms that take effect over the forward estimate period. These reforms will depress property tax growth in years up to and including 2010-11 as shown in chart 7.3.

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 2008 values

Payroll taxes for 2008-09 are estimated to be $888 million, a real decrease of $37 million from the estimated result for 2007-08. The payroll tax threshold will be increased from $504 000 to $552 000 from 1 July 2008 and further increased to $600 000 from 1 July 2009. In addition, the payroll tax rate will be reduced from 5.0 percent to 4.95 percent from 1 July 2009.

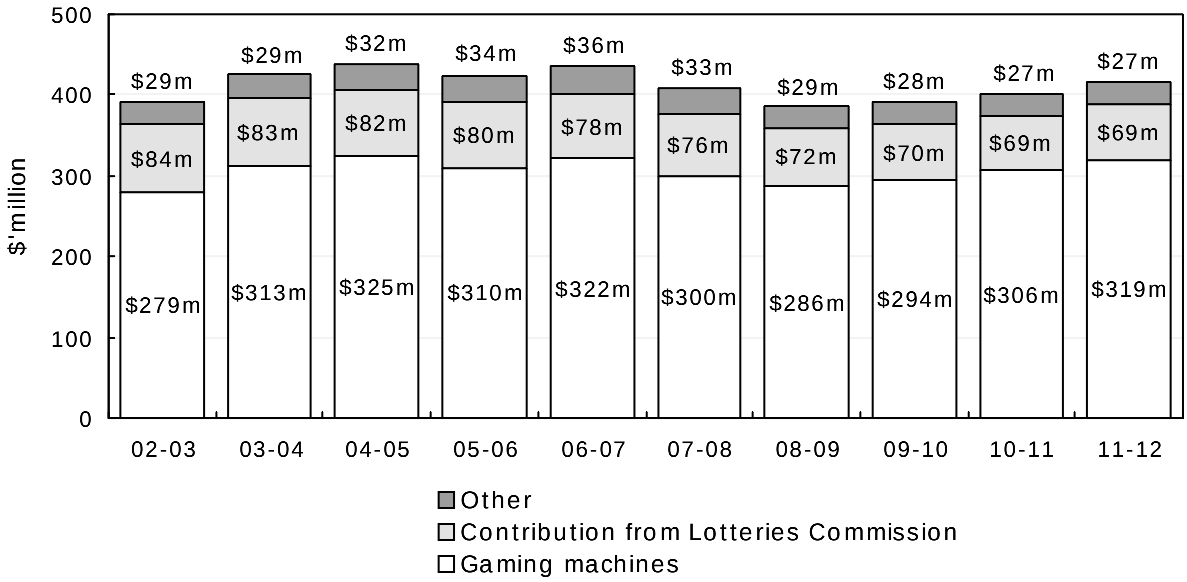
Payroll taxes are expected to be $1028 million in 2011-12, a real increase of $25 million compared to 2007-08.

7.1.2.3 Gambling Taxes

Gambling taxes for 2008-09 are estimated to be $401 million, a real decrease of $22 million from the estimated result for 2007-08. Gambling taxes are expected to be $464 million in 2011-12, a real increase of $5 million compared to 2007-08.

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

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



(a) Estimated June 2008 values

Gaming machine revenues, which account for 73 percent of 2007-08 gambling taxes, fell in 2007-08 and are expected to decline in 2008-09 reflecting the expected full year effect 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 2007-08. Sales of goods and services by the general government sector include Government fees and charges most of which increase by 3.5 percent from 1 July 2008 reflecting the annual indexation of fees.

Revenue from sales of goods and services is fairly stable over the forward estimates period (increasing from $1.54 billion in 2008-09 to $1.6 billion in 2011-12 (real terms).

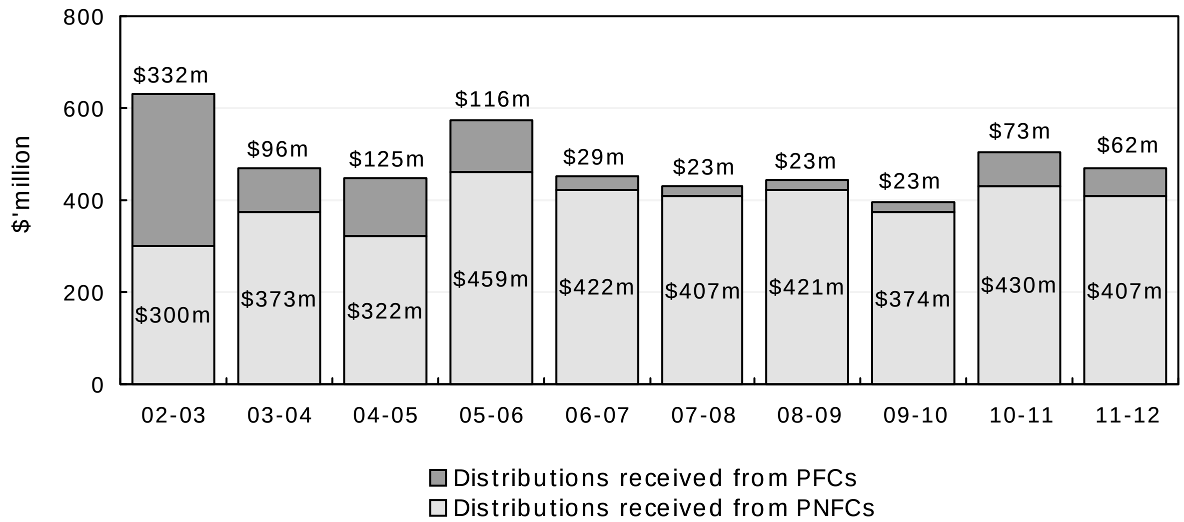
7.1.4 Other Revenue

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.

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 2011-12.

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



The chart highlights after early variability up to 2005-06, PNFC and PFC distributions are reasonably stable through to 2009-10. Estimated PFC distributions increase from 2010-11. The Budget Papers note that SAFA has excess capital and this can be prudently reduced by a larger distribution in 2010-11. Also, estimated SAAMC distributions in 2011-12 are higher reflecting the expectation that the activities of SAAMC will largely be completed by 2011-12 when the entity is likely to be wound up.

7.1.4.1 Public Non-Financial Corporations

In 2007-08, distributions received from PNFCs are estimated to amount to $407 million, a decrease of $16 million (4 percent) from the previous year's result but $41 million (11 percent) over budget. The increase from budget mainly reflects higher than expected distributions from the Land Management Corporation.

7.2 RISKS TO REVENUE

The Budget Statement 2008-09 provides quite detailed consideration of various risks to the amount and the flexibility of the revenue budget. Included in the risk analysis is:

- ***taxation*** — a variance of 1 percent in state taxation revenue equates to about $36 million per annum.

- ***Commonwealth general purpose grants*** — A variance of 1 percent in GST revenue growth has a revenue impact of $39 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 (CGC). Methodology changes may impact on the State, either positively or adversely.

  A 0.01 change in South Australia's CGC relativity results in a change in GST revenue grants of $37 million.

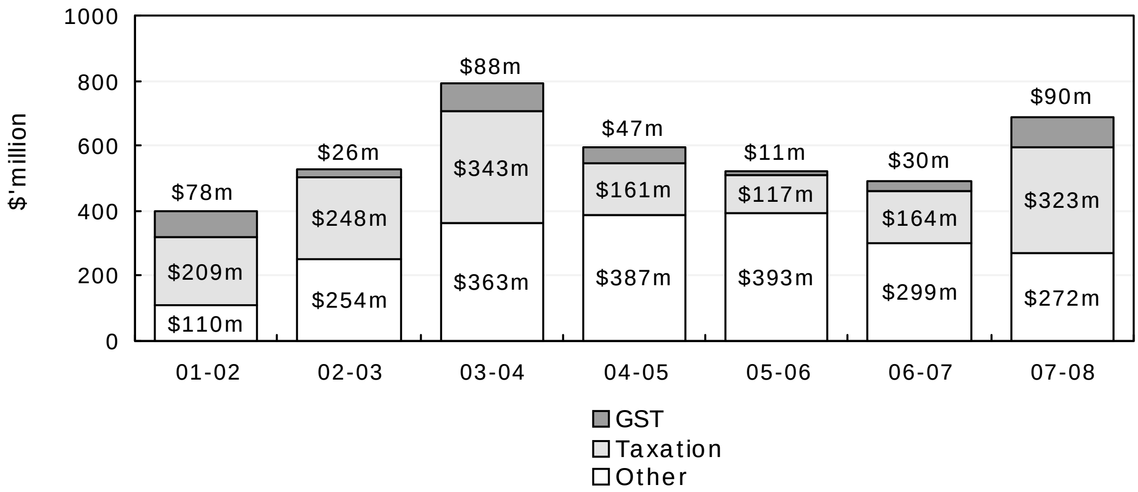
- ***Commonwealth specific purpose grants*** — Funding levels of SPPs are exposed to the risk of variability in the parameters that determine funding levels and variability in Commonwealth policy settings.

