[P.P.4A

SOUTH AUSTRALIA

Report

of the

Auditor-General

Supplementary Report

for the

year ended 30 June 2010

Tabled in the House of Assembly and ordered to be published, 24 November 2010

First Session, Fifty-Second Parliament

State Finances and Related Matters:

November 2010

By Authority: B. Morris, Government Printer, South Australia

2010

Government of South Australia
Auditor-General's Department

23 November 2010

9th Floor
State Administration Centre
200 Victoria Square
Adelaide SA 5000
DX 56208
Victoria Square
Tel +618 8226 9640
Fax +618 8226 9688
ABN 53 327 061 410
audgensa@audit.sa.gov.au
www.audit.sa.gov.au

The Hon R K Sneath, MLC
President
Legislative Council
Parliament House
ADELAIDE SA 5000

The Hon L R Breuer, MP
Speaker
House of Assembly
Parliament House
ADELAIDE SA 5000

Dear President and Speaker

REPORT OF THE AUDITOR-GENERAL
SUPPLEMENTARY REPORT FOR THE YEAR ENDED 30 JUNE 2010
STATE FINANCES AND RELATED MATTERS: NOVEMBER 2010

The 2009-10 Annual Report of the Auditor-General that was tabled in Parliament on 30 September 2010 comprised two parts, Part A and Part B. The Annual Report generally includes a Part C that provides specific analysis and comment on the State's finances and related matters.

The 2010-11 State Budget was tabled in Parliament on 16 September 2010 when my Annual Report was in the final stages of its preparation. As such, there was not sufficient time to prepare detailed commentary on the State's finances for presentation as Part C of the Annual Report.

The specific analysis and commentary on the State's finances has been completed.

Pursuant to section 36 (3) of the *Public Finance and Audit Act 1987*, I herewith provide to each of you a copy of my Supplementary Report for the year ended 30 June 2010 'State Finances and Related Matters: November 2010'.

Yours sincerely

S O'Neill
AUDITOR-GENERAL

Report of the Auditor-General

Supplementary Report for the year ended 30 June 2010

TABLE OF CONTENTS — STATE FINANCES AND RELATED MATTERS

Report of the Auditor-General

Supplementary Report for the year ended 30 June 2010

TABLE OF CONTENTS — STATE FINANCES AND RELATED MATTERS

Report of the Auditor-General

Supplementary Report for the year ended 30 June 2010

TABLE OF CONTENTS — STATE FINANCES AND RELATED MATTERS

Page

Report of the Auditor-General

Supplementary Report for the year ended 30 June 2010

TABLE OF CONTENTS — STATE FINANCES AND RELATED MATTERS

Page

STATE FINANCES AND RELATED MATTERS

1 INTRODUCTION

This Supplementary Report provides Audit observations and comments 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 2010-11 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 2009-10. 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.

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 and details follow in later sections. 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

The 2009-10 Budget was set against the backdrop of uncertainty as economies emerged from the worst of the global financial crisis. The crisis had a striking effect on the State's finances. Declining revenues combined with higher infrastructure and operating spending led to an operating deficit in 2008-09, the first in six years, with a further deficit budgeted for 2009-10 and previously unbudgeted growth in net debt.

In the 2009-10 Budget, the Government advised that its fiscal strategy was to return the State to sustainable surpluses in the medium-term. To achieve this aim, the 2009-10 Budget contained a range of budget improvement targets to take effect over the four years of the budget, particularly from 2010-11. Specific measures to achieve the targets were to be identified in the 2010-11 Budget. These would build on measures announced in the 2008-09 mid-year budget review (MYBR) in December 2008.

The 2010-11 Budget states that the fiscal strategy is to establish and maintain sustainable surpluses. While an operating surplus is now estimated for 2009-10, a deficit is budgeted for 2010-11 with a return to initially small but growing surpluses thereafter.

The Government also has a set of broader fiscal targets that are published annually in the Budget. Two of those fiscal targets are not expected to be achieved in part of the four year period of the 2010-11 Budget namely:

- at least a net operating balance in the general government sector in every year. A net operating deficit of $389 million is budgeted for 2010-11.
- 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. The ratio is forecast to increase across the forward estimates peaking in 2011-12 before declining across the forward estimates. Except for New South Wales, the other triple-A rated jurisdictions are also expecting increases in their ratios through to 2011-12.

2.2.1 The State credit rating

Another of the fiscal targets is to ensure that risks to state finances are managed prudently to maintain a triple-A credit rating.

South Australia has had a triple-A credit rating since September 2004. Key factors to this rating, as noted by rating agencies Moody's and Standard & Poor's subsequent to the global financial crisis, include:

- an expected temporary peak in net financial liabilities, partly reflecting changes to discount rates

1 See section 4.1.2 of this Report.

- savings measures announced which aim to support the operating position, restore budget balance and reduce borrowings
- a history of underspending capital budgets
- the State's positive record of financial performance
- relatively low debt burden.

Another factor underpinning the rating is the stable history of Commonwealth-State relations and the related support system and mechanisms such as the independent Grants Commission.

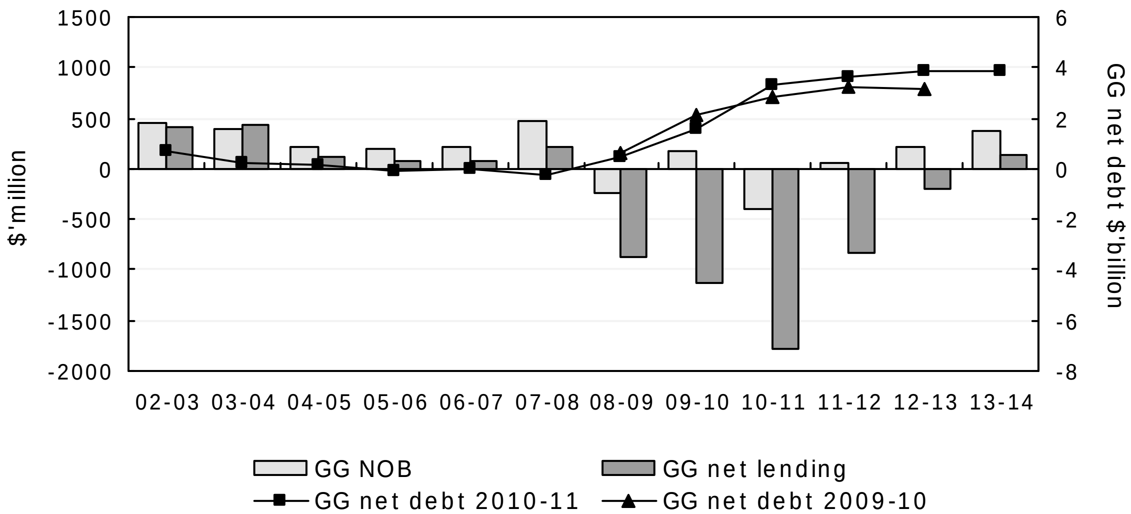
In September 2010, following the announcement of the 2010-11 Budget, Standard & Poor's reported that the Budget was consistent with the triple-A credit rating and stable outlook assigned to the State.[2] Standard & Poor's noted that the economic outlook, as well as implementation of several key savings measures, had led to a strengthening of the State's operating position. They considered that the vast majority of the 2010 election commitments were funded and that additional expenditure initiatives were matched by stronger revenue growth and/or additional savings measures.

The rating agency considered a re-assessment of the rating could occur if the underlying levels of debt were more severe than forecast. Standard & Poor's noted that this could occur through lack of political will or ability to deliver proposed savings or that expenditure proposals were not matched by stronger revenue growth and/or savings measures.

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 2013-14 for the general government sector.

Chart 2.1 — General government sector net operating balance (NOB), net lending and net debt



2 At the time of this Report rating agency Moody's had not reported since the 2010-11 Budget was presented to Parliament.

The chart shows the net operating deficit for 2008-09 after six years of surpluses. After a deficit in 2010-11, net operating surpluses are targeted to resume from 2011-12. Large net lending deficits and steeply rising net debt continue from 2008-09 into 2010-11.

The Government adopted a strategy of net operating balance surpluses and net lending deficits (borrowing to finance higher capital spending) in the 2006-07 Budget. The budgeted net lending deficits would, in turn and if realised, lead to rising net debt. The strategy was maintained through to the 2008-09 Budget but with net lending deficits and net debt expected to increase with each budget in response to escalating capital programs. In fact, general government had a net financial assets position rather than net debt for the three years to 2007-08.

The general government net debt 2009-10 line illustrates what was anticipated in the 2009-10 Budget. The global financial crisis led to an operating deficit in 2008-09 and, with higher capital spending, to much higher projected net borrowing for the three years to 2010-11, adding about $1.2 billion more to net debt in 2011-12 than was estimated in the 2008-09 Budget.

The 2010-11 Budget projects net operating results lower than previously budgeted and net lending deficits that are higher than previously budgeted. Consequently, it is anticipated net debt will rise more than previously projected and is now expected to reach $3847 million in 2013-14.

Chart 2.1 highlights how the settings of the 2010-11 Budget build toward the targeted sustainable budget. While not defined as such, by 2013-14 the operating surplus is estimated to be $370 million and is projected to reach $840 million in 2014-15. Similarly, a net lending surplus of $126 million is estimated for 2013-14 and is projected to reach $689 million in 2014-15. At these levels the Budget returns to the sort of operating and net lending results achieved in the six years to 2007-08 placing the finances in a position to reduce the built up net debt, should that be the priority at the time.

The chart also highlights that for 2010-11 and 2011-12, there is little or no room for unfavourable outcomes without increasing the risk of achieving longer term targets.

2.4 OPERATING STATEMENT

2.4.1 Estimated results for 2009-10

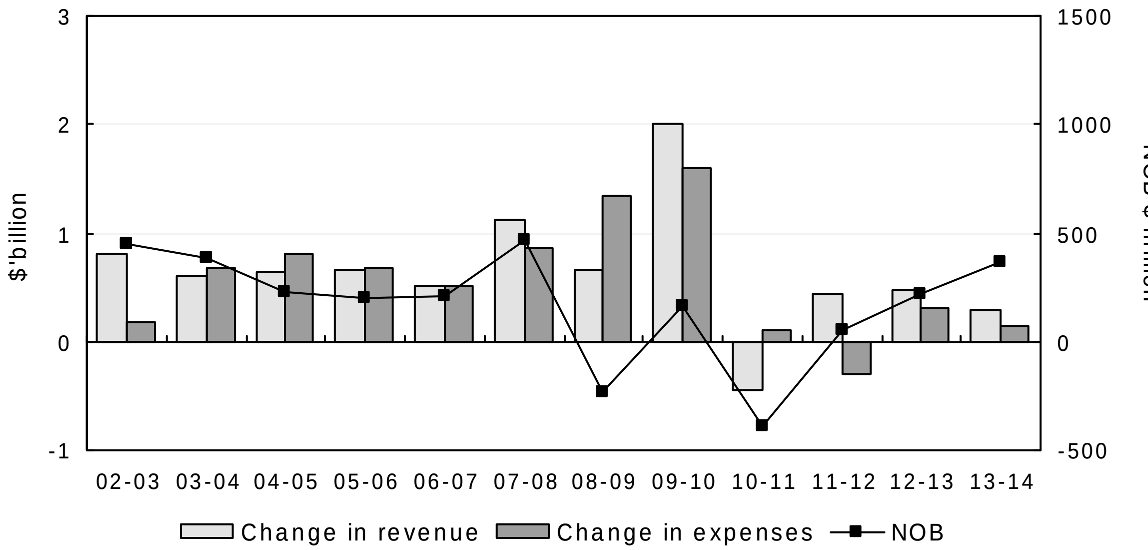
The 2010-11 Budget Papers show that the Government now estimates recurrent financial operations for 2009-10 to result in a net operating balance surplus of $167 million. This is a $471 million improvement on the budgeted deficit. The improvement in the estimated net operating balance is principally from increased Commonwealth grants revenue which is estimated to exceed budget by $810 million. Offsetting this improvement are increased grant expenses, estimated to exceed budget by $416 million. The additional Commonwealth grant revenue was a combination of goods and services tax (GST) revenue grants (including transitional assistance), up $241 million, and national partnership and other grants, up $569 million. The partnership and other grants are mainly on-passed to recipients as grant expenses or are used for specific capital spending programs.

The net lending deficit is estimated to be $1124 million, compared to the budgeted $1541 million, the difference being due to the improvement in the net operating balance. The general government sector is estimated to have net debt of $1587 million at the end of 2009-10, $555 million lower than was budgeted.

2.4.2 Budget forecasts 2010-11 to 2013-14

The following chart shows some of the 2010-11 Budget targets against past experience.

Chart 2.2 — Annual change in general government sector revenue, expenses and net operating balance (NOB) [(a)]



(a) 2009-10 and 2010-11 are influenced by Commonwealth stimulus grants.

As shown, net operating surpluses to 2007-08 were achieved with annual expense increases generally matched or exceeded by revenue growth. The net operating balance fell steeply to a deficit in 2008-09.

While an operating surplus is estimated for 2009-10, revenue is budgeted to fall and is not able to cover the growth in expenses leading to an operating deficit in 2010-11. This is largely due to timing of Commonwealth receipts and payments between the two years. Growth in grant revenues outstripped grant expenses in 2009-10 by $378 million contributing to the surplus. In 2010-11, grant expenses are in turn higher than grant revenues by $465 million, contributing to the deficit.

The chart shows the projected rising net operating balances and the underlying expectations for revenue and expenditure growth. Total revenues are expected to increase annually from 2011-12. This includes revenue measures in the 2010-11 Budget that are projected to also grow annually and contribute $179.2 million in 2013-14.

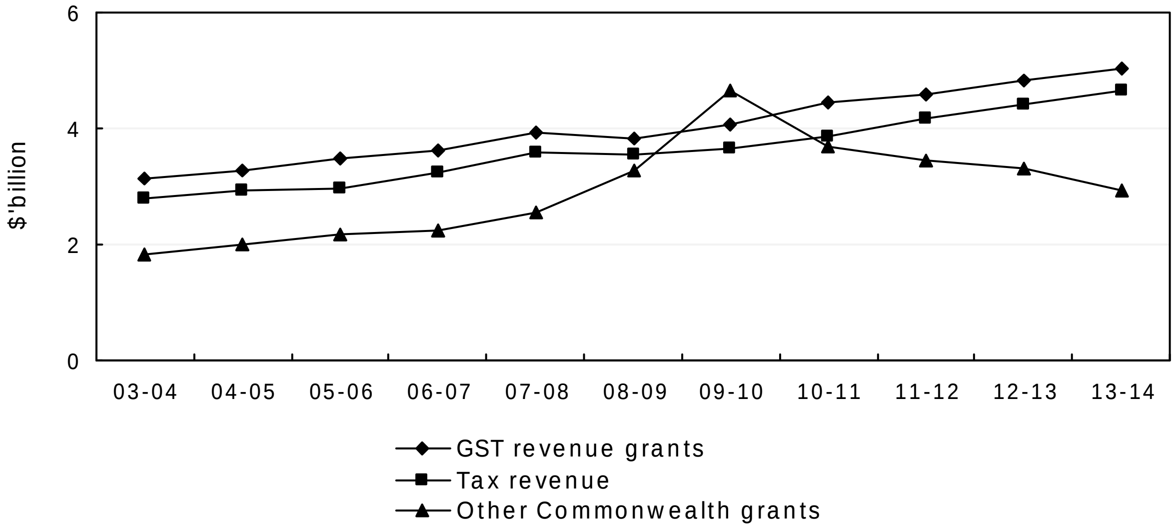
The chart highlights the anticipated low growth in expenses through to 2013-14 which is clearly at variance with what was experienced or estimated in the previous seven years notwithstanding recent grant trends. Achieving these expenditure targets is a major task and therefore a risk to the current budget strategy.