Readers are referred to the Budget Statement 2008-09, 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*



* 2007-08 estimated result

The chart highlights the very large favourable variations from budget that have been enjoyed up to 2007-08.

8 EXPENSES

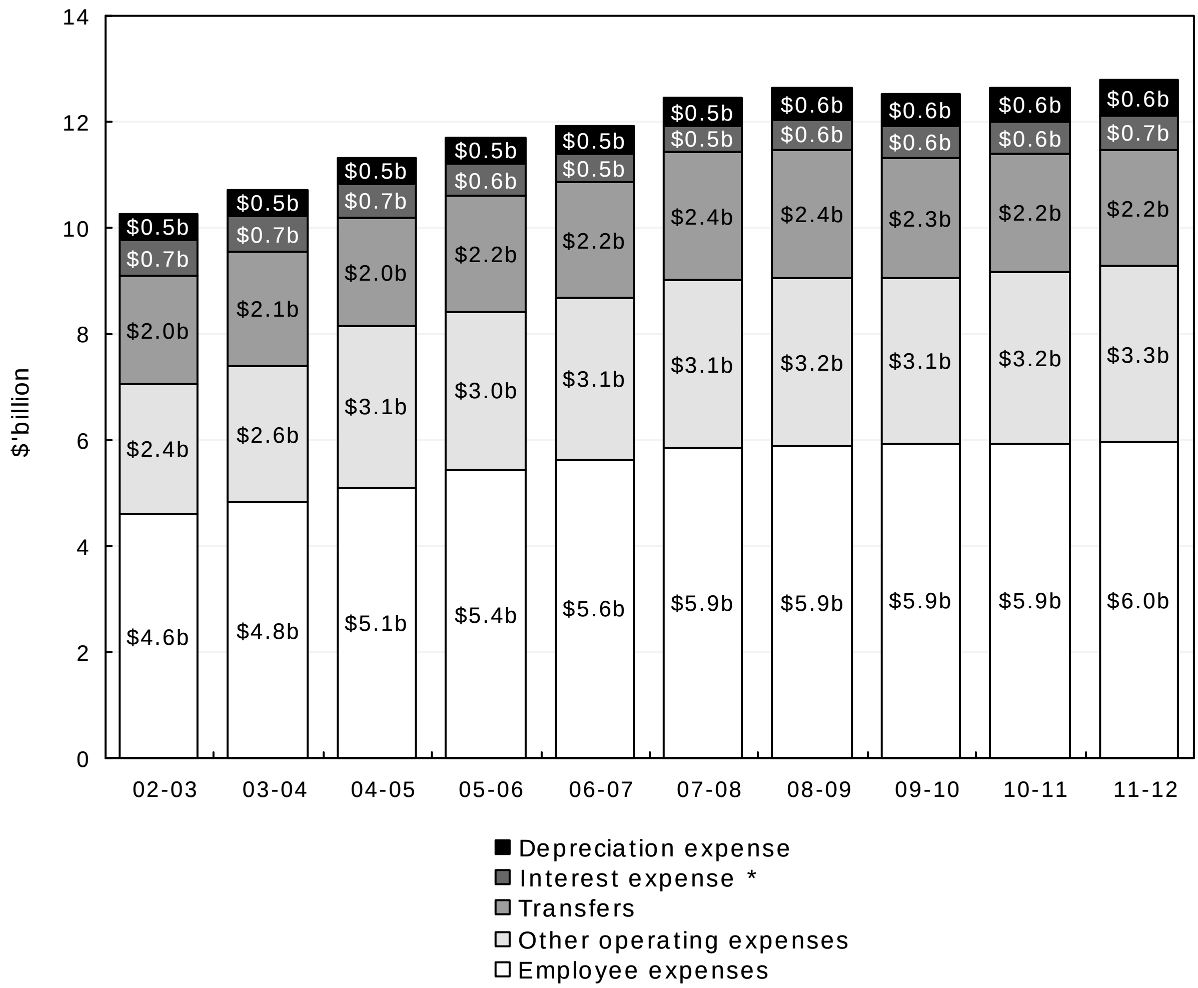
8.1 EXPENSES OVERVIEW

For 2007-08 estimated GFS expenses total $12.5 billion and exceed budget by $342 million or 2.8 percent.

Total GFS expenses for 2008-09 are budgeted to be $13.1 billion, $642 million or 5.2 percent higher than 2007-08 and grow to $14.3 billion in 2011-12, a real increase of 2.6 percent from 2007-08.

The following chart highlights the trends in GFS expenses (in real terms) that have emerged since 2002-03.

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



(a) Estimated June 2008 values.
* Includes nominal superannuation interest expense.

The chart shows GFS expenses (in real terms) grew annually from 2002-03 to 2007-08 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 2008-09, Budget Paper 3, Chapter 2.

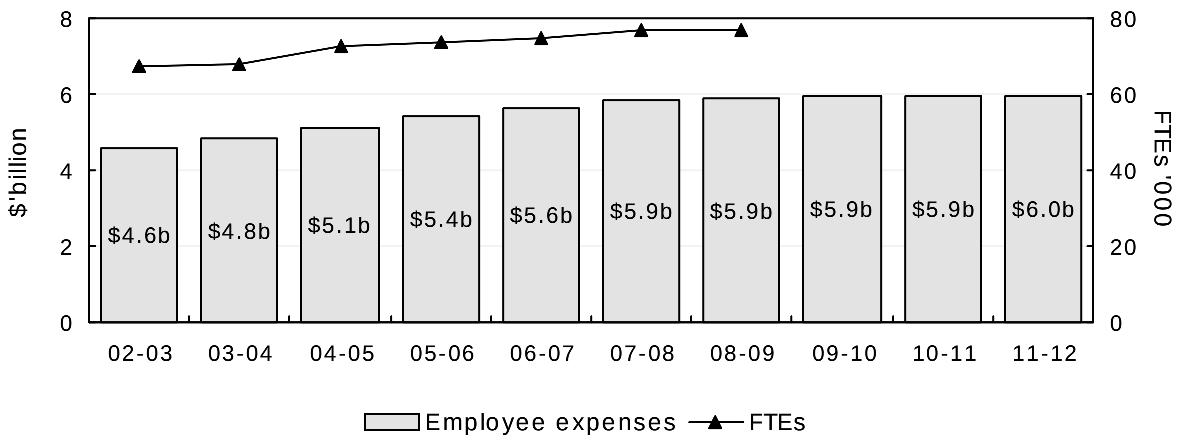
8.2 EXPENSES BY TYPE

8.2.1 Employee Expenses

Employee expenses (an estimated $5.9 billion in 2007-08) represent the highest proportion (47 percent) of GFS expenses. They are estimated to increase by 4.4 percent in 2008-09 and about 2.9 percent per year to 2011-12.

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

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



(a) 2007-08 and 2008-09 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 2008-09.

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 2007-08 employee expenses grew by an average of 8 percent per year. The 2008-09 Budget shows employee expenses growing in real terms on an average of 0.4 percent, a much lower rate than in prior years. This is mainly because, for presentation purposes, the employee expenses line in the forward estimates does not include full estimates for enterprise agreements to be renegotiated in 2008-09.

The 2008-09 Budget provides for anticipated public sector wage increases over the forward estimates period, both in individual agency budgets, and in the total of the contingency items in the 'Administered Items for Department of Treasury and Finance' to cover future enterprise agreement outcomes.

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 at the time of presentation of the 2008-09 Budget are for:

- salaried medical officers
- teachers
- TAFE lecturers
- metal and building trades employees
- Metropolitan Fire Service fire fighters.

8.2.2 Other Operating Expenses

Other operating expenses include general purchases of goods and services.

These expenses are estimated to be $3.3 billion for 2008-09, an increase of $139 million or 4.4 percent in nominal terms from 2007-08.

The projection for the forward years to 2011-12 is for a real terms increase of 5.6 percent from 2007-08 to 2011-12.

The Budget Papers state that under the forward estimates indexation policy, agencies are required to absorb any cost increases within their existing budget allocations unless the specific price increase has a material effect on the agency budget. The materiality test is: a price change alters the overall agency price indexation by more than 0.5 percentage points above or below the standard 2.5 percent indexation.

8.2.3 Contingency Provisions

Contingency amounts are incorporated into the budget to provide flexibility if additional expenditure is required to be made by the Government. The 2008-09 Budget includes contingency amounts totalling $335 million, $201 million more than the previous Budget. The following table shows the composition of contingency provisions for two years to 2008-09.