2.4.3 Revenue forecasts 2010-11 to 2013-14

There were significant, temporary compositional changes in revenues following the global financial crisis. Immediate and large reductions in GST revenue grants and taxation revenue were offset by Commonwealth economic stimulus and other nation building funding to the States. Importantly, these monies are required to be spent on projects and are not available as general purpose revenue. Further, the crisis coincided with major changes in the Commonwealth's financial relations with the States. This resulted in other changes in timing and composition of Commonwealth revenues.

The following chart shows expected trends for the major revenue items in the 2010-11 Budget against the experience of recent years.

Chart 2.3 — General government sector Commonwealth grants and taxation revenue



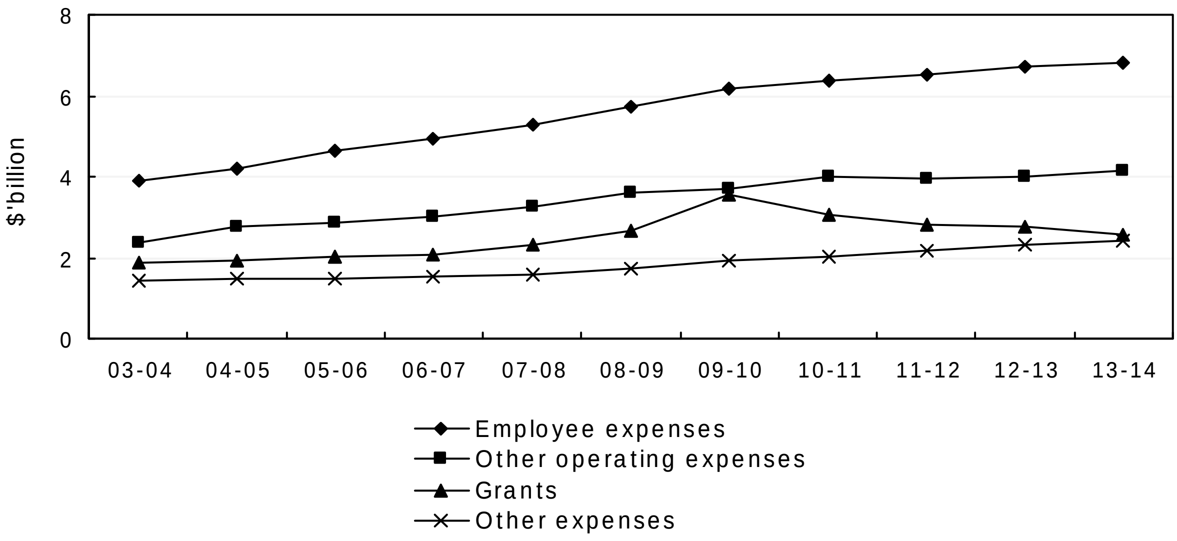
The chart highlights the break in trend when GST revenue grants and taxation revenue fell in 2008-09. Both are, however, now estimated to increase in 2009-10 and are to grow steadily, in real terms, over the forward estimates.

Other Commonwealth grants increased markedly in 2008-09 and 2009-10 mainly due to the Commonwealth Government's Nation Building — Economic Stimulus Plan and Nation Building Plan for the Future capital grants. These reduce after 2009-10 and some cease in 2012-13. The grants are mainly on-passed to recipients as grant expenses or are used for specific capital spending programs.

2.4.4 Expense forecasts 2010-11 to 2013-14

The following chart shows trends expected for total expenses in the 2010-11 Budget, split into four main categories, against the experience of recent years.

Chart 2.4 — General government sector expenses



All categories of expenses are estimated to increase in 2009-10. The rise in grant expenses is largely associated with Commonwealth grant revenues discussed above. These grant expenses fall away in line with related additional grant revenues some of which cease by 2012-13.

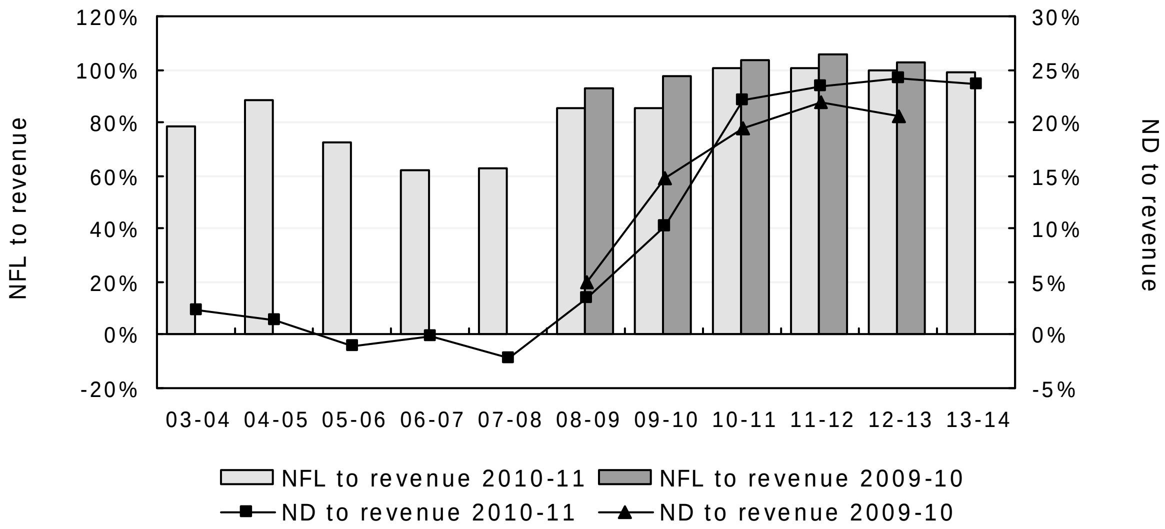
The chart highlights that other than grants and other operating expenses in 2011-12, all categories of expenses are projected to increase across the forward estimates. The small changes in total expenditure, noted earlier in chart 2.2, reflect the combined result of spending and saving initiatives in the 2010-11 Budget and the fall in grants expenses over the four years to 2013-14. Excluding grant expenses, in real terms (after inflation), all other expenses are estimated to be steady from 2011-12 emphasising the tight settings in this Budget.

2.4.5 Ratios of net financial liabilities to revenue and net debt to revenue

One of the Government's fiscal targets 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. Another of its key general government budget indicators is the ratio of net debt to revenue.

Chart 2.5 shows the ratios of net financial liabilities and net debt to revenue for recent years and for the 2009-10 and 2010-11 Budgets.

Chart 2.5 — General government sector ratios of net financial liabilities to revenue and net debt to revenue Budget comparisons



The chart shows that both the ratios of net financial liabilities to revenue and net debt to revenue were projected to increase in the 2009-10 Budget, peaking in 2011-12. This reflected the operating deficits expected and the capital expenditure program, financed in part by borrowings. Net financial liabilities were also influenced by an increase in the value of unfunded superannuation liabilities in 2008-09.

The 2010-11 Budget projects that net debt will rise higher than was previously estimated in the 2009-10 Budget. Consequently the ratio of net debt to revenue is higher than previously budgeted.

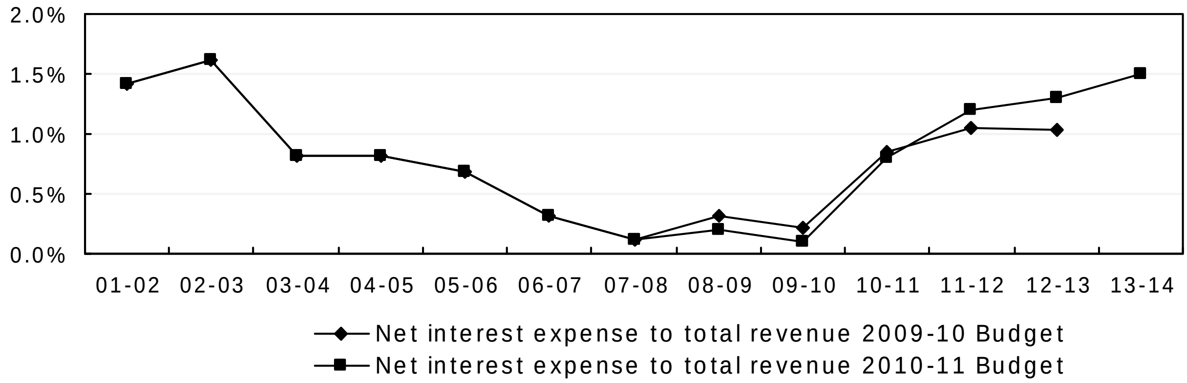
The ratio of net financial liabilities to revenue is slightly lower across the forward estimates than previously budgeted but still peaking in 2011-12. This outcome is not consistent with its related fiscal target, but the Government notes that most states expect increases in this ratio. Chart 10.3 in section 10 of this Report sets out the five year estimates to 2013-14 including for other states. It shows the similarity of movement in this ratio between most states.

2.4.6 Ratio of interest to revenue

The projected increase in net debt leads to increased interest rate risk. The Budget Papers note that higher than expected interest rates could adversely affect the general government and public non-financial corporations sectors' budget position through increased interest payments.

Chart 2.6 shows the outcomes for the general government ratio of net interest to revenue for recent years and as estimated in the 2009-10 and 2010-11 Budgets.

Chart 2.6 — General government sector interest to revenue ratio



This chart shows the ratio of net interest to revenue rising steeply from 2009-10 to 2013-14. On current projections this ratio is now higher in the forward years than was estimated for the 2009-10 Budget. The ratio was previously projected to decline in 2012-13. As mentioned, net debt rises over the period of the forward estimates higher than was budgeted for 2009-10. Interest rates are also now rising from the low levels experienced during early 2009.

Exposure to rising interest rates is heightened through the increase in net debt. The Budget notes that a 1 percent increase in the average interest rate applying to general government sector debt would increase net interest expense by approximately $25 million in 2010-11 rising to $39 million in 2013-14. This would, other things being equal, further increase the ratio of net interest to revenue.

2.4.7 Interstate comparison

Section 10 of this Report includes comment on 2010-11 Budget comparisons for key budget aggregates across jurisdictions. In 2010-11, South Australia, Tasmania, and Queensland are forecasting general government net operating balance deficits. New South Wales, Victoria and Western Australia have budgeted net operating surpluses. All other jurisdictions are predicting net lending deficits (borrowing) up to 2013-14. Most jurisdictions are budgeting to invest significant funds into infrastructure projects.

2.5 NON-FINANCIAL PUBLIC SECTOR BALANCE SHEET[3]

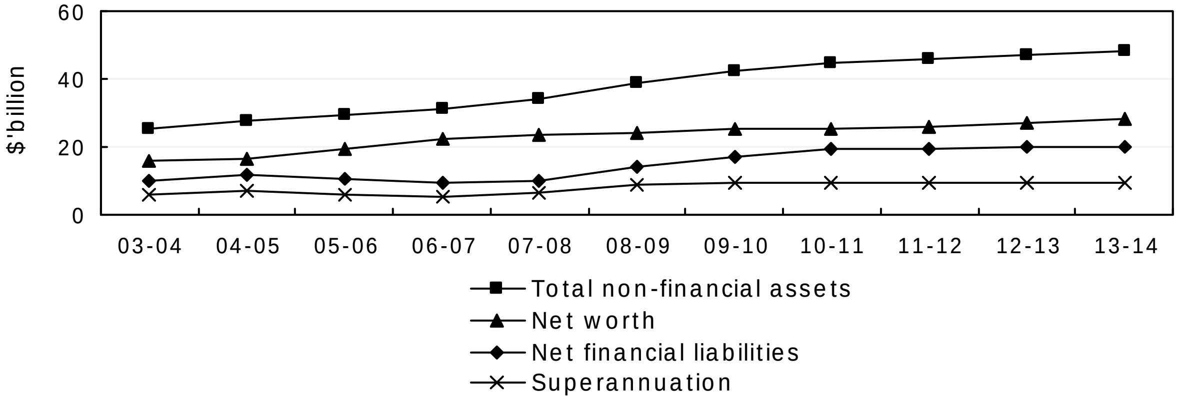
The State's balance sheet is expected to strengthen over the four years of the 2010-11 Budget as measured by net worth. Net financial worth, however, deteriorates due to the growth of financial liabilities.

[3] 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 Balance sheet trends

Chart 2.7 shows the trend of outcomes for some major balance sheet categories for recent years and as estimated in the 2010-11 Budget.

Chart 2.7 — Non-financial public sector balance sheet items



The chart shows that net worth is projected to steadily increase through to 2013-14. This is the combined effect of a steep rise in the value of non-financial assets, due to projected valuation increases and asset acquisitions, offset by increases in net financial liabilities.

Net worth is estimated to add $3187 million over the forward estimates to reach $28.4 billion by 2013-14 with the growth of assets outstripping liability growth.

2.5.2 Assets

Total assets are estimated to increase by $3262 million in 2009-10 to over $46 billion and are expected to continue to rise over the forward estimates to $53 billion by 2013-14. Through the major infrastructure program, non-financial assets increase by over $2 billion in 2009-10 due to net acquisitions after depreciation and asset sales. Net acquisitions through to 2013-14 add a further $3 billion. Revaluations are also estimated to add substantially to non-financial assets. Rising property values have had a marked positive influence on the balance sheet over a number of years, particularly from growth in the value of rental properties of the South Australian Housing Trust.

Total financial assets are expected to be $4287 million in 2009-10. After reducing in 2010-11, they rise to $4703 million in 2013-14.

Included in financial assets is the value of the Government's interest in Public Financial Corporations including the Motor Accident Commission and WorkCover Corporation of South Australia (WorkCover). Improved investment market conditions through 2009-10 resulted in recoveries in the market value of investment assets. The Superannuation Funds Management Corporation of South Australia (Funds SA), which manages the majority of the Government's financial assets, reported net income of $1517 million compared to a net loss from investing activities in 2008-09 of $1993 million. As the managed funds include superannuation assets, this result is partly reflected in an improvement in the unfunded superannuation liability against budget.

The positive market returns contributed to the Motor Accident Commission reporting a comprehensive profit result for the year of $168 million. The Commission's statutory solvency level, calculated in accordance with a formula determined by the Treasurer, improved to 97.1 percent (91.3 percent) of the target level of solvency. As at 30 June 2010 the Commission had net assets of $239 million ($70 million). WorkCover, which manages its own investments, also reported a profit in 2009-10. The comprehensive result for the year was a profit of $77 million. This resulted in an improvement of its funding ratio to 61.5 percent from 56.7 percent, compared to its approved target funding range of 90 to 110 percent. As at 30 June 2010 WorkCover had a net liability position of $982 million ($1059 million).

2.5.3 Liabilities

Borrowing becomes the major component of liabilities over the period of the forward estimates. Net debt, mainly borrowings less cash and deposits, is estimated to rise by $1992 million to $4.9 billion at 30 June 2010 and to $7.5 billion by 2013-14. The general government sector net debt increases to $1587 million at 30 June 2010 and to $3847 million by 2013-14.

The other major component of liabilities, unfunded superannuation liabilities, are estimated to be $9.5 billion for the year to 30 June 2010, an improvement on the budgeted expectation of $9.8 billion. The improvement is mainly due to the following:

- Unfunded superannuation liabilities are valued at points in time by discounting future superannuation benefit payments by a discount rate that reflects the risk-free interest rate consistent with the requirement of prevailing Australian Accounting Standards. A discount rate of 5.3 percent was used for the estimate as at the 2010-11 Budget, compared with 5.2 percent for the 2009-10 Budget. Should interest rates increase in the future, the value of the liability will reduce. Noting the current environment of rising interest rates, a 1 percent rise in the discount rate is estimated to decrease the superannuation liability by $1.6 billion.

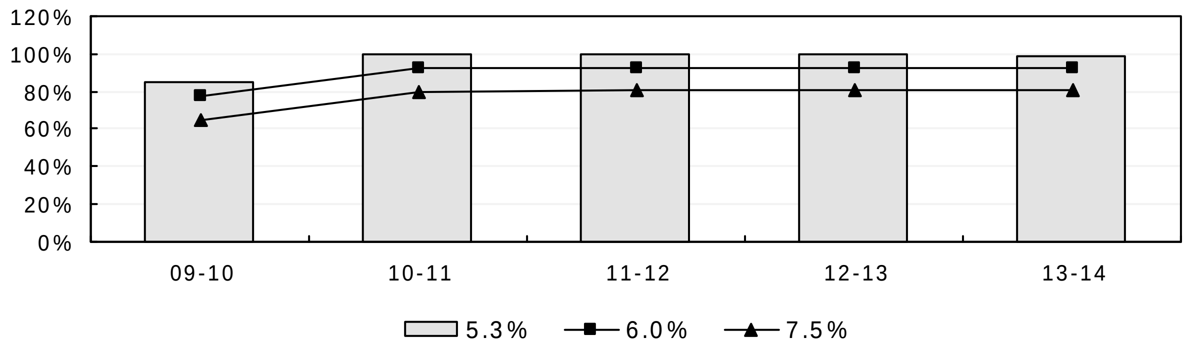
- Improvement in actual returns from investment markets. The actual earnings rate for 2009-10 of 12.2 percent compares to the long term assumption of 7 percent. The actual earnings rate in 2008-09 was negative 17.6 percent. A 1 percentage point higher than expected return would reduce the estimated unfunded superannuation liabilities by around $42 million.

The unfunded superannuation liability is a long-term liability to current and past members of closed defined benefit superannuation schemes. The Budget records that while financial market volatility in the recent past has resulted in multibillion dollar revisions to the value of the liability recorded on the balance sheet, there has been no material change in the actual expected payments to beneficiaries underlying the liability.

The Government reports that it remains committed to fully fund the superannuation liability by 2034.

The ratio of net financial liabilities to revenue is influenced by the value of the unfunded superannuation liability which, in turn, is sensitive to interest rate movements. Chart 2.8 highlights the effect on the ratio, of changes to the interest (discount) rate used to estimate the liability.

Chart 2.8 — General government sector net financial liabilities to revenue ratio



As shown, an increase in interest rates above the 5.3 percent discount rate used in the 2010-11 Budget, would, without any other factors changing, bring the ratio back under 100 percent,. Interest rates alone, however, do not influence the trend of the ratio.

2.6 RISKS AND MANAGEMENT TASKS FOR THE 2010-11 BUDGET

Last year's Report commented on a Budget framed against the immediate effects of the global financial crisis. The stated fiscal strategy of the 2010-11 Budget is to establish and maintain sustainable operating surpluses.

The 2010-11 Budget reports a partial recovery of the previously predicted decline in revenues, due to improved economic conditions and upward revisions to Commonwealth grants. Uncertainty continues around the global economic recovery, which could adversely impact on domestic economic growth and consequently revenue projections over the forward estimates.

The Budget includes operating initiatives, including those announced in the lead up to the March 2010 election, amounting to $1937 million (gross of operating savings) over the next four years, and investing initiatives of $898 million over the same period.

The 2010-11 Budget also includes new operating savings totalling $1526 million over the next four years. These are additional to cost recovery and revenue measures ($478.6 million) and the retention of some savings included in agencies from previous budgets. The new operating savings apply to all portfolios. All portfolios have specific saving tasks and there are a number of savings measures described as across government (eg improving the mix of the motor vehicle fleet).

The Budget Papers[4] explain there are many budget risks to monitor and manage. This section focuses on some of those risks.

2.6.1 Net operating balance

The net operating result is at risk from both revenue and expense outcomes. Sound financial management includes budgeting to achieve a surplus to provide some flexibility and buffer against unfavourable influences and events that may affect Budget outcomes. Given a deficit is expected for 2010-11 no buffer is expected from that source this year.

Buffers are built into the budget through contingency provisions including headroom. These amounts are provided for events that have not occurred or for expenditure that is subject to further approvals. The 2010-11 Budget includes contingency buffers to a similar extent as previous years. Beyond this and in the absence of other changes in spending or taxation policies, unfavourable outcomes will flow to the net operating result and to net debt.

2.6.2 Operating revenues

As mentioned, the 2010-11 Budget reflects a partial recovery of the previously predicted decline in revenues. The main revenue lines, GST and taxation revenue, grew in real terms for 2009-10 and are projected to do so in most of the next four years.

GST revenue in 2009-10 is estimated at $4053 million (excluding transitional assistance), representing 26 percent of total revenue. GST revenue consistently exceeded budget in past years but it has now also shown to be highly sensitive to deteriorating economic conditions. An agreement for the States and Territories to receive a guaranteed minimum amount (GMA) from GST funding expired at the end of

[4] Budget Statement 2010-11, Budget Paper 3, Chapter 6.

2008-09. Consequently, the State became totally reliant on actual GST revenues from 2009-10 and has a greater exposure to variations in national economic activity. A last payment of GMA transitional assistance funding of $7.5 million was received in 2009-10 relating to the 2008-09 year.

The Budget records that revenue estimates were prepared in the context of a positive outlook for the economy. Current circumstances suggest a low likelihood of receiving favourable revenue outcomes. The Government acknowledges that there continues to be uncertainty around the global economic recovery, which could adversely impact on domestic economic growth and consequently revenue projections over the forward estimates.

An indication of the uncertainty over revenue estimates occurred in November 2010. Following the Commonwealth Government's Mid-Year Economic and Fiscal Outlook 2010-11, the Government announced that the State faced a reduction of GST revenues of $143 million over the next four years.

Risk analysis in the Budget Papers notes that state taxation revenues are also exposed to variations and fluctuations in both the volume and value of activity. The Budget estimates that a variance of 1 percent in state taxation revenue, not including GST revenues, equates to about $39 million per annum.

2.6.3 Operating expense variations

In the absence of better than budgeted revenue outcomes, the key to achieving the budget targets is to control expenses. The 2010-11 Budget contains significant new spending and savings initiatives overlaying a substantial annual spending base. Past Auditor-General's Reports have included commentary on operating expense variations. The Budget Papers provide summary details of parameter and policy changes that occur between budgets that typically have added hundreds of millions to spending commitments.

Parameter effects typically involve adjustments for enterprise bargaining outcomes, the carryover of expenditure from the previous year, revised timing of expenditure and changes to interest expenses. Some expenses are covered by using provisions set aside in the annual budget. Audit notes that parameter and other variations up to the 2009-10 MYBR added $727 million (before provisions) to operating expenses over four years to 2012-13. A further $718 million (excluding the reversal of previously unallocated savings) was added after the MYBR and up to the 2010-11 Budget. Use of provisions covered only a small part of these adjustments.

Salaries and wages remains the main public sector operating cost. The Budget states that enterprise agreements are progressing for a number of major workforce groups. Budget commentary states that the outcomes of future wage negotiations will be crucial in determining whether expenditure forward estimates in this budget can be achieved and the level of government services that can be delivered, particularly in light of the current challenging economic conditions.

The Budget records that if public sector wide wage outcomes for new enterprise agreements vary by 1 percent per annum from allowances in the forward estimates, the budget impact will be approximately $180 million in 2013-14.

The 2010-11 Budget reports that policy decisions up to the 2009-10 MYBR added $649 million to operating expenses over four years to 2012-13. While various individual expense items have attendant risks, it is evident from past practices and outcomes that the ongoing practice of approving expenditure commitments between budgets may be a high risk to achieving Budget targets. While a practical necessity for many reasons, it is an area that will warrant a high degree of scrutiny given the 2010-11 Budget settings.

2.6.4 Savings initiatives

Setting large savings targets is a feature of past Budgets. Other factors, principally revenue outcomes, have, however, tended to overshadow savings effects on budget outcomes. The 2010-11 Budget consolidates a range of savings targets proposed in past Budgets and adds significant new savings measures needed to cover new expenditure commitments and the fiscal strategy to establish and maintain sustainable operating surpluses.

The 2008-09 Budget announced a savings target of $250 million over three years to 2011-12. Further savings were announced in the 2009-10 Budget the majority of which were unspecified and held centrally by DTF pending the Government considering and approving budget improvement measures recommended by the Sustainable Budget Commission.

The Sustainable Budget Commission has reported to the Government and the 2010-11 Budget states that specific measures announced in the 2010-11 Budget achieve the remaining unspecified savings of over $700 million per annum by 2013-14.

The 2010-11 Budget also includes new operating savings totalling $1526 million over the next four years. These are additional to cost recovery and revenue measures ($478.6 million) and some retained savings included in agencies from previous budgets. The net effect of the expenditure and savings initiatives after taking into account inflation is that the 2010-11 Budget projects negative, annual real terms change in expenses over the four years to 2013-14. I note this is influenced by the reduction in grant spending over those years.

The Government has published itemised savings initiatives in Budget Paper 6 '2010-11 Budget Measures Statement'. This provides a reference for monitoring progress of the new savings initiatives announced in the 2010-11 Budget. The Budget Papers do not itemise initiatives scheduled to commence in 2010-11, or that were not fully implemented, from previous Budgets.

An inherent risk of the 2010-11 saving strategy is its sheer size and breadth. New savings of $1525 million and existing savings measures of $559 million total to $2084 million over four years to 2013-14. Achieving the task will require significant discipline. Agencies have developed some experience with implementing savings strategies over recent years but not at this scale. It introduces risks including industrial action, public demand to maintain services and administrative delays. Some anecdotal evidence of these risks is found in various media articles reported since the Budget was presented.

The savings task falls on all portfolios of Government. There has been mixed success in previous years in meeting savings targets. It is well known that health and, to a lesser but nonetheless substantial degree, families and community service areas, have either found savings targets difficult to meet over time or have other service demands that have necessitated additional funding. The savings task for the Department of Health in this Budget is $316 million over four years. In my recent 2009-10 Auditor-General's Annual Report to Parliament, I reported that various factors have meant that savings from the shared services initiative may be lower than currently factored into the Budget. For example, in 2009-10 savings are expected to fall $28 million short of the budgeted savings of $60 million. Also Shared Services SA advised that, as part of the 2010-11 Budget, savings targets were revised downwards from $60 million for each of the three years to 2012-13. The extent of the savings in subsequent years will depend on the success of the reform activities within Shared Services SA.

I refer to these various instances as examples to demonstrate the difficult nature and extent of the savings task and risks to be mitigated in managing the achievement of the 2010-11 Budget outcomes.

2.6.5 Full-time equivalents reduction management strategy

A key part of the savings strategy is to further reduce public sector full-time equivalents (FTEs) by 3743 FTEs. At an average savings of $70 000 per year per FTE, this measure will achieve savings of $262 million per annum if fully implemented by 2013-14. To assist agencies to achieve this target, the Government has introduced an enhanced redeployment process to match excess employees with suitable vacant roles. The Government considers that successful redeployment of excess employees into funded vacancies would significantly reduce the potential cost of reducing the workforce. The Government also approved further targeted voluntary separation program (TVSP) arrangements. Some audit observations on the TVSP scheme that operated in 2009-10 were made in my recent 2009-10 Auditor-General's Annual Report to Parliament. A key condition was that TVSP offers were only to be made to employees who were declared excess to requirements because their positions had been or were to be abolished. Audit noted difficulty in ascertaining whether this had generally occurred.

I note that guidelines for the new TVSP arrangements propose improvements to the previous scheme that should address the audit issues. The scheme guidelines emphasise to agencies that a critical requirement to meet the criteria of a genuine redundancy payment for taxation purposes, is that it is fundamentally the employer's decision that the employee is genuinely redundant. That is, the employer decides who is genuinely excess to requirements and who will get a separation package. The Audit findings were cited and it was also emphasised that offers of a TVSP are only to be made to employees who are deemed to be excess to requirements because their assigned role or position has or is to be abolished and agencies' internal systems need to be able to evidence that positions have in fact been abolished.

The TVSP scheme is planned to be available until 2013-14. It is also structured to encourage acceptance of an offer within six months of it being made but offers may be accepted beyond that time frame for a lesser amount. Given this timeframe and structure, it may be some time before it is clear what impact the scheme has had in providing incentive for reducing FTE numbers and meeting targeted savings. The Government has indicated an initial target of 1011 FTE reductions for 2010-11. The Government has also announced that if the required rate of reduction in employee numbers is not evident after 12 months of TVSPs being available, through redeployment of excess employees and voluntary separation packages, the Government will reconsider its 'no forced redundancy' policy.

2.6.6 Capital payments

The 2009-10 Budget, with the combined influence of state and Commonwealth spending initiatives, elevated general government sector capital spending estimates to very high levels. The estimated result for 2009-10 purchases of non-financial assets of $2162 million, is on budget for the year. This represents an increase of $857 million or 66 percent over 2008-09.

Last year I indicated that the significant increase in capital outlays and activity may introduce a heightened risk to the proper management and control of capital project management. This situation remains, with the budget for purchases of non-financial assets in 2010-11 being $2283 million.

Audit comments on aspects of capital spending were included for relevant agencies in Part B of my recent 2009-10 Auditor-General's Annual Report to Parliament.

2.6.6.1 Public private partnership projects

Public private partnership projects (PPPs) continue to form a sizeable part of the annual capital program. Planned capital spending on new schools and the New Royal Adelaide Hospital in the four years of the 2010-11 Budget is in the order of $250 million.

Contractual close of the Education Works New Schools PPP Project was achieved in early July 2009. The total value of the contracts of $323 million (net present cost) represents the cost of construction, management and maintenance of the schools over a 30 year period. In November 2009, Cabinet approved a revised indicative capital cost of the new Royal Adelaide Hospital project of $1798 million (nominal value). Audit commentary on aspects of these projects is included in Part B of my recent 2009-10 Auditor-General's Annual Report to Parliament.

2.6.7 Budget monitoring

Past Audit Reports have consistently emphasised the need for strong monitoring of budget progress. Following the 2010-11 Budget, I asked DTF for details of any changes to capital, operating expenditure and saving/revenue monitoring processes for 2010-11.