Table 8.1 — Contingency Provisions

	2007-08 Budget $'million	2007-08 Estimated Result $'million	2008-09 Budget $'million
Employee entitlements	16	76	**70**
Investing Contingencies	36	31	**55**
Supplies and services	82	34	**210**
	134	142	**335**

While allocating sums to each of the categories for presentation purposes, contingency funds may also be transferred from other lines where available. This is demonstrated in table 8.1 where the 2007-08 estimated result for employee entitlements is $60 million higher than the original budget.

The inclusion of contingencies is a consistent approach to previous Budgets.

8.2.4 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
- community service obligation (CSO) payments to the South Australian Water Corporation and Forestry SA.

Transfer payments are estimated to be $2.4 billion for 2007-08, that is, $111 million or 5 percent above budget.

Current transfers are estimated to increase in 2008-09 ($82 million) largely due to payments to be made under the joint Commonwealth/State Exceptional Circumstances drought relief program, additional support to address growth in the number of children in care and for supported residential facilities.

8.2.5 Nominal Superannuation Interest Expense

In 2008-09 and across the forward estimates, nominal superannuation interest expense is expected to be higher than estimated in the 2007-08 Budget in the order of $90 million each year. This reflects the effect of increases in the unfunded superannuation liability across the forward estimates, primarily as a result of changes in demographic and economic factors recommended by the 2007 independent triennial actuarial review and significantly lower than expected earnings on superannuation assets in 2007-08.

As the estimate of the liability is not final at the time of the Budget, it may be further adjusted for actual earnings on superannuation assets in 2007-08. The Budget Papers note that a one percentage point lower than expected return on superannuation assets invested by Funds SA would increase estimated unfunded superannuation liabilities by around $61 million. An increase in unfunded superannuation liabilities of this magnitude would increase nominal superannuation interest expenses, decreasing the net operating balance result by around $5 million per annum.

8.2.6 Interest Expense

Estimated interest expense in 2007-08 was $225 million and is projected to increase by 70 percent to $382 million in 2011-12 as a result of projected borrowing to fund capital programs.

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

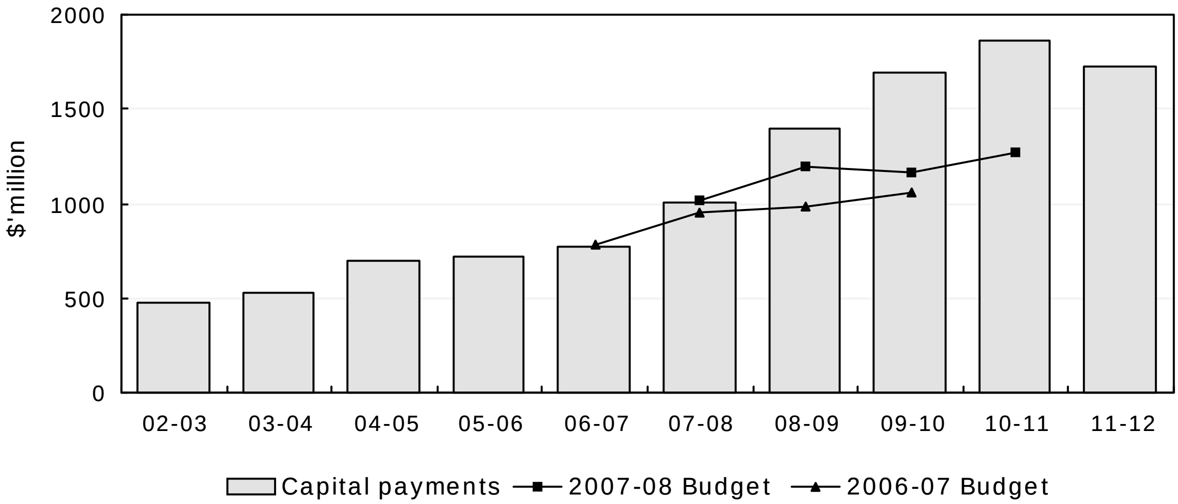
8.2.7 Capital Payments

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 $1 billion in 2007-08, increase to $1.4 billion in 2008-09 and be $1.7 billion in 2011-12.

The following chart shows purchase of non-financial assets over the 10 year period to 2011-12, overlayed with budgeted purchases from the 2006-07 and 2007-08 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 2008-09 Budget, particularly compared to that estimated for the 2006-07 Budget.

Although there will be components of future expenditure that have effectively been committed, the forward years contain funds contingent on approvals. The investing contingency provision for 2008-09 is $55 million.

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

8.2.7.1 Infrastructure Planning

Past Reports have commented that proper infrastructure planning is fundamental to the efficient and effective use of public resources. The Strategic Infrastructure Plan for South Australia was released on 6 April 2005. The Plan sets priorities and establishes new processes which will effectively guide the delivery of major infrastructure projects until 2015. The Plan is currently under mid term review by the Department for Transport, Energy and Infrastructure.

8.2.8 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), prisons (lead agency Department for Correctional Services) and youth detention infrastructure (lead agency Department for Families and Communities) in 2006-07.

In December 2007 the Government issued an Expression of Interest (EOI) for the New Prisons and Secure Facilities (NPSF) and Education Works New Schools PPP projects.

Further comments on the progress of these developments during 2007-08 are contained in the sections of Part B of this Report titled 'Department for Correctional Services' and 'Department of Education and Children's Services'.

In December 2007, the Government announced that the new Marjorie Jackson-Nelson Hospital would be delivered under a public private partnership procurement model.

Most importantly, the nature of these transactions is they involve private sector financing. The credit market crunch experienced in 2007-08 and continuing at the time of preparation of this Report, raises the credit and financing risk for the PPPs. In such extraordinary circumstances, progress of these transactions should be done with high degree of caution and may indeed need review of assumptions and information used to date. There may be a significant risk to the fundamental premise of whether a PPP provides a net benefit to the public compared to conventional public sector procurement.

8.2.8.1 Financial Reporting of PPPs

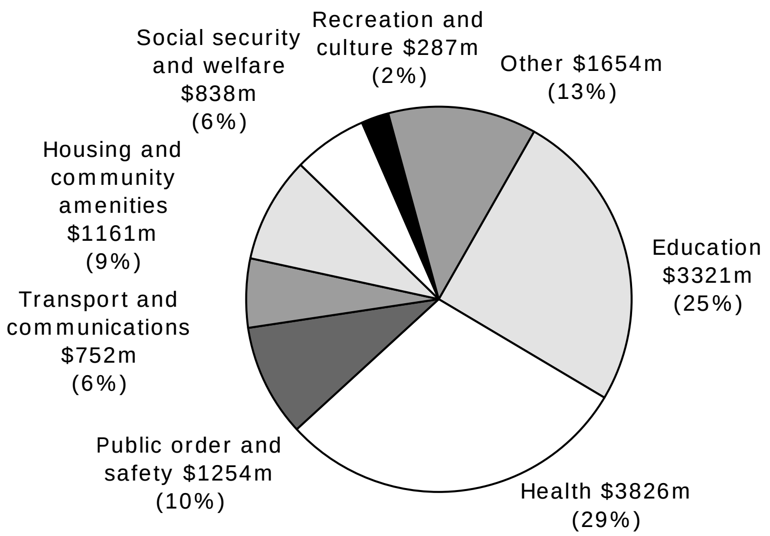
The use of PPPs can alter the financial reporting of costs associated with the construction and operation of relevant infrastructure. Depending on the terms of contracts, PPPs may, under current accounting standards, be excluded from state Balance Sheets (may be off-Balance Sheet) through their contractual arrangements and assignment of risks and benefits.

The 2008-09 Budget Papers indicate the PPPs arrangements for prisons and secure facilities and schools are recognised as finance leases in the Balance Sheet, and consequently have an impact on net debt and net financial liabilities.

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 2008-09 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[19] ($'million)



8.4 RISKS TO EXPENSES

8.4.1 Overview

As with revenue, the Budget Statement 2008-09 provides detailed consideration of various risks to the expenditure budget and acknowledges the management task for achieving budgeted outcomes.[20]

Some of the key risks reported are:

- ***wages and salaries*** — An increase of 1 percent per annum above the amounts factored into the Budget would have an adverse impact of approximately $200 million in 2011-12
- ***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

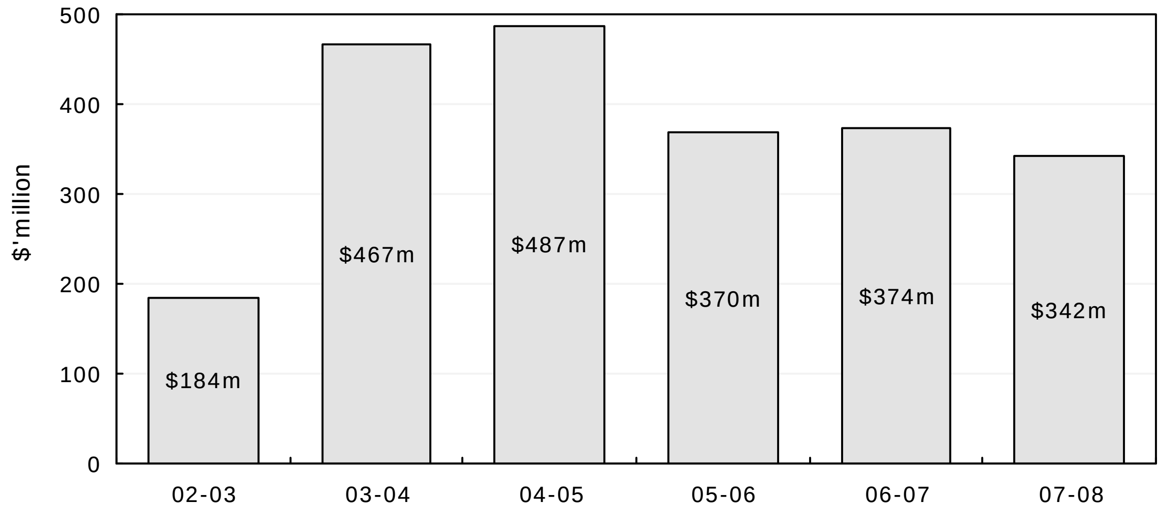
[19] Budget Statement 2008-09, Budget Paper 3, Table 2.18.