DTF advised that regular monitoring regime coordinated by DTF includes monthly monitoring of financial performance against approved budget and quarterly monitoring of capital projects, budget initiatives and fulltime equivalents. Reports on each aspect of the monitoring regime based on information supplied by agencies and an analysis prepared by DTF is provided to the Sustainable Budget Cabinet Committee (SBCC).

DTF indicated that given the size of the savings target and the importance of achieving the fiscal outlook, an enhanced monitoring process would be introduced. This includes requiring chief executives to write to and then appear before SBCC with their implementation plans and discuss their progress. Subsequent appearances will be based on a risk assessment as part of the regular return monitoring.

The new approach requires chief executives to present how they will achieve savings and how achievement will be measured. These measures aim to ensure attention is given to the task and provide confidence to SBCC on progress or highlight issues as they arise.

DTF advised that monitoring of progress against specific individual savings initiatives forms part of the initiative monitoring which covers operating expenditure, savings, revenue and asset sales and will include all initiatives disclosed in the Budget Papers. From the 2010-11 Budget this will include all items in the Budget Measures Statement. It will also include initiatives scheduled to commence in 2010-11, or that were not fully implemented from previous Budgets.

For 2009-10, DTF advised that two agencies had large deteriorations against the net operating balance result. The net operating deterioration for the Department of Health was about $128 million. The net operating deterioration for the Department for Transport, Energy and Infrastructure was about $60 million. The Department of Health was the only agency reported to not meet the budget savings arising from the 1200 FTE reduction target in 2009-10 required as part of the 2008-09 MYBR.

Audit review of FTE monitoring data to 30 June 2010 showed that agencies were collectively close to the total approved cap for all agencies of 77 232 FTEs, exceeding this by 230 FTEs. However, the Department of Health was 887 (3.1 percent) above its cap, primarily due to overspending, not achieving savings and early employment of nursing and medical staff. The Department of Further Education, Employment, Science and Technology was 70 (2.1 percent) above its cap, due to additional demand for fee for service activity. These outcomes were largely offset by a number of agencies being under their caps.

2.7 CONCLUDING OBSERVATIONS

2009-10 is estimated to result in better than expected outcomes. This is largely to do with timing of Commonwealth related grant revenues and expenses between 2009-10 and 2010-11. However, the Australian economy weathered the global financial crisis better than expected at the time. The State's balance sheet was strengthened by positive financial markets for financial institutions improving the position of the Motor Accident Commission and WorkCover and to some extent the unfunded superannuation liability.

The 2010-11 Budget establishes the Government's aim to return to sustainable operating surpluses. Targets are set for the net operating balance, net lending, net debt and the ratio of net financial liabilities to revenue. These targets are set against the continuing uncertainty around the global economic recovery, which could adversely impact on domestic economic growth and consequently revenue projections over the forward estimates. The budgeted operating deficit in 2010-11 and the small operating surplus estimated for 2011-12 leave little room for unfavourable outcomes in the next two years without increasing the risk to longer term targets.

The Commonwealth Government's Mid-Year Economic and Fiscal Outlook 2010-11 gave an indication of the uncertainty over revenue estimates with the State facing a reduction of GST revenues of $143 million over the next four years.

To achieve its outcomes, the Budget introduces significant budget improvement measures that are additional to savings announced in previous budgets. The Government also states its program will be delivered within manageable state debt levels. A key factor for the budget is the projected very low or no growth in operating expenses reflecting the savings targets.

In the 2009-10 Budget, savings were targeted but specific measures largely unidentified and deferred until 2010-11. The Sustainable Budget Commission recommended measures many of which the Government adopted, but the savings target has also escalated to a much higher level. An inherent risk of the 2010-11 saving strategy is its sheer size and breadth. Achieving the task will require significant discipline. Agencies have developed some experience with implementing savings strategies over recent years but not at this scale. It introduces risks including industrial action, public demand to maintain services and administrative delays. Some recent anecdotal evidence of these risks is found in various media articles reported since the Budget was presented.

A significant component is the FTEs reduction management strategy, worth $260 million per annum at $70 000 per FTE if fully achieved. This strategy introduces new administrative demands in placing excess employees with suitable vacant roles. It also has a new TVSP scheme. I note that various proposals seek to improve on aspects of the previous scheme. Given the timeframe and structure of the scheme, it may be some time before it is clear what impact it has had in providing incentive for reducing FTE numbers and meeting targeted savings.

There are many challenges to agencies in the Budget with some agencies having all three major Budget strategies to manage and implement while retaining base services Many of the initiatives have significant administrative demands. Projects such as asset sales, system changes, service and administrative reform, involve risks that need prudent management to achieve value and avoid unexpected unfavourable outcomes. Examples of tasks and risks to manage are:

- the Department of Health, which has not been able to meet savings targets in the past, is to contribute savings of $316 million over four years
- the TVSP program is a spending initiative estimated to cost $354 million over four years.

DTF have detailed how Budget initiatives including the new Budget measures will be monitored through enhanced processes reporting to the SBCC.

Given the magnitude of the overall program and its components, selective areas will also receive audit attention through 2010-11 and the forward years.

3 REPORTING FRAMEWORK

3.1 INTRODUCTION

Three reporting frameworks are used for reporting on the State's finances, namely the:

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

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

3.2 UNIFORM PRESENTATION FRAMEWORK

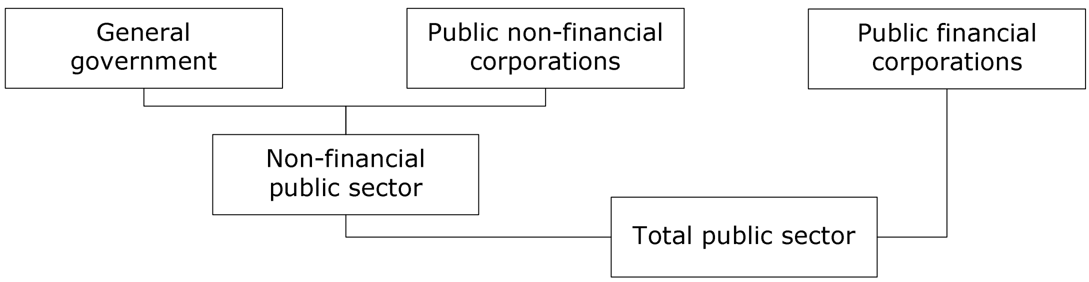
3.2.1 Background

The UPF is a reporting standard based on the Australian Bureau of Statistics' accrual-based Government Financial Statistics (GFS) framework. As a result of a project to harmonise generally accepted accounting principles and the GFS (discussed later), the Commonwealth, States and Territories agreed to update the UPF. This would continue to provide a common core of financial information in budget papers and comparable data amongst jurisdictions while maintaining the current level of transparency.

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

The GFS accrual reporting has many similarities to the AAS framework. GFS framework excludes revaluations from the GFS net operating balance, as they are not transactions for the purposes of the GFS framework.

Three sectors (which are then consolidated into two additional sectors) of government activity are used in the GFS framework recognising that State Government responsibilities cover a wide range of activities. They are:



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 include the following GFS financial statements:

- 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 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.

3.2.1.1 Key Government Financial Statistics 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 financial liabilities*** — comprises total liabilities less financial assets (net financial worth), but excludes equity investments (net worth) in the other sectors of the jurisdiction.

- ***Net debt*** — comprises certain financial liabilities less financial assets. The items included in this measure are discussed in depth in the Budget Papers.[5]

3.2.2 Scope of audit review of Government Financial Statistics financial statements

This Report primarily covers commentary on GFS based information. Although Audit seeks to have a sound understanding of the budget preparation process, the data and assumptions are not subject to audit. Work performed on the 2010-11 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

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

5 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.

3.3.1 Agency financial reports

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

3.3.2 AASB whole-of-government financial report

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

Whole-of-government financial reports for South Australia up to 2007-08 were prepared by DTF pursuant to Accounting Standard AAS 31 'Financial Reporting by Governments'.

Since 2008-09, the whole-of-government financial report has been prepared pursuant to Accounting Standard AASB 1049 'Whole of Government and General Government Sector Financial Reporting'. AASB 1049 specifies requirements for whole-of-government financial reports and general government sector financial reports of each government. The Standard requires compliance with other applicable AASs except as specified in the Standard and disclosure of additional information such as reconciliations to key fiscal aggregates determined in accordance with the ABS GFS Manual.

3.3.3 Convergence of Government Financial Statistics and Australian Accounting Standards

The AASB issued ED 174 'Amendments to Australian Accounting Standards to facilitate GAAP/GFS Harmonisation for Entities within the general government sector [AASB 101, 107 and 1052]' in January 2009. ED 174 was issued as part of the second, and final, phase of the AASB's implementation of the FRC's GAAP/GFS harmonisation broad strategic direction.

The objective of harmonising generally accepted accounting principles and the GFS is to achieve a single standard to produce comparable government budgets and financial statements that are auditable and comparable.

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* and reported as an Appendix in Part B of my recent 2009-10 Auditor-General's Annual 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 2010-11 Budget Papers[6] 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 fiscal targets is to achieve net operating balances every year. This means that revenues are covering expenses, including interest and depreciation.

The Government states in the 2010-11 Budget Papers that a key fiscal target is to achieve net operating balances every year. This means that revenues are covering expenses, including interest and depreciation. South Australia is forecasting a net operating deficit in 2010-11 before returning to a surplus in 2011-12.

4.1.2 General government ratio of net financial liabilities to revenue

Another of the Government's fiscal targets 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. Net financial liabilities is a broader measure than net debt as it includes significant liabilities other than borrowings, such as unfunded superannuation and long service leave entitlements.

The ratio is forecast to increase across the forward estimates up to 2011-12, with a decrease estimated/projected to 2014-15. This reflects a moderation in infrastructure spending to return the budget to surplus by 2013-14. It is evident that a similar situation exists for New South Wales and Victoria, whilst Queensland, Western Australia and Tasmania show a steady ratio incline.

6 Budget Statement 2010-11, Budget Paper 3, Table 1.5

4.2 FISCAL MEASURES IN OTHER JURISDICTIONS

In considering the State's fiscal strategy, it is useful to note the current practice across Australian jurisdictions. This is set out in the following table.

Jurisdiction	Budget fiscal objective/strategy [(a)] [(b)]
Commonwealth	Achieving a budget surplus, on average, over the medium term.
	Keeping taxation as a share of GDP on average below the level for 2007-08.
	Improving the Government's net financial worth 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 (0.9 percent of GSP).
VIC	Short-term: Target Operating Surplus of at least $100 million in each year.
	Long-term: Maintain a substantial budget operating surplus that allows for the delivery of the Government's infrastructure objectives.
QLD	In the general government sector, meet all operating expenses from operating revenue (where operating revenue is defined as total revenue from transactions and operating expenses are defined as total expenses from transactions less depreciation).
	Achieve a general government net operating surplus as soon as possible, but not later than 2015-16.
WA	Achieve operating surpluses for the general government sector.
TAS	By 2014-15, achieve, on average, a Net Operating Surplus for the general government sector over four year rolling period.
	By 2014-15, achieve a modest Fiscal Surplus.
ACT	Achieve a general government sector Net Operating Surplus.
	Maintain Operating Cash Surpluses.
NT	Expenditure growth not to exceed revenue growth, excluding tied Commonwealth funding.

(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

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.

Like South Australia, other jurisdictions have framed budgets working towards achieving budget surpluses. Consistent with the prior year, the majority of jurisdictions continue to have a medium term focus.

5 ESTIMATED RESULTS FOR 2009-10

5.1 OVERVIEW

The following section summarises the estimated operating results for 2009-10.

5.2 2009-10 ESTIMATED RESULTS

5.2.1 General government sector

The estimated result for the year was a net operating surplus of $167 million (budget $304 million deficit) and net lending deficit (borrowing) of $1124 million (budget $1541 million).

The following table shows 2008-09 financial year data and differences between the estimated result and budget for 2009-10

Table 5.1 — General government budget comparisons 2008-09 to 2009-10

	2008-09 Actual $'million	**2009-10 Budget $'million**	**2009-10 Estimated result $'million**	Difference to Budget $'million	Difference to Budget Percent
Revenue					
Taxation revenue	3 537	3 526	3 641	115	3
Grants:					
Current	6 651	6 466	7 009	543	8
Capital	598	1 599	1 848	250	16
Sales of goods and services	1 697	1 834	1 933	99	5
Interest income	150	144	163	19	13
Dividend and income tax equivalent income	382	388	425	37	10
Other	517	489	512	23	5
Total revenue	13 531	14 444	15 531	1 087	8
Less: **Expenses**					
Employee expenses	5 749	6 035	6 177	142	2
Superannuation expenses:					
Superannuation interest cost	383	444	455	11	2
Other superannuation expenses	580	623	646	23	4
Depreciation and amortisation	566	601	626	25	4
Interest expenses	180	174	179	5	3
Other operating expenses	3 624	3 728	3 720	(8)	-
Grants	2 682	3 145	3 560	415	13
Total expenses	13 764	14 748	15 364	616	4
Net operating balance	(233)	(304)	167	471	(155)
Less: **Net acquisition of non-financial assets**					
Purchases of non-financial assets	1 305	2 180	2 162	(18)	(1)
Less: Sales of non-financial assets	108	343	245	(98)	(29)
Less: Depreciation	566	601	626	25	4
Less: Change in inventories	7	-	-	-	-
Total net acquisition of non-financial assets	639	1 237	1 290	80	6
Net lending (borrowing)	(872)	(1 541)	(1 124)	417	(27)

Note: Totals may not add due to rounding.

As shown in the table, when compared to 2008-09, the 2009-10 Budget anticipated an increase in the net operating balance deficit from higher growth in expenses than in revenues, and higher purchases of non-financial assets leading to a net lending deficit.

The estimated result for 2009-10 shows a significant improvement from budget. This improvement in the estimated net operating balance principally results from increased Commonwealth grants and taxation revenues partially offset by increased grant expenses and employee expenses. Further commentary on these main items is as follows:

- ***Commonwealth grants*** — Commonwealth grants are expected to exceed budget by $810 million due to Commonwealth funding received under the Nation Building - Economic Stimulus Plan (mainly on-passed to recipients as grant expenses or are used for specific capital spending programs) and increased GST revenue. The stimulus monies are required to be spent on projects and are not available as general purpose revenue.

- ***Taxation revenue*** — Taxation revenue is expected to exceed budget by $115 million due mainly to conveyance duty exceeding budget by $95 million following stronger than expected property sales.

- ***Grant expenses*** — Up $415 million on budget reflecting application of increased Commonwealth grants (see above).

- ***Employee expenses*** — Expected to exceed budget by $142 million following finalisation of enterprise agreements for the wages parity (salaried) group, medical specialists and Parliament House employees.

5.2.1.1 Net acquisition of non-financial assets

The 2009-10 estimated result for purchases of non-financial assets is slightly less than budget, down $18 million. The 2009-10 budget of $2180 million for purchases of non-financial assets, included a slippage allowance of $200 million to allow for likely project delays. Table 5.2 shows that consistent with the high value of capital spending, some large adjustments were made in the course of 2009-10. The original budget was increased by policy decisions and carryovers from 2008-09. The estimated result for 2009-10 allows for timing adjustments and carryovers beyond the year. Finally, the estimated result is influenced by the removal of the slippage allowance reflecting the reduced uncertainty of projections.

Table 5.2 — Purchases of non-financial assets budget to estimated result comparison 2009-10

	$'million	$'million
2009-10 Budget		2 180
Add: Policy decisions	80	
Carryover from 2008-09	118	
		198
Less: Timing Adjustments - MYBR	(157)	
Approved budget time carryovers	(260)	
Other	1	
		(416)
Add back: Capital slippage reversal		200
2009-10 Estimated result		2 162

The Budget Papers[7] show the estimated result for many portfolios was lower than budgeted. The majority of under expenditure qualifies for carryover into future budgets. Investing carryovers from 2009-10 to 2010-11 and future years are $260 million[8] ($86.6 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 net lending deficit (borrowing) of $2007 million, which is $504 million less than budget for the year.

The following table summarises the position.

Table 5.3 — NFPS Budget comparisons 2007-08 to 2008-09

	2008-09 Actual $'million	**2009-10 Budget $'million**	**2009-10 Estimated result $'million**	Difference to Budget $'million	Difference to Budget Percent
Revenue	14 360	15 303	16 303	1 000	7
Less: **Expenses**	14 567	15 307	15 810	503	3
Net operating balance	(207)	(4)	492	496	-
Less: **Net acquisition of non-financial assets**	1 249	2 507	2 499	(8)	-
Net lending (borrowing)	(1 456)	(2 511)	(2 007)	504	(20)

Note: Totals may not add due to rounding.

The decline in the net lending deficit (borrowing) of $504 million comprises the improvement in the general government result by $417 million and the public non-financial corporations sector's result by $87 million.

The public non-financial corporations sector's[9] net operating balance is estimated to improve $25 million from budget to a surplus of $325 million. Total net acquisition of non-financial assets decreases by $62 million compared to budget due mainly to unbudgeted purchases of non-financial assets of $23 million offset by an increase in the sales of non-financial assets of $94 million compared to budget. The combination of these results causes an improvement of $87 million in the net lending deficit to $883 million.

7 Budget Statement 2010-11, Budget Paper 3, Table 2.10.

8 Budget Statement 2010-11, Budget Paper 3, Table 1.11.

9 Budget Statement 2010-11, Budget Paper 3, Table A.2.

6 BUDGET 2010-11 OVERVIEW

6.1 OVERVIEW

The following commentary focuses on the trends arising from the 2010-11 Budget tabled in Parliament in September 2010. It provides an overview of:

- the Budget for 2010-11 having regard to the estimated result for 2009-10
- a longer term view of the forecast results going forward to 2013-14.

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

6.1.1 Matters of significance to the 2010-11 Budget

The 2010-11 Budget was developed in an environment which saw a partial recovery from the effects of the Global Financial Crisis, the anticipated winding back of Commonwealth Stimulus funding (with matching forecast reductions in expenditure) and continued uncertainty in the global economic recovery.

The fiscal strategy documented in the 2010-11 Budget is to establish and maintain sustainable surpluses. While an operating surplus is now estimated for 2009-10, a deficit is budgeted for 2010-11. This volatility is largely due to timing of Commonwealth receipts and payments between the two years. Initially small but growing net operating surpluses are targeted to resume from 2011-12.

In the balance sheet, borrowings are a growing component of liabilities over the forward estimates. Net debt, mainly borrowings less cash and deposits, is budgeted to climb significantly in 2010-11, with general government sector net debt increasing by $1.7 billion. This increase in net debt is targeted to support the governments capital investment program.

Some specific items to note in the 2010-11 Budget estimates years are:

- new operating and investing initiatives totalling $2835 million over the next four years[10]
- targeted savings and revenue offsets totalling $1521 million over four years[11]
- expenditure restraint compared to revenue growth is projected to lift the net operating balance to $370 million by 2013-14
- higher capital investment leads to general government sector net debt increasing by $2260 million to $3847 million between June 2010 and June 2014.

Budgeted total revenues and expenses for 2010-11 are significantly higher than was budgeted in 2009-10.

Total revenue for 2010-11 is now budgeted at $15.1 billion, $689 million or 4.8 percent more than was estimated for 2010-11 in the previous, 2009-10 Budget. Expenses for 2010-11 are now budgeted at $15.5 billion, $1156 million or 8.1 percent higher than was estimated at the time of the 2009-10 Budget.

As a consequence of these changes, a net operating balance deficit of $389 million is now budgeted, down from the estimated $78 million 2010-11 surplus result projected in the 2009-10 Budget and not achieving the fiscal objective of at least a net operating balance for the general government sector.

[10] Budget Statement 2010-11, Budget Paper 3, Table 2.1.

[11] Budget Statement 2010-11, Budget Paper 3, Table 2.1.

6.2 GENERAL GOVERNMENT SECTOR – OPERATING STATEMENT

Table 6.1 sets out the differences between the 2010-11 Budget and the estimated results for 2009-10.

Table 6.1 — GFS - General government sector budget comparison of 2009-10 estimate results and 2010-11 Budget

	2009-10 Estimated result $'million	2010-11 Budget $'million	Difference $'million	Difference Percent
Revenue				
Taxation revenue	3 641	3 858	217	6.0
Grants:				
Current grants	7 009	7 257	248	3.5
Capital grants	1 848	1 063	(786)	(42.5)
Sales of goods and services	1 933	1 877	(56)	(2.9)
Interest income	163	143	(20)	(12.3)
Dividend and income tax equivalent income	425	353	(72)	(16.9)
Other	512	536	24	4.7
Total revenue	15 531	15 086	(445)	(2.9)
Less: **Expenses**				
Employee expenses	6 177	6 379	202	3.3
Superannuation expenses:				
Superannuation interest cost	455	427	(28)	(6.2)
Other superannuation expenses	646	676	30	4.6
Depreciation and amortisation	626	681	55	8.8
Interest expenses	179	255	76	42.5
Other operating expenses	3 720	3 983	263	7.1
Grants	3 560	3 073	(487)	(13.7)
Total expenses	15 364	15 475	111	0.7
Net operating balance	167	(389)	(556)	(332.2)
Less: **Net acquisition of non-financial assets**				
Purchases of non-financial assets	2 162	2 283	121	5.6
Less: Sales of non-financial assets	245	201	(44)	(18.0)
Less: Depreciation	626	681	55	8.8
Total net acquisition of non-financial assets	1 290	1 402	112	8.7
Net lending (borrowing)	(1 124)	(1 791)	(667)	59.4

Note: Totals may not add due to rounding.

As shown, the differences for the 2010-11 year are due mainly to:

- increased taxation revenue arising from projected increases in property taxes (especially conveyance duty and guarantee fees) and to a lesser extent payroll tax
- increased current grants income due mainly to a $405 million estimated increase in GST revenue grants from the Commonwealth partially offset by a $184 million decrease in Commonwealth National Partnership grants
- a $786 million decrease in capital grants income, principally Commonwealth National Partnership grants. This large decrease reflects the winding back of payments under the Commonwealth's Nation Building - Economic Stimulus Plan
- increased employee expenses (including targeted separation costs)
- increased other operating expenses
- decreased grants expenses arising from the winding back of Commonwealth funding.

More detail of the factors influencing the 2010-11 Budget is considered in the context of the longer-term trends discussed later in this Report.

6.2.1 Reconciliation of variations since 2009-10 Budget

Each year a reconciliation is included in the Budget Papers of the current budget estimates with the corresponding estimates for the previous year. This explains 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 2009-10 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

	2009-10 Estimated result $'million	2010-11 Budget $'million	2011-12 Estimate $'million	2012-13 Estimate $'million
2009-10 Budget	(304)	78	96	304
Parameter and other variations				
Revenue - taxation	115	323	405	420
Revenue - other	922	329	411	347
Operating expenses	(330)	(637)	(662)	(738)
Net effect of parameter and other variations	707	15	154	29
Policy measures				
Revenue - taxation	-	(87)	(49)	(42)
Revenue - other	51	124	174	200
Operating expenses	(344)	(574)	(371)	(318)
Net effect of policy measures	(293)	(537)	(246)	(160)
Use of provisions set aside in the 2009-10 Budget and the 2009-10 MYBR				
Operating expenses	59	55	50	42
2010-11 Budget	167	(389)	55	216

Note: Totals may not add due to rounding.

6.2.1.1 Revenue variations

The table highlights the expected overall recovery in taxation revenue across the forward estimates and increases in other revenues primarily from Commonwealth funding changes since the 2009-10 Budget.

[12] Budget Statement 2010-11, Budget Paper 3, Table 1.9.

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

Table 6.3 — Revenue parameter changes

	2009-10 Estimated result $'million	2010-11 Budget $'million	2011-12 Estimate $'million	2012-13 Estimate $'million
Commonwealth Specific Purpose and National Partnership grants:				
Capital	134	(187)	(60)	16
Current	309	162	219	173
Commonwealth contributions	34	41	54	50
GST revenue grants and transitional assistance	241	445	335	317
Property related taxes	107	295	350	367
Dividends and income tax equivalents	38	(96)	(9)	(38)
Interest income	19	(63)	(135)	(169)
Other	155	55	62	51
Total	1 037	652	816	767

Table 6.3 shows clearly the compositional changes to total revenues that are estimated to follow the global financial crisis.

6.2.1.2 Operating expense variations

Table 6.2 shows that parameter effects are estimated to add $2367 million to operating expenses over the four years to 2012-13.

Policy spending decisions add a further $1607 million to operating expenses over the four year period of which $344 million is for 2009-10.[14] The following table shows the value of policy measures taken in each of the past five years after presentation of the Budget for the year.

Table 6.4 — Policy spending decisions

	2005-06 $'million	2006-07 $'million	2007-08 $'million	2008-09 $'million	2009-10 $'million
Policy measure operating expenses	217	163	274	296	344

Table 6.4 shows that $1294 million was added to spending for the past five years. In past years, increases reflected an established practice of discretionary expenditure decisions being taken after Budgets were announced. This was generally enabled by favourable revenue outcomes. By comparison to past years, expense adjustments since the 2009-10 budget, as shown in table 6.2, mainly arise from governmental response to the global financial crisis and changed inter-government financial arrangements. Additional expenses peak in 2010-11 as current stimulus arrangements end by 2012-13.

13 Budget Statement 2010-11, Budget Paper 3, Table 1.11 and 2009-10 Mid Year Budget Review, Table 1.6.

14 Budget Statement 2010-11, Budget Paper 3, Table 1.9.

6.3 PUBLIC NON-FINANCIAL CORPORATION SECTOR – OPERATING STATEMENT

A net operating deficit of $25 million is budgeted in 2010-11 ($325 million surplus), the deterioration due to increases in operating expenses and corresponding decreases in total revenues (principally grants). The net lending deficit of $510 million is lower than estimated for 2009-10 due to a decrease in the net operating balance between years of $350 million, a $390 million decrease in budgeted purchases of non-financial assets and a $203 million increase in sales of non-financial assets. The differences between the two years are set out in the following table.

Table 6.5 — GFS - PNFC budget comparison 2009-10 and 2010-11

	2009-10 Estimated result $'million	**2010-11 Budget $'million**	Difference $'million	Difference Percent
Revenue				
Sales of goods and services	1 534	1 697	163	10.6
Other	1 347	1 022	(325)	(24.1)
Total revenue	2 882	2 720	(162)	(5.6)
Less: **Expenses**				
Employee expenses	168	170	2	1.2
Depreciation and amortisation	305	368	63	20.7
Interest expenses	184	247	63	34.2
Other property expenses	373	270	(103)	(27.6)
Other operating expenses	1 385	1 581	196	14.2
Other expenses	140	109	(31)	(22.1)
Total expenses	2 556	2 745	189	7.4
Net operating balance	325	(25)	(350)	-
Less: **Net acquisition of non-financial assets**				
Purchases of non-financial assets	1 751	1 361	(390)	(22.3)
Less: Sales of non-financial assets	309	512	203	65.7
Depreciation	305	368	63	20.7
Add: Change in inventories	72	4	(68)	(94.4)
Total net acquisition of non-financial assets	1 208	485	(723)	(59.9)
Net lending (borrowing)	(883)	(510)	373	(42.2)

Note: Totals may not add due to rounding.

6.4 NON-FINANCIAL PUBLIC SECTOR – OPERATING STATEMENT

The consolidated result for the non-financial public sector is a net lending deficit (borrowing) of $2301 million, a deterioration of $294 million from the 2009-10 estimated result.

6.5 A LONGER TERM PERSPECTIVE OF FINANCIAL PERFORMANCE

The following sections provide additional details in an historical perspective.

6.5.1 General government sector operating statement time series

Table 6.6 provides a 10 year time series for those individual elements that contribute to the budget result.

Table 6.6 — GFS - General government sector operating statement - time series

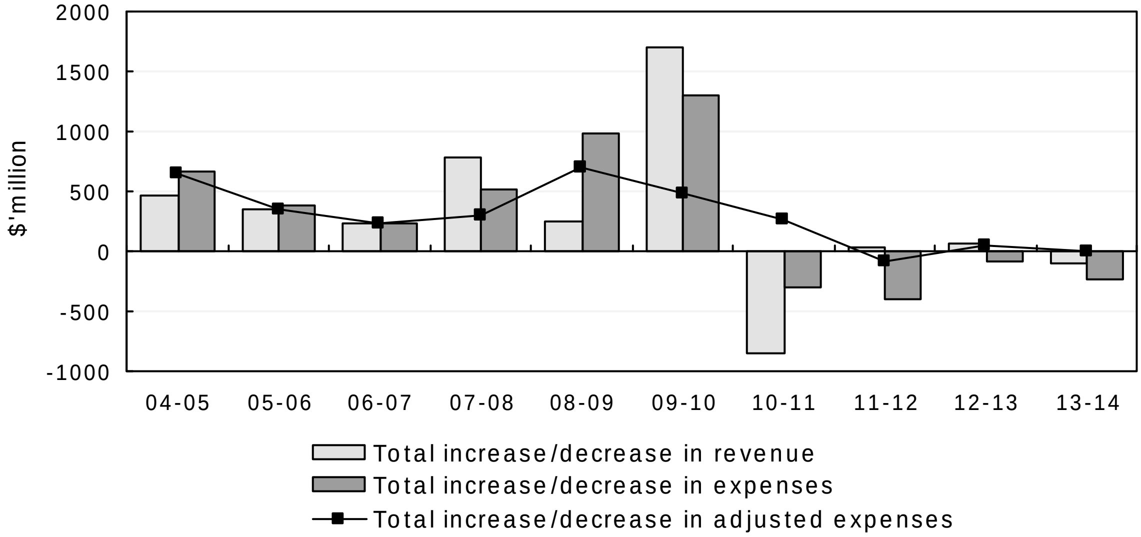
	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13	2013-14
						Estimated				
	Actual	Actual	Actual	Actual	Actual	result	Budget	Estimate	Estimate	Estimate
Revenue	$'million	$'million	$'million	$'million	$'million	$'million	$'million	$'million	$'million	$'million
Taxation revenue	2 941	2 979	3 250	3 570	3 537	3 641	3 858	4 188	4 424	4 657
Grants:										
Current	5 206	5 556	5 715	6 294	6 651	7 009	7 257	7 545	7 767	7 881
Capital	200	210	254	322	598	1 848	1 063	619	486	220
Sales of goods and services	1 244	1 333	1 464	1 572	1 697	1 933	1 877	2 041	2 108	2 147
Interest income	161	147	167	203	150	163	143	127	152	174
Dividend and income tax equivalent income	455	575	450	429	382	425	353	388	420	549
Other	386	441	456	490	517	512	536	620	648	666
Total revenue	10 592	11 242	11 757	12 879	13 531	15 531	15 086	15 527	16 005	16 294
Less: **Expenses**										
Employee expenses	4 220	4 644	4 933	5 268	5 749	6 177	6 379	6 522	6 694	6 803
Superannuation expenses:										
Superannuation interest cost	351	344	316	276	383	455	427	420	417	412
Other superannuation expenses	429	480	506	546	580	646	676	692	703	712
Depreciation and amortisation	453	454	498	525	566	626	681	763	829	869
Interest expenses	248	223	204	218	180	179	255	316	366	408
Other operating expenses	2 742	2 874	3 021	3 246	3 624	3 720	3 983	3 932	4 015	4 141
Grants	1 925	2 021	2 069	2 337	2 682	3 560	3 073	2 826	2 765	2 579
Total expenses	10 368	11 040	11 547	12 414	13 764	15 364	15 475	15 472	15 789	15 924
Net operating balance	224	202	209	464	(233)	167	(389)	55	216	370
Less: **Net acquisition of non-financial assets**										
Purchases of non-financial assets	695	717	771	875	1 305	2 162	2 283	1 934	1 626	1 216
Less: Sales of non-financial assets	119	144	134	108	108	245	201	275	387	104
Less: Depreciation	453	454	498	525	566	626	681	763	829	869
Add: Change in inventories	(18)	-	-	-	7	-	-	-	-	-
Total net acquisition of non-financial assets	105	119	139	242	639	1 290	1 402	896	410	244
Net lending (borrowing)	119	83	71	222	(872)	(1 124)	(1 791)	(841)	(194)	126

Note - Totals may not add due to rounding.