[20] Budget Statement 2008-09, Budget Paper 3, p 7.8

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. A 1 percent increase in costs for the capital program will increase expenditure by approximately 14 million per year.

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) 2007-08 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 due to parameter variations and policy measures funded by rising revenues.

8.4.2 Savings and Revenue Offsets

Large value savings to fund new spending initiatives are a feature of the past three Budgets. The 2008-09 Budget identifies operating savings over four years of $290 million. These come on top of the 2006-07 and 2007-08 Budget savings identified by agencies, based on either achieving efficiency or reducing particular services. A summary of the published total operating savings initiatives for the past three Budgets for the four years to 2011-12 is as follows:

Table 8.2 — Summary of Budget Operating Savings

	2008-09 $'million	2009-10 $'million	2010-11 $'million	2011-12 $'million
Total Savings 2006-07 Budget	223	277	*	*
Total Savings 2007-08 Budget	45	64	82	*
Total Savings 2008-09 Budget	8	36	86	161
Total Savings	276	377	168	161

* Not published

A relatively small proportion of 2006-07 savings initiatives were reversed or delayed. After adjustments, the savings target for 2008-09 is in the order of $270 million, in excess of $100 million more than was sought in 2007-08.

Revenue offsets are revenues received from external parties for the specific purpose of, and incidental to, a Budget expenditure measure. The 2008-09 Budget includes revenue offsets of $447 million. These include contributions from the Commonwealth Government totalling $351 million including $252.9 million under the AusLink program and $73 million under the Commonwealth State Territory Disability Agreement.

8.4.3 Nature of Savings Initiatives

The 2006-07 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

- identified savings as a result of proposed structural changes to government totalling $40 million over four years.

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

The 2008-09 Budget states that savings measures announced in the Budget have been removed from agency overall budgets in amounts shown in table 8.2. The means for achieving some of the savings is not yet determined. The 2008-09 Budget states that details of the specific measures that will achieve $25 million savings from 2009-10 will be presented in the 2009-10 Budget. Specific savings measures of $40.4 million over the next four years in the Families and Communities portfolio include a range of administrative efficiencies and rationalisation of service delivery arrangements implemented to partially address overspending in that portfolio.

8.4.4 Savings Initiatives – Shared Services

The shared services initiative was projected to be a significant contributor to the total savings targets in the 2006-07 Budget, reaching $45 million by 2008-09 and $60 million per year by 2009-10.

The initiative is a complex project involving transferring staff and services responsible for administering public sector operations encompassing payroll, creditor payments, revenue collection, procurement and various supporting arrangements such as ICT from various agencies to a single organisation.

The major transition phase commenced in early 2008-09 some months after the original target timeframe. This delay and costs for accommodation are putting pressure on the likelihood of the initiative meeting its savings targets at least in the original timeframes. I note that SSSA believes that, with support, shared services reform can be successfully implemented and produce significant ongoing savings.

A discussion of the progress of the shared services initiative is included in Part A of this Report.

8.4.5 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 the past two years, DTF has advised that a number of strategies are undertaken to allow DTF, the Treasurer and the Expenditure Review and Budget Cabinet Committee (ERBCC) 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
- quarterly reporting of progress of achieving budget initiatives or whether the initiative is at risk
- end of October, December and February reporting by agencies on the status of their Capital Investment Program
- a carry over policy to identify under expenditure by agencies allowing Cabinet to approve carryovers or redirect funds
- 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)
- FTE monitoring against FTE caps
- 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.

8.4.6 Audit Review of Budget Monitoring and Reporting

Audit reviewed aspects of the DTF and ERBCC budget monitoring process for 2007-08. The following summarises processes observed and/or advised. The review focussed on the processes and evidence of completion of the process. It did not address the reliability of reported data.

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

- Reporting on operating and capital budget positions, FTE caps and 2007-08 budget initiatives and 2006-07 savings initiatives (that scheduled to begin in 2007-08) 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.

Detailed consolidated reports were prepared as at September 2007, December 2007, March 2008 and June 2008 for each initiative within classifications of complete, expected success, at risk/delayed, not proceeding. For the year to June 2008 most of the operating expenditure initiatives was reported as spent. Capital expenditure initiatives of $158 million were underspent by $74 million.

Of $109 million budgeted savings initiatives, agencies achieved $101 million of savings and of $44 million of centrally held savings, $37 million was achieved, mainly, from $25 million of ICT savings adjustments to agency budgets. Savings from printing and publications, motor vehicles and office accommodation were not achieved and/or proceeding. Last year DTF advised that for motor vehicles, this was to support local industry. Accommodation savings would be pursued as opportunities arise.

- Reporting agency FTE caps commenced in 2007-08. Initially reporting was monthly but reduced to quarterly for most agencies after December 2007. As at 31 March 2008, most agencies were well under their caps. Health was significantly over its cap by 925 FTEs or 3.5 percent, reporting unbudgeted activity in health units as the cause. DECS and DTEI were only slightly above their FTE caps.

- For 2008-09, a new process was introduced to increase scrutiny of out-of-budget expenditure submissions. Submissions were submitted to ERBCC for approval before review by the full Cabinet. Submissions not approved required a revised submission for further consideration. For ERBCC, submissions were accompanied by DTF comments on submission recommendations and costings.

Last year I reported it was evident there was a need for improvement of data quality in some areas. From review of the summaries to May 2008 this remains the case. This was again 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 also continued to be consistently rated by DTF as medium and low on a high to low scale.

The overall end of year projection for 2007-08 was again 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 is provided to ERBCC for the completed year generally in October following the year. The report is prepared from completed agency financial reports for the financial year.

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).[21]

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)

	2004-05 Actual $'million	2005-06 Actual $'million	2006-07 Actual $'million	2007-08 Estimated Result $'million	2008-09 Estimate $'million	2009-10 Estimate $'million	2010-11 Estimate $'million	2011-12 Estimate $'million
Financial assets	16 915	17 979	19 311	19 736	20 433	21 146	21 903	22 907
Non-financial assets	12 505	13 857	14 018	15 054	15 848	16 841	17 930	18 857
Total assets	29 420	31 836	33 329	34 791	36 281	37 987	39 833	41 764
Total liabilities	13 061	12 133	11 201	13 109	13 856	14 625	15 513	16 337
Net worth	16 359	19 703	22 128	21 682	22 425	23 361	24 320	25 427
Net financial worth	3 853	5 846	8 110	6 627	6 577	6 520	6 390	6 570
Net debt	144	(119)	(24)	82	610	1 154	1 677	1 983

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 2004-05 to 2011-12. 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
- net worth (assets less liabilities) increases across the forward estimates. This is due to asset growth
- net debt increased across the forward estimates to $2 billion in 2011-12 due mainly to increased borrowing to fund major capital investment programs.

[21] Budget Statement 2008-09, Budget Paper 3, Appendix D details agencies within the respective sectors.

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)

	2004-05 Actual $'million	2005-06 Actual $'million	2006-07 Actual $'million	2007-08 Estimated Result $'million	2008-09 Estimate $'million	2009-10 Estimate $'million	2010-11 Estimate $'million	2011-12 Estimate $'million
Financial assets	3 450	3 902	4 084	3 739	3 930	4 114	4 482	5 145
Non-financial assets	27 363	29 592	30 922	32 851	34 394	36 458	38 694	40 327
Total assets	30 813	33 494	35 006	36 590	38 324	40 571	43 176	45 472
Total liabilities	14 454	13 790	12 878	14 908	15 899	17 210	18 856	20 045
Net worth	16 359	19 703	22 128	21 682	22 425	23 361	24 320	25 427
Net financial worth	(11 004)	(9 889)	(8 795)	(11 169)	(11 969)	(13 096)	(14 374)	(14 900)
Net debt	2 126	1 786	1 989	2 029	2 776	3 804	4 849	5 230

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 $1.9 billion in 2007-08 to $32.9 billion, and a further $7.5 billion by 2011-12 to $40.3 billion. The main increases in 2007-08 are revaluations of South Australian Housing Trust rental assets, estimated to increase by $396 million in 2007-08
- 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.