6.5.2 Net operating balance influences

Achieving at least a net operating balance in every year is a 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 2013-14.

Chart 6.1 — Increase / decrease of total revenue and total expenses to previous year [(a)] [(b)]



(a) Estimated June 2010 values.
(b) 2009-10 and 2010-11 are influenced by Commonwealth stimulus grants.

Chart 6.1 starkly demonstrates the short and medium term responses to the global financial crisis. 2009-10 shows the highest growth in revenues over the period due to additional Commonwealth stimulus money. On current projection, in 2010-11 expenses fall in real terms whilst revenues generally remain static.

Revenue is affected by the very large Commonwealth stimulus grants wind down. Part of the decrease in expenses is the matching fall in related grant expenses in 2010-11 and 2011-12. The line adjusted to exclude grant expenses shows the significance of movements in grant expenses over the three years to 2010-11.

Expenses, excluding grants, also decrease or are constrained from proposed savings strategies and general expenditure control. It can be seen that expenditure projections from 2011-12, even after allowing for grant expenses, are lower than actual or estimated results over the period 2004-05 to 2009-10. Expenses budgeted for 2010-11 are consistent with, in real terms, the lowest actual results experienced over the preceding six years. While the circumstances in the previous years differed, the task of decreasing spending stands out as a challenge.

7 REVENUE

Trend data in charts in this section is in real terms at estimated June 2010 values unless otherwise stated.

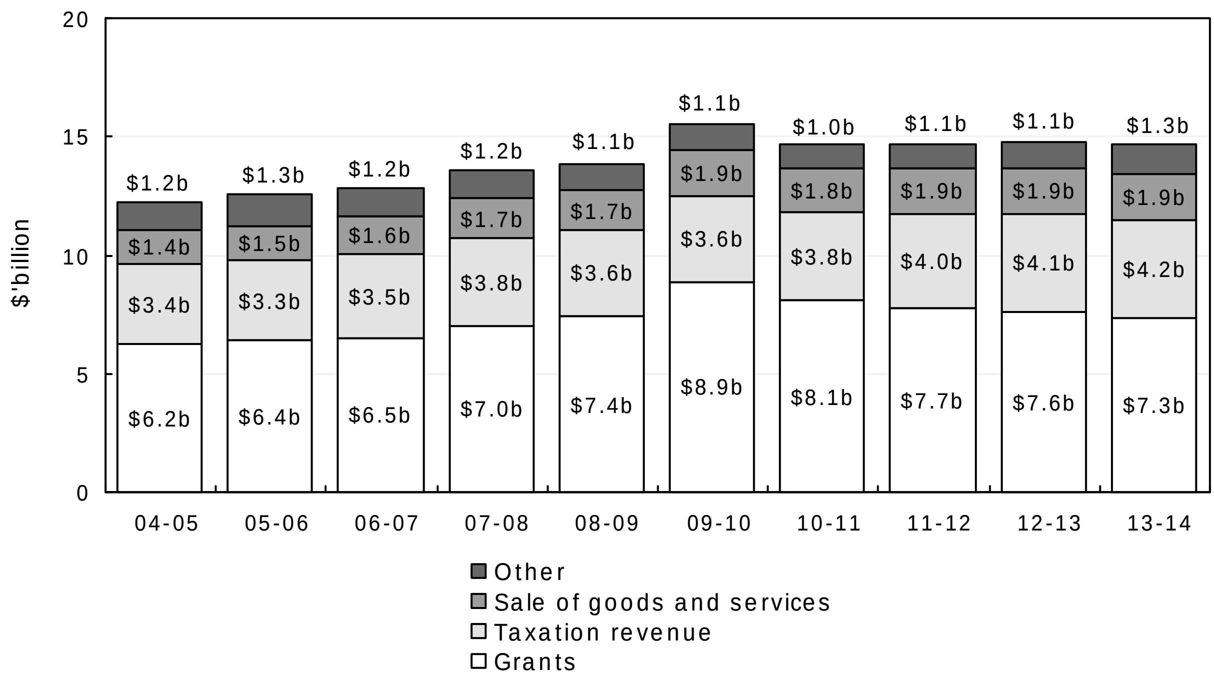
7.1 REVENUE OVERVIEW

The global financial crisis combined with changes to Commonwealth and States financial arrangements has caused a temporary change in the composition of total revenue over the period 2009-10 to 2013-14. Essentially projections show the Government expects it will take about four years for revenues to return to longer term trends. Total general government sector revenues are estimated to be $15.1 billion in 2010-11, a decrease of $445 million (2.9 percent) over the previous year's estimated result, and a real decrease of $843 million or 5.4 percent. The substantial decrease reflects a decline in Commonwealth capital grant stimulus funding.

Total revenue is then estimated to rise slightly in real terms over 2011-12 and 2012-13, before falling slightly to $14.7 billion in 2013-14.

The makeup of total revenue and trends in real terms are illustrated in the following chart:

Chart 7.1 — General government sector total revenue (real)



As shown the amount of taxation revenue rises steadily from 2009-10 through to 2013-14. Grants, mainly from the Commonwealth, vary over the period from 2008-09.

Chart 7.1 highlights the importance of Commonwealth grants to the State's revenues. Over most years Commonwealth grants represent about 50 percent of total revenue. This percentage declines over the forward estimates to 48.9 percent (nominal) in 2013-14. While a relatively small change in percentage terms, this represents some hundreds of millions when total revenues are in the order of $16.3 billion (nominal) and supports significant spending activity in targeted areas.

The following commentary provides some additional analysis of the main revenue areas. Detailed commentary is provided in Chapter 3 of the Budget Statement 2010-11.

7.2 COMMONWEALTH GRANTS

Total estimated Commonwealth grant funding to the State for 2010-11 is $8153 million (nominal). Funding in 2013-14 is estimated at $7966 million (nominal) reflecting the cessation of Commonwealth stimulus funding.

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

7.2.1 Changes to financial relations with the Commonwealth

From 1 January 2009, the 'Intergovernmental Agreement on Federal Financial Relations' (IGA) came into operation. The IGA provided a new framework for the Commonwealth's financial relations with the States and Territories. Accompanying the reform process was a rationalisation of the Commonwealth–State payment structure.

Table 7.1 — Commonwealth grants 2009-10 to 2013-14 (nominal)

	2009-10	2010-11	2011-12	2012-13	2013-14
	$ million	$ million	$ million	$ million	$ million
Current Grant Revenue	6 888.4	7 142.7	7 430.5	7 652.8	7 695.5
Capital Grant Revenue	1 819.3	1 022.1	601.0	467.4	201.4
Total Grants	8 707.7	8 164.8	8 031.5	8 120.2	7 962.9

Table 7.1 highlights the anticipated decline in large Commonwealth capital grants expected from 2011-12 to 2013-14.

7.2.2 GST revenue grants

GST revenue grants for 2009-10 are expected to be $233.5 million higher than the original budget estimate reflecting a stronger recovery than originally estimated by the Commonwealth Treasury. The total GST pool is expected to grow by around 7 percent in 2009-10, compared to the Commonwealth's original budget estimate of growth of 0.5 percent.

GST revenue grants are distributed according to the principle of horizontal fiscal equalisation (HFE). The principle of HFE is based on Commonwealth'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, South Australia's GST revenue grants are expected to grow by 2.8 percent in 2011-12, 5.2 percent in 2012-13 and 4.7 percent in 2013-14.

7.2.3 Specific purpose payments

Specific purpose current and capital payments (SPPs) are provided under section 96 of the Constitution for both recurrent and capital expenditure purposes. The reform of Federal financial relations resulted in a significant rationalisation in the number of SPPs, effective from 1 January 2009. Previously, the allocation of Commonwealth payments for specific purposes among the states was based on many approaches including Commonwealth discretion, historical allocation and formula based allocation. Under the new IGA arrangements, national SPPs will eventually be distributed between the states on a purely per capita basis based on Australian Bureau of Statistics' population estimates. This is being phased in over five years from 2009-10.

Over the forward estimates, SPPs are expected to increase from $2148 million (real) in 2010-11 to $2205 million in 2013-14, a real increase of $42 million from 2009-10. Over the forward estimates, growth in national SPPs reflects indexation arrangements specified in the new IGA partially offset by the phasing-in of per capita distribution.

7.2.4 National Partnership Commonwealth grants

National Partnership current and capital payments (NPP) are a form of time limited payment under the new Federal-state funding arrangements to fund specific projects and to facilitate and/or reward states that deliver on nationally significant reforms.

In 2010-11, South Australia will receive an estimated $607 million of NPP funding for recurrent purposes. This is a decrease of 23.3 percent compared to the $791 million estimated for 2009-10 and reflects the discontinuation of the First Home Owner Boost scheme, the winding back of exceptional circumstances assistance (paid to regions experiencing severe climatic conditions - the drought) and the high level of funding provided for remote indigenous housing in 2009-10.

7.2.5 Monitoring of specific purpose funding

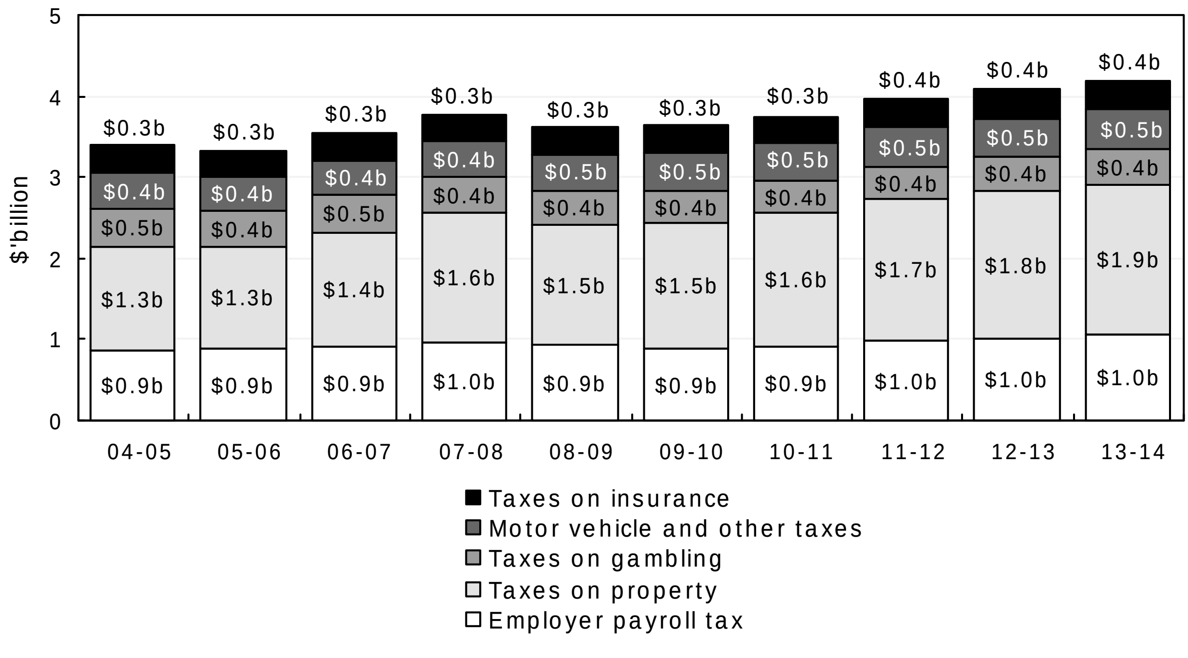
Under Commonwealth-State financial arrangements, SPPs and NPPs will be reviewed by Treasurers not less than every five years, to ensure that funding is adequate to meet expenditure demands. The reporting of outcomes will also be monitored to identify issues that might trigger earlier consideration of funding adequacy.

7.3 TAXATION REVENUE

Taxation revenue is the second largest source of revenue to the State and represents approximately 23.4 percent of revenues in 2009-10. It comprises 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 for 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.[15] The following chart examines the trend in the components of taxation receipts (in real terms) over the 10 year period to 2013-14.

Chart 7.2 — Taxation revenue (real)



15 Budget Statement 2010-11, pp 3.13-3.14 discusses South Australia's relative taxation effort.

Total taxes, in real terms, remain steady over 2009-10 before rising over the remaining forward estimate periods. Chart 7.2 demonstrates that throughout this time series, variations in taxation revenue are primarily attributable to property taxes.

Taxation revenue for 2010-11 is estimated to be $3858 million (nominal) an increase of $217 million over the estimated result for 2009-10. It is expected to be $4657 million (nominal) in 2013-14, a real increase of $558 million compared to $3641 million in 2009-10.

7.3.1 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 2010-11 are estimated to be $1689 million (nominal), a real decrease of $110 million from the estimated result for 2009-10. They are expected to be $2069 million (nominal) in 2013-14, a real increase of $331 million compared to 2009-10. Chart 7.3 shows the trend in property taxes (in real terms).

Chart 7.3 — Taxes on property (real)

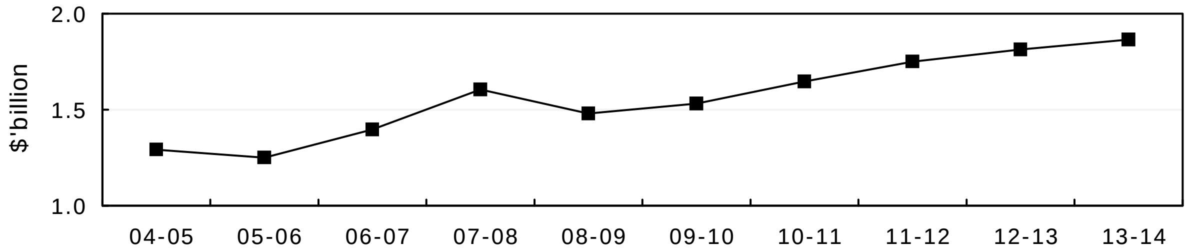


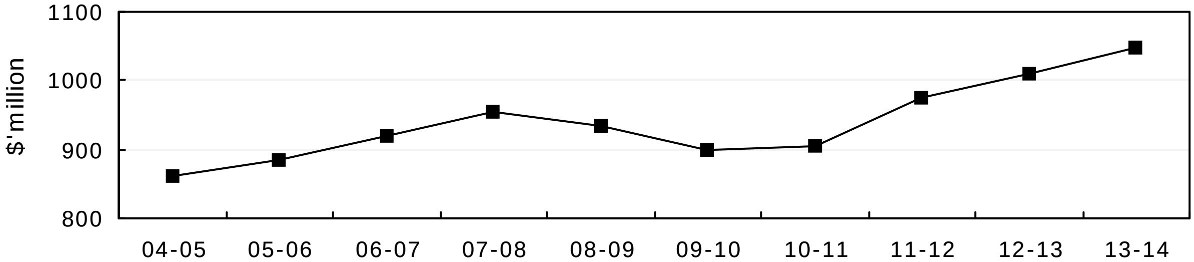
Chart 7.3 reflects the expected strong growth in property taxes over the forward estimates attributable to the adoption of stronger medium-term property value assumptions.

The Budget Papers note that property tax revenues are affected by IGA tax policy reforms as well as revenue policy measures. The IGA reforms affect property growth in 2009-10 (final phase of abolition of mortgage and rental duty) and 2012-13 when stamp duty on non-quoted marketable securities and non-real property transfers is abolished.

7.3.2 Payroll tax

Payroll tax is 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)



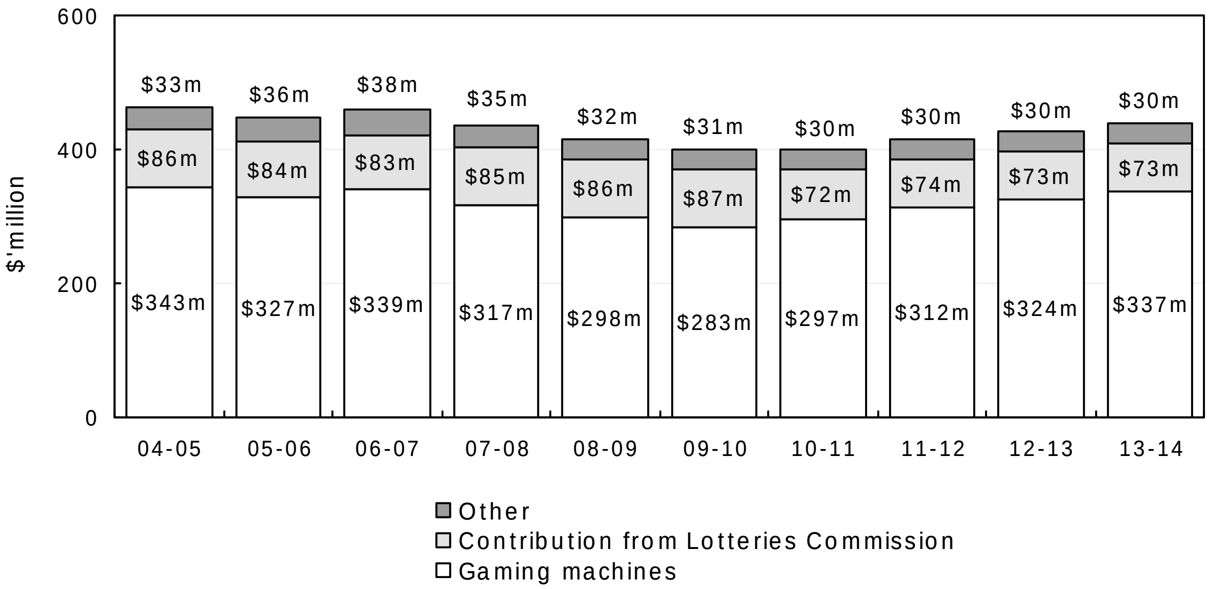
Payroll taxes for 2010-11 are estimated to be $930 million (nominal), a real decrease of $6 million from the estimated result for 2009-10. The payroll tax threshold remained at $600 000 on 1 July 2010. In addition, the payroll tax rate threshold also remained at 4.95 percent.

Payroll tax is expected to be $1162 million (nominal) in 2013-14, a real increase of $149 million compared to 2009-10.

7.3.3 Gambling taxes

Gambling taxes for 2010-11 are estimated to be $411 million (nominal), a real decrease of $0.9 million from the estimated result for 2009-10. Gambling taxes are expected to be $489 million (nominal) in 2013-14, a real increase of $39.6 million compared to 2009-10. The following chart shows the trend in gambling taxes.

Chart 7.5 — Gambling Taxes (real)



The decrease in gaming machine revenue for 2009-10 is as a result of lower expenditure in hotels and clubs. From 2010-11 revenue is expected to grow in line with household consumption expenditure.

7.4 SALES OF GOODS AND SERVICES

Revenue from sales of goods and services represented 12.4 percent of estimated total revenues in 2009-10. Sales of goods and services by the general government sector include Government fees and charges most of which will have increased by 3.3 percent from 1 July 2010 reflecting the annual indexation of fees.

Revenue from sales of goods and services are expected to be $2.15 billion (nominal) in 2013-14, a real increase of $3 million compared to 2009-10.

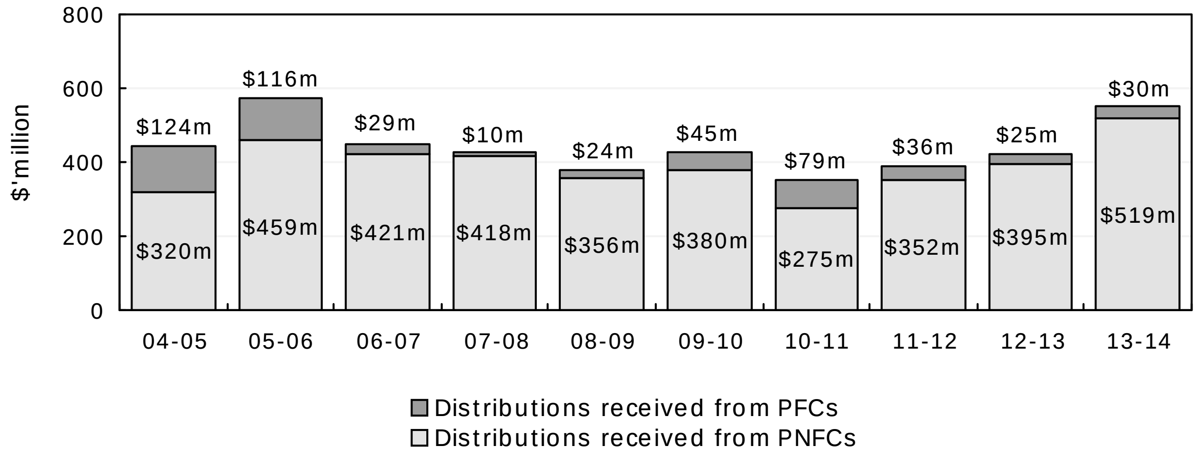
7.5 DIVIDEND AND INCOME TAX EQUIVALENT INCOME

Dividend and income tax equivalent income are the distributions received from public non-financial corporations (PNFCs) and public financial corporations (PFCs). They include 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 the whole-of-government 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 2013-14.

Chart 7.6 — Distributions received by the general government sector (nominal)



The Budget Papers note a significantly higher one-off estimated distribution from SAFA in 2010-11 , reflecting a return of projected excess capital from its treasury operation. The increased SAFA distribution offsets a lower amount expected to be received from the South Australian Water Corporation in 2010-11 due to increased operating expenses and debt levels associated with major infrastructure projects and water security initiatives. The chart shows that total distributions in 2010-11 are estimated to be the lowest for the 10 years covered.

7.5.1 Public non-financial corporations

In 2009-10, distributions received from PNFCs are estimated to amount to $380 million, an increase of $24 million (6.6 percent) from the previous year's result and $42 million (12.5 percent) above budget. The increase from budget is mainly due to an upwards revision to distributions from the Land Management Corporation and the South Australian Forestry Corporation.

In 2010-11, PNFC distributions fall to $275 million. Distributions from the South Australian Water Corporation in 2010-11 are expected to be $92 million below 2009-10 distributions, of $247 million mainly due to increased operating expenses and debt levels associated with major infrastructure projects and water security initiatives. A recovery in contributions is forecast from 2011-12 to 2013-14 mainly due to the South Australian Water Corporation's additional sales revenue from the increase in water charges. Estimated distributions from the South Australian Water Corporation in 2013-14 are $459 million.

7.6 OTHER REVENUE

Other revenue mainly comprises royalties, fines and penalties and schools fundraising revenue. Other revenue is expected to be $667 million (nominal) in 2013-14, a real increase of 17.3 percent compared to 2009-10.

7.7 RISKS TO REVENUE

The Budget Papers provide quite detailed explanations 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 taxation revenue, not including GST revenues, equates to about $39 million per annum.

- ***GST revenue grants*** — a variance of 1 percent in GST revenue growth has a revenue impact of $45 million per annum.

  Commonwealth General Purpose Payments 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 percent change in South Australia's relativity results in a change in GST revenue grants of $32 million.

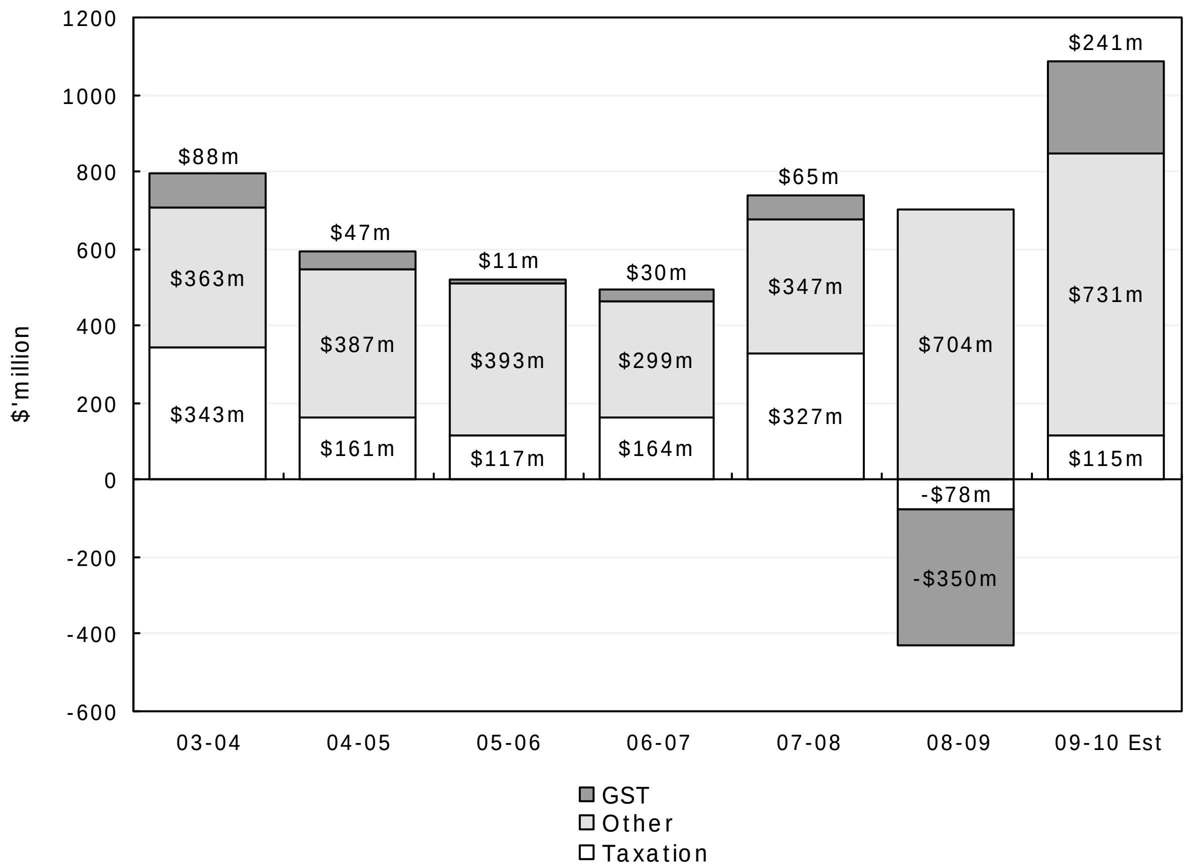
- ***Commonwealth specific purpose grants*** — payments for specific purposes from the Commonwealth account for about 19 percent of state government revenues. Variations in their level or the conditions applying to these payments pose a risk to the Budget.

Readers are referred to the Budget Statement 2010-11, Budget Paper 3, Chapter 6 for the full details.

7.7.1 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 revenue for the past seven years.

Chart 7.7 — Difference between budget and actual revenues (nominal) [(a)]



(a) 2009-10 is influenced by Commonwealth stimulus grants.

The chart highlights the very large favourable variations from budget that were enjoyed up to 2007-08, prior to the unfavourable variations in GST and taxation revenue noted in 2008-09 mainly attributable to the global financial crisis. However, in 2009-10 a return to a favourable variation to budgeted revenue is noted, resulting in a net $1087 million improvement (refer also to Table 5.1).