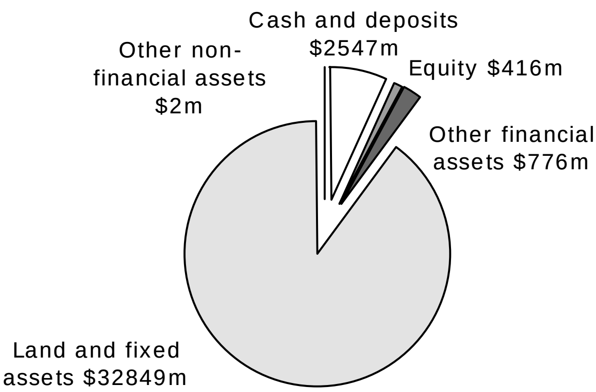
9.3 ASSETS

Table 9.2 shows that the State's asset position is varying significantly from year to year because of major asset acquisitions 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 2008 for the non-financial public sector.

Chart 9.1 — GFS - Non-Financial Public Sector Assets at 30 June 2008 ($'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 2004-05 to 2007-08 for the major agencies in the general government and public non-financial corporations sectors.

Table 9.3 — Revaluation of Non-Financial Assets

	2004-05 $'million	2005-06 $'million	2006-07 $'million	2007-08 $'million	Total $'million
General government	421	646	240	987	2 295
Public non-financial corporations	1 363	707	970	863	3 902
Total	1 784	1 353	1 210	1 850	6 197

Revaluation of the assets of the major agencies added $6.2 billion to the total value of non-financial assets over the four year period to 2007-08.

The rental properties of the South Australian Housing Trust alone contributed $2.4 billion of this as the value of housing stock rose from $4.1 billion as at 30 June 2004 to $6.6 billion as at 30 June 2008.

9.3.2 Public Financial Corporations Financial Assets

From 2007-08, the majority of the Government's financial assets are held by the Superannuation Funds Management Corporation (Funds SA). This includes funds of the Motor Accident Commission and SAFA.

The following table shows Funds SA's holdings of investment assets as at 30 June 2008:

Table 9.4 — Funds SA's Investments [(a)] [(b)]

	Domestic Equities $'million	International Equities $'million	Fixed Interest $'million	Other Investments $'million	Total 30 June 2008 $'million
Funds SA	3 936	3 781	1 977	4 476	14 171

(a) Market values have been used in determining the above amounts for the year ending 30 June 2008.
(b) Excludes WorkCover.

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 Funds SA.

Funds SA incurred a net loss for assets under management in 2007-08 of $1478 million reflecting the negative movements of investment markets for the year.

One impact of the negative market returns was a deterioration in the Motor Accident Commission's solvency level, which while still positive, was at a level where there is little margin for further negative investment performance without risking not meeting the solvency requirements.

Negative market returns also reduced SAFA's insurance investments assets and contributed to SAFA incurring a net loss for 2007-08.

As from 1 July 2008, the Auditor-General became the statutory auditor of WorkCover. I note that WorkCover's half yearly report to 31 December 2007 indicated that it had also been affected by investment returns that were poorer than those of prior periods following the decline in worldwide investment markets. At the time of this Report, WorkCover's full year financial report was not available.

Further commentary is included under 'Motor Accident Commission', South Australian Government Financing Authority' and 'Superannuation Funds Management Corporation' (Funds SA) in Part B of this Report.

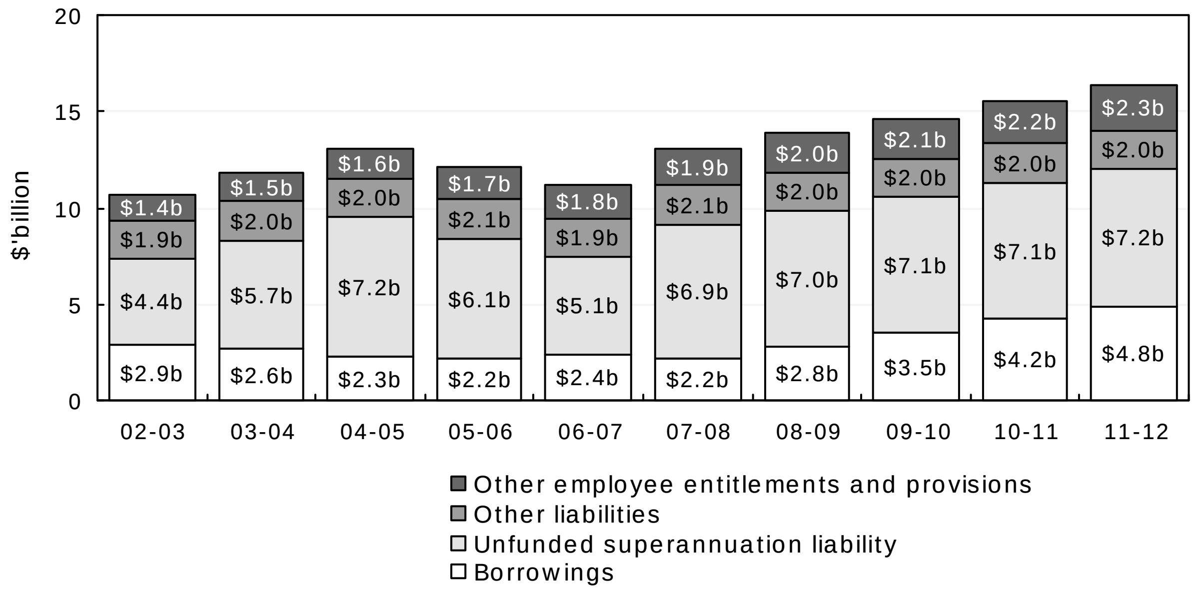
9.4 LIABILITIES

Time series data is presented in the Budget Statement.[22] That data is used as relevant in this section.

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 2011-12.

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



22 Budget Statement 2008-09, Budget Paper 3, Chapter 5 and Appendix B.

Total liabilities are estimated to decrease by $1.9 billion or 17 percent to $13.1 billion in 2007-08. This is due mainly to an increase in the unfunded superannuation liability. The variability in the unfunded superannuation liability in the five years to 2007-08 is due mainly to movements in earnings, actuarial assumptions and the discount rate used to estimate the value of the liability.

Total liabilities are expected to increase $3.2 billion or 25 percent to $16.3 billion over the period of the forward estimates. This is due mainly to increases in borrowings, up $2.6 billion, superannuation liability, up $254 million and other employee entitlements and provisions, up $395 million, offset by decreases in other liabilities, down $56 million, over the four years to 2011-12.

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 $5.1 billion or 35 percent to $20 billion over the period of the forward estimates. A $2 billion or 16 percent increase in total liabilities in 2007-08 is due to an increase in superannuation liabilities, up $1.8 billion or 36 percent, other employee entitlements and provisions, up $92 million or 5 percent, borrowings, up $66 million or 2 percent and other liabilities, up $37 million or 2 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 2008

The following table sets out the major elements that comprise the movement from the estimated unfunded superannuation liabilities at 30 June 2007 to the 30 June 2008 estimated liability.

Table 9.5 — Estimated Unfunded Superannuation Liabilities as at 30 June 2008

		$'million	$'million
Estimated Unfunded Liability (2007-08 Budget)			5 741
Add:	Higher earnings against assumed	(120)	
	Movement in discount rate	(558)	
	Other	12	
	Total changes		(666)
Actual 30 June 2007			5 075

Table 9.5 — Estimated Unfunded Superannuation Liabilities as at 30 June 2008 (continued)

		$'million	$'million
Add:	Nominal interest	276	
	Past service payments	(235)	
	2007 Triennial independent actuarial review	1 060	
	Lower earnings against assumed	708	
	Variation between actual and expected experience	40	
	Other	(14)	
	Total changes		1 835
Estimated Closing Balance June 2008			6 910

9.5.2.1 Superannuation Funding

In 2008-09, total superannuation funding is budgeted to be $928 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 a number of factors including 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 2008-09 is estimated to be $292 million.[23] This is $48 million higher than was estimated in the 2007-08 Budget.

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 Corporation' (Funds SA)) in Part B of this Report.

Lower earnings were estimated to be achieved against the assumed investment earnings. In the 2008-09 Budget an earnings rate of negative 4 percent was estimated for 2007-08. This rate is substantially lower than the long-term assumed earnings rate of 7.5 percent. Previous years have benefitted from higher outcomes than the assumed earnings rate.

9.5.3 Long-Term Funding of Superannuation Liabilities

The commitment to fully fund unfunded liabilities was reaffirmed by the Government in the 2008-09 Budget Papers, with the position as at 30 June 2008 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 2013-14. It is estimated that benefit payments will peak in 2026-27.

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

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23 Budget Statement 2008-09, Budget Paper 3, Table 5.7

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 reduced net debt to historically low levels and the Government now focuses on net financial liability data.

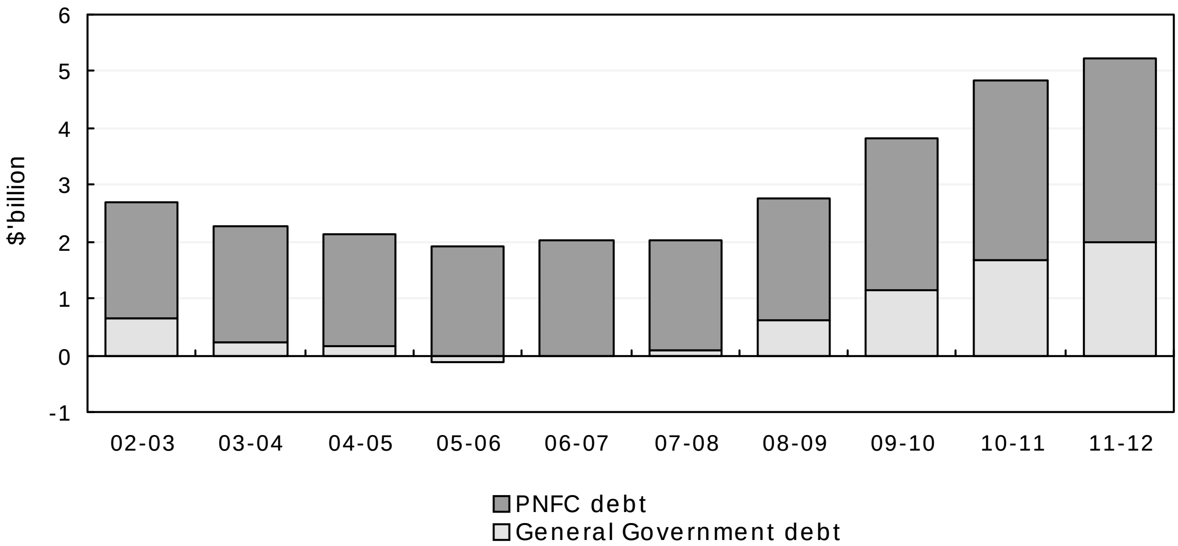
9.6.1 Definition of Net Debt

Net debt[24] 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 $667 million to $2 billion (2.7 percent of South Australia's Gross State Product) in the period 2002-03 to 2007-08. Forward estimates show that net debt is projected to rise to $5.2 billion in 2011-12 (5.6 percent of South Australia's Gross State Product).

Chart 9.3 — GFS - South Australian Public Sector Net Indebtedness 2003 to 2012



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 $82 million for 2007-08. Over the forward estimates net debt increases in this sector by $1.9 billion to $2 billion due to projected net borrowing (net lending deficits) due to the Government's significant capital investment program.

Net debt of the public non-financial corporations increases by $1.3 billion over the same period to $3.2 billion.

24 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.

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.

The 2008-09 Budget Papers state that PPP arrangements for prisons and secure facilities and schools are recognised as finance leases in the balance sheet and consequently have an impact on net debt and net financial liabilities.

9.6.3 Debt Affordability and Servicing

Chart 9.3 clearly highlights the increase in net debt over the period of the 2008-09 Budget and forward estimates.

At the end of 2007-08 total public sector net debt is estimated to represent 2.7 percent of Gross State Product compared to 5.6 percent in 2011-12.

The Government states that net debt remains at responsible levels over the forward estimate period. Noting this comment, I asked DTF to provide any analysis that supports or establishes limits for what is a responsible level of debt for the South Australian budget including details of the basis of the assessment, any sensitivity analysis or other risk assessment and any relationship to the ratio of net financial liabilities to revenue.

In response DTF advised that although it recognised that a responsible level of net debt may be a subjective term, it was considered appropriate for reasons including:

- net debt remains at historically low levels
- increases in net debt reflect the major infrastructure program, aimed at improving the social and economic efficiency of the state and which results in an increase in net worth
- it is supported by strong operating surpluses
- when considered as part of recognised reporting ratios (eg net financial liabilities to revenue) support the continuation of the State’s triple-A rating.

I note that the increase in net debt forecast is not comparable to the increase experienced from 1991 principally from the collapse of the State Bank as that increase reflected the write–off of assets associated with the collapse. I also note that net debt, as then measured, peaked at 26.9 percent of gross state product in 1992 and 1993.

9.6.4 Debt Management Policy

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 2007-08 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.

The Budget Papers state that SAFA's ability to raise funding has not been materially impacted by the recent volatility in global financial markets during 2007-08 from issues such as the United States sub-prime crisis. I requested advice of any effect on SAFA's funding costs and if the debt management framework is influenced by the projected increase in net debt over the forward estimates.

In response SAFA confirmed its ability to raise funding indicating the global credit crunch ensured a 'flight to quality' favouring government issuers over non-government issuers. SAFA also advised that a review of the debt management framework was scheduled for 2008-09 and it was premature to indicate whether the projected increase in net debt over the forward estimates would impact the debt management framework.

For further details on SAFA refer to the section '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), $2 billion for 2007-08 and workers compensation and other liabilities of entities including outstanding insurance claims, $2 billion for 2007-08.

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 $1.18 billion for 2007-08 and $1.15 billion in 2008-09. Long service leave is calculated by an estimation process in most cases subject to guidelines issued by DTF

- estimated workers compensation totalling $357 million for 2007-08 and $357 million in 2008-09

- outstanding claims payable to entities external to SAFA amount to $211 million for 2006-07 and $278 million in 2007-08. These liabilities are funded. Details of SAFA's insurance operations are included in Part B of this Report.[25]

9.8 CONTINGENT LIABILITIES

As reported in the Budget Papers[26] 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.

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

26 Budget Statement 2008-09, Budget Paper 3, pp 7.10 – 7.18 provides a detailed summary of contingent liabilities.

- The amount of the liability cannot be measured reliably.
- There is significant uncertainty as to whether an obligation presently exists.

Contingent liabilities of the Government can arise from:

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

Guarantees and contingent liabilities of the Government of South Australia as at 30 June 2007 were valued at $723 million ($696 million as at 30 June 2006). Guarantees are valued at nominal values without adjustment for the probability of actual liabilities occurring.

The $27 million increase is due mainly to a $20 million 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 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 can 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 2012.

The following table shows 2008-09 budgeted GFS total revenue for each state.

Table 10.1 — 2008-09 Budgeted General Government GFS Total Revenue by State

State	NSW $'million	VIC $'million	QLD $'million	WA $'million	SA $'million	TAS $'million
GFS Total Revenue	47 882	37 810	36 582	19 872	13 255	4 131

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 2008-09 budget data.

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

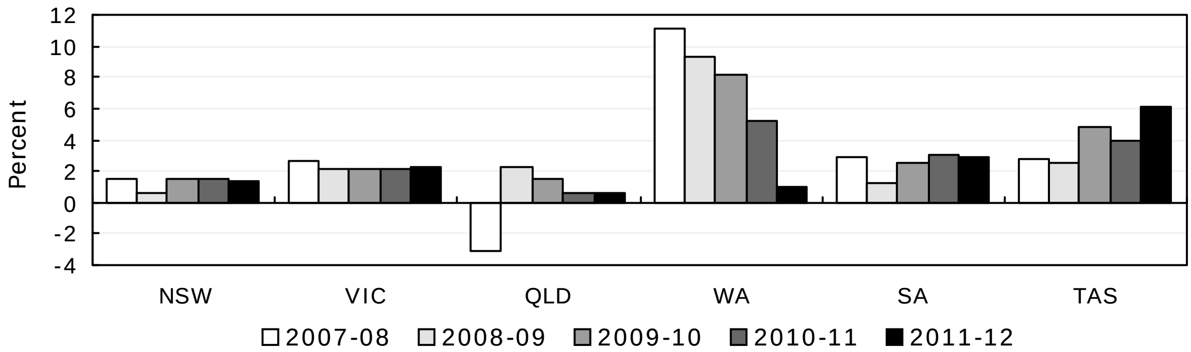
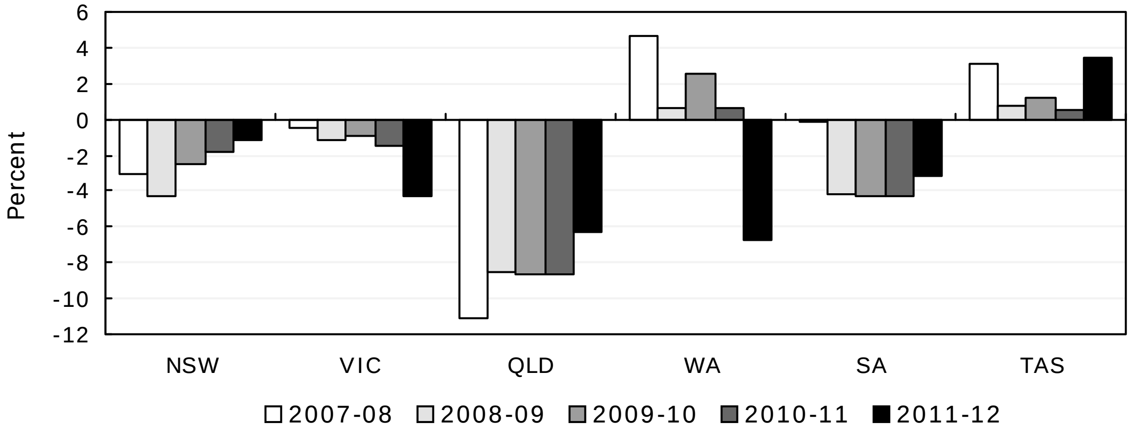


Chart 10.1 shows that South Australia's net operating balance as a ratio to total revenue compares very favourably with most other states.

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 2011-12.

Chart 10.2 shows that South Australia's net borrowing as a proportion of GFS total revenues is consistent with other borrowing States.

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

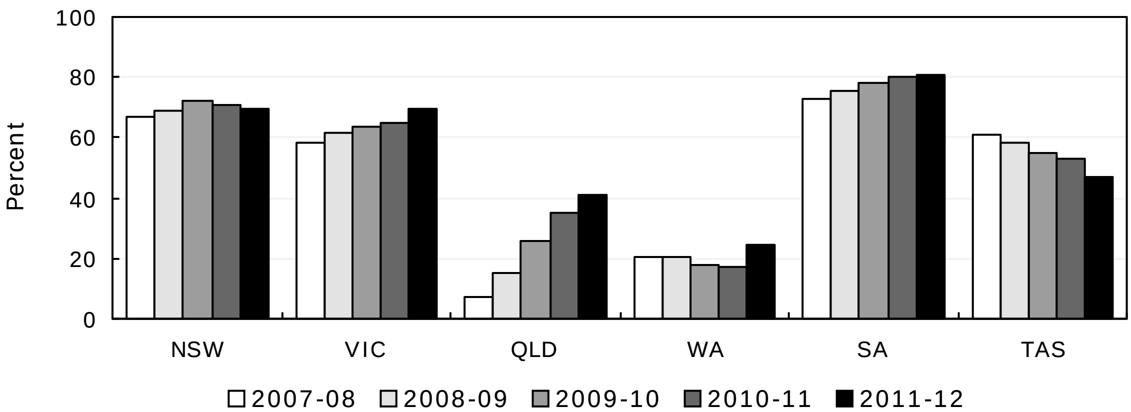


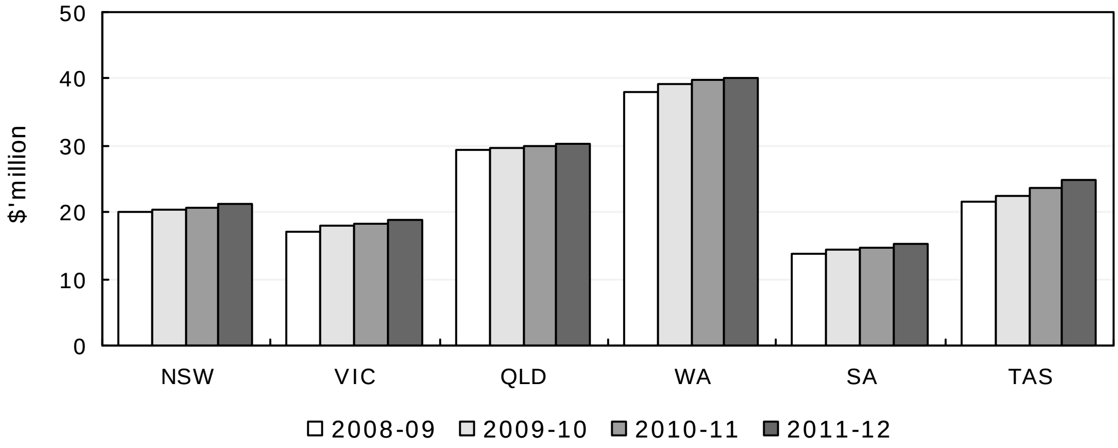
Chart 10.3 shows the 2008-09 Budget settings result in the ratio for South Australia essentially rising until 2011-12. It is evident that a similar situation exists for Victoria and Queensland and NSW rises to 2009-10 before declining. Accordingly, South Australia's relative standing against most other 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 2011-12 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 areas where improvements could be made.

Follow-up review findings are provided 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 2007-08.

Table 11.1 — 2007-08 Appropriation Authority and Payments

	Appropriation Authority $'million	Actual Payments $'million
Appropriation Act 2007	8 356	8 229
Public Finance and Audit Act 1987, section 15	57	57
The Governor's Appropriation Fund	232	175
Specific appropriations authorised in various Acts	125	125
Total	8 770	8 586

The result on the Consolidated Account and variations from budget for 2007-08 was as follows.

Table 11.2 — 2007-08 Consolidated Account Result

	2007-08 Budget $'million	2007-08 Actual $'million	Increase Variation $'million
Total Receipts	8 122	8 703	582
Total Payments	8 481	8 586	105
Consolidated Account Financing (Requirement) Surplus	(359)	117	476

The surplus of $117 million ($107 million deficit in 2006-07) is reflected in a decrease in net debt serviced from the Consolidated Account as shown in Statement J of the Treasurer's Statements.

The key differences between actual and budgeted amounts were:

- ***receipts*** — main items exceeding budget were stamp duty by $281 million; payroll tax $53 million; GST revenue grants $59 million; distributions from Land Management Corporation $44 million; Mitsubishi Limited grant payment $35 million; land services $24 million and infringement notice expiation fees $19 million offset by lower than expected land tax receipts $30 million

- ***payments*** — Higher payments from Minister for Tourism $50 million, Department of Education and Children's Services $38 million and Department for Families and Communities $29 million. 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 2007-08.

Table 11.3 — Appropriation Flexibility

	Authority / Budget $'million	Actual Payments $'million
Governor's Appropriation Fund	232	175
Contingency provisions in Administered Items for DTF	134	120
Public Finance and Audit Act 1987, section 15	57	57
Total Flexibility	423	352

Use of these provisions 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). Generally the GAF is used to fund new Government initiatives or to meet unexpected expenditure needs.

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 as follows.

Table 11.4 — Main Governor's Appropriation Fund Payments

Agency	Purposes	Actual Payments $'million
Minister for Tourism	Entertainment Centre	50
Department of Education and Children's Services	Student mix and enrolments, land	38
Department for Families and Communities	Children in care	29
Administered Items for the Department for Environment and Heritage	Adelaide Zoo	19
Department of the Premier and Cabinet	Grants	15

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 main items were as follows.

Table 11.5 — Main Contingency Provision Payments

Agency	Total Payments $'million
Department of Health	46
South Australia Police	19
Department for Transport, Energy and Infrastructure	17
Administered Items for the Department of Treasury and Finance	10
Department of Further Education, Employment, Science and Technology	10
Department of the Premier and Cabinet	7

11.4.3 Appropriation by the Treasurer for Additional Salaries

Section 15 of the *Public Finance and Audit Act 1987* provides that the Treasurer may appropriate from the Consolidated Account an amount sufficient to cover increases in public sector salaries, wages, allowances, payroll tax or superannuation contributions arising by reason of the award, order or determination of a court, tribunal or other body empowered to fix salaries, wages or allowances.

As with the Governor's Appropriation Fund, use of this provision adds to the amount appropriated by Parliament each year and may affect the budget result where these are unbudgeted expenses.

In 2007-08 $57 million was appropriated by the Treasurer pursuant to section 15. This amount was added to the line 'Administered Items for Department of Treasury and Finance'. Payments are reflected against that line. This measure was last used in 2005-06 when $125 million was appropriated by the Treasurer.

11.4.4 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. No section 13 transfers occurred in 2007-08. 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.[27]

Table 11.6 shows that over $2 billion is in special deposit accounts and deposit accounts as at 30 June 2008, up $164 million from the previous year.

[27] *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.

Table 11.6 — Special Deposit Accounts and Deposit Accounts

	2006-07 $'million	2007-08 $'million	Increase $'million
Special Deposit Accounts	1 447	1 599	152
Deposit Accounts	519	531	12
Total	1 966	2 130	164

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 2008 were:

- ***Special Deposit Accounts*** — Accrual Appropriation Excess Funds ($415 million), Highways Fund ($165 million) and Premier and Cabinet Operating Account ($64 million)
- ***Deposit Accounts*** — Land Management Corporation ($52 million), SAFA ($52 million) and South Australian Housing Trust ($38 million).

I note the Land Management Corporation received an equity contribution of $35 million in 2007-08 to facilitate a potential joint development with the private sector. If not required, the equity injection will be repayable to the Government.

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

11.5.1 Accrual Appropriation Excess Funds Account

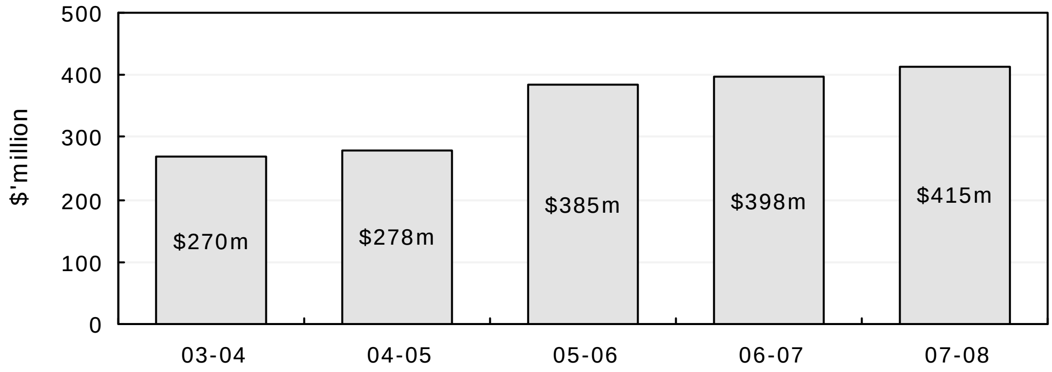
The approved purpose of the Accrual Appropriation Excess Funds Account (the Account) is to record all receipts and payments associated with surplus cash balances generated in agencies by the shift to accrual appropriations.

Accrual appropriations are made to agencies 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.

Past Reports have commented on inconsistent use of the Account by agencies. 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'. Processes were found to be operating satisfactorily in 2007-08.

I noted last year that 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 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. The following chart shows the 30 June balance trend of the account for the past five years.

Chart 11.1 — Accrual Appropriation Excess Funds Account



11.5.2 Cash Alignment Policy

The Government has a cash alignment policy (CAP) to align 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. All special deposit accounts are reviewed at least annually to determine whether there was surplus cash in an account. The policy supports the Treasurer's discretionary power to require surplus funds in special deposit accounts, to be paid to the Consolidated Account.

A total of $74 million ($40 million in 2006-07) of surplus cash was returned to the Consolidated Account during 2007-08. The main amounts were as follows.

Table 11.7 — Cash Alignment Policy Repayments

Agency	Actual Payments $'million
Department for Transport, Energy and Infrastructure	19
Department of Education and Children's Services	16
Department of the Premier and Cabinet	14
Department of Treasury and Finance	6
Department for Environment and Heritage	6
Department of Further Education, Employment, Science and Technology	5

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

The whole-of-government financial report presents 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 financial report, the last completed report relates to the year ended 30 June 2007, and the following commentary has therefore been kept purposely brief.

12.1 AAS 31 WHOLE-OF-GOVERNMENT FINANCIAL REPORT

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 AASB 24 'Consolidated and Separate Financial Statements', 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 REPORT

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 report. Therefore, unless relevant legislative provisions are passed, I will not issue a formal independent audit opinion on the whole-of government financial report.

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 report for each year since 1999.

The key features of the audit undertaken of the financial report 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 report

- the preparation of the whole-of-government general purpose financial report

- 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 the report 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 report.

12.2.1 Audit Findings and Comments

Following the Audit review of the financial report for 2006-07, a management letter was forwarded to DTF in December 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 report. 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 report published by DTF.[28]

The matters raised included:

- timeliness issues with the preparation of whole-of-government financial report. In particular, it was noted that a number of other States had been able to finalise and publish their whole-of-government financial report many months before South Australia, which did so in December 2007

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

- the use of unaudited data in the preparation of the whole-of-government financial report

- the gain on revaluation of property, plant and equipment per the Statement of Changes in Equity not reconciling with relevant notes to the whole-of-government financial report

- matters relating to the Cash Flow Statement.

Departmental Response

DTF responded positively to each of the issues raised.

In particular, DTF advised:

- it considers the impact of any differences in values between audited and unaudited health services data would be immaterial to the whole-of-government financial report

- it will implement automatic checks in data collection tools to ensure balance between revaluations shown in the Statement of Changes in Equity and related notes to the whole-of-government statements

- it will work with agencies to improve the quality of data used in the preparation of the Cash Flow Statement to ensure compliance with AASB 107 'Cash Flow Statements'

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[28] Government of South Australia, Consolidated Financial Report for the year ended 30 June 2007.

- it is not content with being a month behind other jurisdictions. It is prepared to question its consolidated financial reporting principles to bring South Australia in line with the reporting of other jurisdictions.

12.3 AAS 31 FINANCIAL PERFORMANCE

The following briefly discusses the financial result of the AAS 31 reports as at 30 June 2007. 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.[29] 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 2007, with comparative amounts for the preceding four years.

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

	2003 $'million	2004 $'million	2005 $'million	2006 $'million	2007 $'million
Revenues					
Taxation	2 285	2 651	2 760	2 779	3 032
Grants	5 010	5 289	5 589	5 952	6 162
Sale of goods and services, fees and levies	2 898	3 282	3 305	3 517	3 610
Investment revenues	878	1 757	1 737	2 396	3 007
Net revenues from asset disposals	28	41	-	33	34
Other	893	738	821	450	610
Total Revenues	11 992	13 758	14 212	15 127	16 455
Expenses					
Employee expenses	5 032	6 057	6 710	4 567	4 800
Supplies and services	2 713	2 305	2 307	3 359	3 393
Grants and subsidies	1 395	1 466	1 661	1 627	1 691
Borrowing cost expenses	761	737	688	645	674
Other	3 000	3 856	4 324	3 762	4 703
Total Expenses	12 901	14 421	15 690	13 960	15 261
Net Surplus (Deficit)	(909)	(663)	(1 478)	1 167	1 194

The table highlights significant growth in revenues over the five years to 2007. Up to 2005, this has been exceeded by growth in expenses and deficits have been incurred.

The main variations in revenues in 2006-07 were as follows:

- ***Investment Revenues*** — increased by $611 million due mainly to an increase in dividends ($335 million) and gains on revaluation of investments ($148 million).

- ***Taxation*** — increased by $253 million due mainly to a increase in stamp duty on property ($116 million) and payroll tax ($61 million).

- ***Grants*** — increased by $210 million due mainly to an increase in Commonwealth special purpose grants ($128 million) and Commonwealth general purpose grants ($85 million).

29 Government of South Australia, Consolidated Financial Report for the year ended 30 June 2007.

The main variations in expenses in 2006-07 were as follows:

- ***Employee Expenses*** — increased by $233 million due mainly to an increase in annual leave ($188 million) and salaries and wages ($96 million), offset by a decrease in TVSP payments ($21 million), superannuation expense ($16 million) and other employee related expenses ($19 million).

- ***Other Expenses*** — increased by $941 million due mainly to an increase in imputed expense of increased liability in respect of superannuation fund deposits ($481 million), revaluation of workers compensation liabilities ($193 million) and other expenses ($130 million).

12.4 AAS 31 FINANCIAL POSITION

The following summarises the financial position for the five financial years 2002-03 to 2006-07.

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

	2003	2004	2005	2006	2006
	$'million	$'million	$'million	$'million	$'million
Assets					
Cash and investments	6 289	6 643	6 154	6 099	7 019
Superannuation assets	5 411	6 635	7 934	10 326	13 146
Physical assets	24 234	25 261	28 124	30 424	31 880
Other	2 063	1 869	1 838	1 980	1 952
Total Assets	37 997	40 408	44 050	48 829	53 997
Liabilities					
Unfunded superannuation	4 445	5 668	7 227	6 146	5 075
Borrowings	7 468	6 781	6 607	5 896	6 376
Employee entitlements	1 440	1 595	1 387	1 486	1 562
Superannuation liabilities	5 372	6 599	7 901	10 290	12 809
Other	4 768	4 710	5 295	5 868	6 724
Total Liabilities	23 493	25 353	28 417	29 686	32 546
Net Assets	14 504	15 055	15 633	19 143	21 451

The $2.3 billion increase in net assets for 2006-07 was due mainly to an increase in Superannuation Assets ($2.8 billion) and Physical Assets ($1.5 billion) and decrease in Unfunded Superannuation Liabilities ($1.1 billion), offset by an increase in Superannuation Liabilities ($2.5 billion).