8 EXPENSES

8.1 EXPENSES OVERVIEW

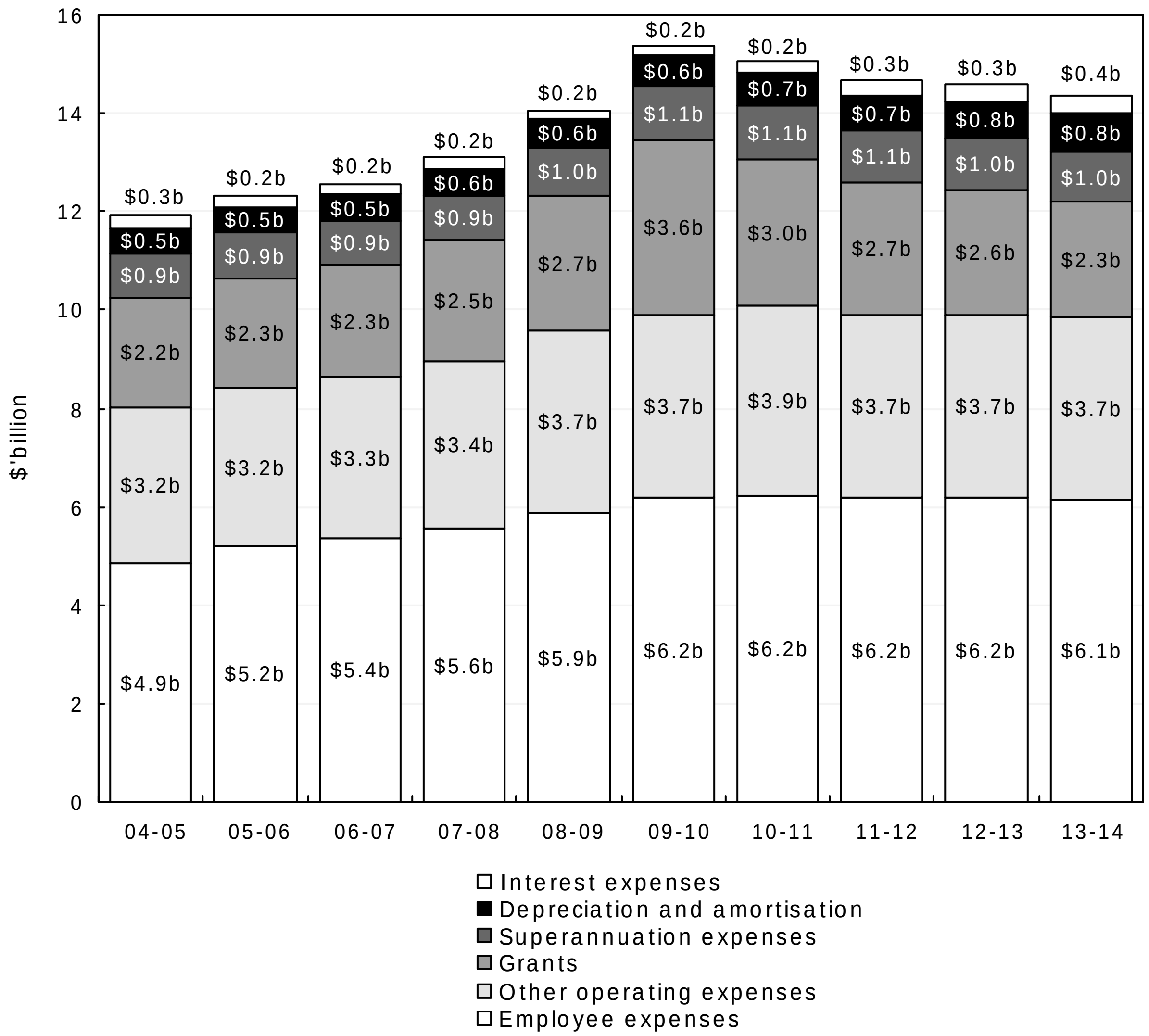
As with revenue, the global financial crisis combined with changes to Commonwealth and state financial arrangements caused a change in the composition of total expenses over the period 2008-09 to 2012-13 as grants expense is influenced by the flow through of Commonwealth grant revenue.

For 2009-10 estimated expenses total $15.4 billion and exceed budget by $616 million or 4.2 percent. Unbudgeted grants expense make up $415 million of the increase.

Total expenses for 2010-11 are budgeted to be $15.5 billion, $112 million or 0.7 percent higher than 2009-10 and grow to $15.9 billion in 2013-14.

The following chart highlights the trends in expenses (in real terms) that have emerged since 2004-05.

Chart 8.1 — General government sector - expenses



The chart shows expenses grow annually from 2004-05 to 2009-10, gradually declining thereafter.

The following discussion focuses on some of the major components that make up expenses. Detailed comments on expenditure are provided in Budget Statement 2010-11, Budget Paper 3, Chapter 2.

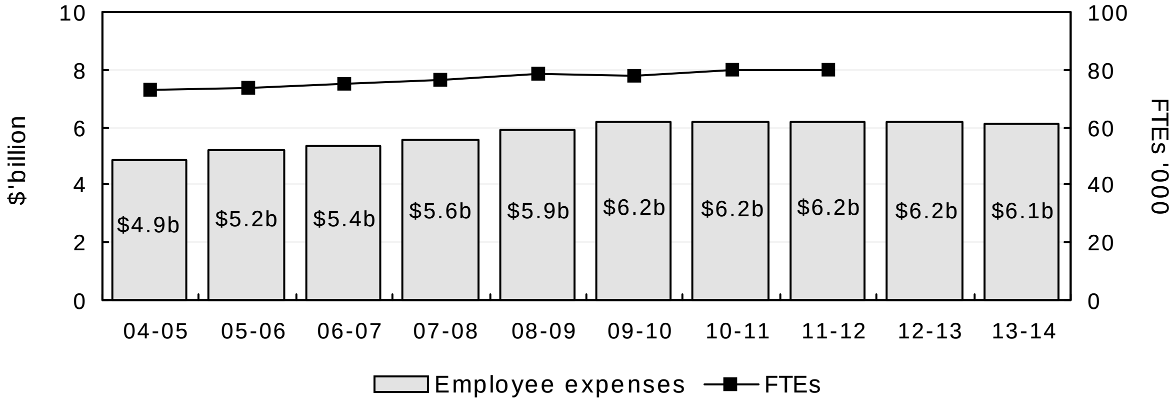
8.2 EXPENSES BY TYPE

8.2.1 Employee expenses

Employee expenses (an estimated $6177 million in 2009-10) represent the highest proportion (40 percent) of total expenses. They are estimated to increase by 3.3 percent in 2010-11 and about 2.2 percent per year to 2013-14.

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

Chart 8.2 — General government sector – employee expenses (real) and FTEs[(a)(b)]



(a) 2004-05 to 2006-07 are actual FTEs provided by OPE.
(b) 2007-08 to 2011-12 are DTF estimates

The chart highlights the real terms growth in employee expenses until 2010-11. This growth is consistent with FTE numbers up to 2008-09.

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

In the four years to 2009-10 employee expenses grew by an average of 7.4 percent per year. The 2010-11 Budget shows employee expenses decreasing in real terms on an average of 0.2 percent. 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 or finalised in 2010-11.

The 2010-11 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.

A 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 2010-11 Budget are for:

- nurses and midwives, salaried medical officers and clinical academics
- police, SA Metropolitan Fire Service (fire fighters) and SA Ambulance Service

- wages parity group (weekly paid employees)
- wages parity (building, metal and plumbing trades)

The Government has indicated it will seek to limit future wage outcomes to 2.5 percent per annum in an effort to provide real wage increases to public sector employees and prevent further job losses being required. Enterprise agreements generally extend over three years with annual increases/outcomes within agreement sometimes differing from year to year. Outcomes in recent years, while in strong economic times, have in some periods been within this limit but generally exceed the Government's current target, with some sectors receiving much more.

Examples of some annual outcomes (excluding non-wage items) within agreements are: police – 1 January 2008 – 5.2 percent, 1 July 2009 3.5 percent; nurses – 1 October 2009 – 4.5 percent; fire fighters – 1 January 2009 – 8.2 percent; salaried medical officers and clinical academics – 14 April 2008 – 14.7 percent, 14 April 2009 – 3.5 percent; pre-school and school sector education classifications - 1 October 2009 - 4 percent; TAFE sector lecturers - 1 October 2009 - 3.5 percent; wages parity (salaried group) - 1 October 2009 - 2.5 percent; visiting medical specialists - 1 January 2010 - 3.5 percent; parliament house employees - 1 October 2010 - 2.5 percent. Circumstances for the respective groups naturally differ, but many of these examples were beyond the Government's current target and vary across groups.

8.2.2 Other operating expenses

Other operating expenses include general purchases of goods and services.

These expenses are estimated to be $4 billion for 2010-11, an increase of $263 million or 7.1 percent in nominal terms from 2009-10. The projection for the forward years to 2013-14 is for a real terms increase of 0.4 percent from 2009-10 to 2013-14.

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 applied is that a price change experienced has altered agency costs by more than 0.5 percentage points above or below the standard indexation provided for in agency budgets.

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 following table shows the composition of contingency provisions for two years to 2010-11.

Table 8.1 — Contingency provisions

	2009-10 Budget $'million	2009-10 Estimated result $'million	2010-11 Budget $'million
Employee entitlements	207	198	156
Investing contingencies	42	44	64
Supplies and services	218	126	269
	467	368	489

The 2010-11 Budget includes contingency amounts totalling $489 million, $22 million more than the previous Budget. While allocating sums to each of the categories for presentation purposes, contingency funds may also be transferred from other lines where available.

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

8.2.4 Grants

Grants expense from the general government sector represents payments to other sectors of government and the private sector. These payments include:

- grants to non-government schools, local government and industry
- appropriations for the South Australian Housing Trust
- community service obligation payments to the South Australian Water Corporation and the South Australian Forestry Corporation.

As mentioned, over the period 2008-09 to 2012-13 grants expense is influenced by the flow through of Commonwealth grant revenue. Table 6.6 shows the changes in grants expense over the forward estimates. Grants are estimated to be $3560 million for 2009-10, that is, $415 million or 13.2 percent above budget.

Grants are budgeted to decrease by $487 million to $3073 million in 2010-11 largely due to reductions in grants to the South Australian Housing Trust under the Nation Building – Economic Stimulus Plan and National Partnership Agreements on Social Housing and Remote Indigenous Housing and a reduction in stimulus funding to non-government schools.

8.2.5 Superannuation expenses

8.2.5.1 Superannuation interest cost

In 2010-11 and across the forward estimates, superannuation interest cost is expected to be marginally lower than estimated in the 2009-10 Budget, in the order of $16 million each year. This reflects the effect of decreases in the unfunded superannuation liability across the forward estimates, primarily as a result of higher than expected returns on investments in 2009-10 and a higher discount rate used to value the unfunded superannuation liability.

The Budget Papers note that a 1 percent lower than expected return on superannuation assets invested by Funds SA would increase estimated unfunded superannuation liabilities by around $42 million. An increase in unfunded superannuation liabilities of this magnitude would increase superannuation interest cost, decreasing the net operating balance result by around $3 million per annum.

8.2.5.2 Other superannuation expenses

Other superannuation expenses are employer superannuation contributions incurred by government agencies during the reporting period and include superannuation contributions on salaries and wages. It also includes superannuation on-cost on accrued leave. Estimated other superannuation expenses were $646 million in 2009-10 and are projected to increase to $712 million in 2013-14, a real decrease of 0.6 percent.

8.2.6 Depreciation and amortisation

Estimated depreciation and amortisation expenses were $626 million in 2009-10 and are projected to increase by 39 percent to $869 million in 2013-14. The increase reflects the growth in the value of fixed assets through purchases and revaluations.

8.2.7 Interest expense

Estimated interest expense in 2009-10 was $179 million and is projected to increase by 128 percent to $408 million in 2013-14 as a result of projected increased borrowing to fund capital programs.

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

8.2.8 Capital payments

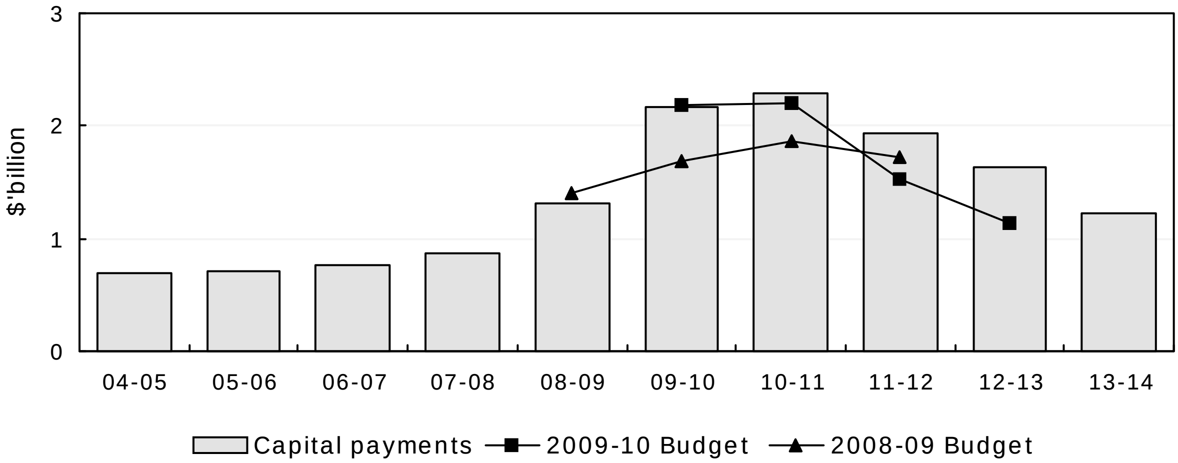
Capital payments are represented by the value of purchases of non-financial assets in the General Government Sector Operating Statement.

The 2009-10 Budget, with the combined influence of state and Commonwealth spending initiatives, elevated general government sector capital spending estimates to extraordinarily high levels. The estimated result for 2009-10 purchases of non-financial assets is $2162 million, virtually on budget for the year. This represents an increase of $857 million or 66 percent over 2008-09.

Purchases of non-financial assets are estimated to be $2283 million in 2010-11. This is $121 million more than estimated for 2009-10 and is the peak in capital spending. The budget includes a slippage allowance of $300 million, $100 million higher than the previous year.

The following chart shows the purchase of non-financial assets over the 10 year period to 2013-14, overlayed with budgeted purchases from the 2008-09 and 2009-10 Budgets.

Chart 8.3 — 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 increases since the 2009-10 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 2010-11 is $63.7 million.

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 support from appropriate project management expertise, information systems and controls. Nation building funding requires states to ensure that there is no substitution of capital expenditure effort in the targeted areas. State coordinators are appointed to oversee implementation and progress is reported quarterly to the Commonwealth Treasurers' Ministerial Council. Audit comments on aspects of capital spending were included for relevant agencies in Part B of my recent 2009-10 Auditor-General's Annual Report to Parliament.

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

8.2.9 Public private partnerships

Public private partnership projects (PPPs) continue to form a sizeable part of the annual capital program. Anticipated investing spending on new schools and the new Royal Adelaide Hospital in the four years of the 2010-11 Budget is in the order of $250 million.

Contractual close of the Education Works New Schools PPP Project was achieved in early July 2009. The total value of the contracts of $323 million (net present cost) represents the cost of construction, management and maintenance of the schools over a 30 year period.

The new Royal Adelaide Hospital project involves the construction of a new, state of the art, purpose built hospital on the existing rail yards next to the Adelaide Railway Station. Cabinet, in November 2009 approved a revised indicative capital cost of the new Royal Adelaide Hospital project of $1798 million (nominal value). Final bids to a request for proposal, issued in November 2009 were received in May 2010. It is anticipated that the preferred bidder will be selected later this year with construction beginning soon after. The new hospital is expected to be opened in 2016.

Audit commentary on aspects of these projects is included in Part B of my recent 2009-10 Auditor-General's Annual Report to Parliament.

8.2.9.1 Financial reporting of public private partnership projects

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.

DTF have advised that capital components of PPPs arrangements for schools and the hospital are recognised as finance leases in the balance sheet, and consequently have an impact on net debt and net financial liabilities.

The Portfolio Statements Budget Paper 4 Volume 3 for Education and Children's Services records an increase in total assets partly due to recognising an asset for the finance lease associated with the establishment of the new schools as per Education Works Stage 1 PPP arrangement ($178 million). An increase in total liabilities is due mainly to the recognition of a liability for the finance lease for the PPP ($178 million).

8.2.10 Asset sales

The 2008-09 MYBR resulted in decisions to sell a range of assets as part of the Government's debt reduction measures namely:

- South Australian Forestry Corporation harvests
- building assets
- regional housing assets.

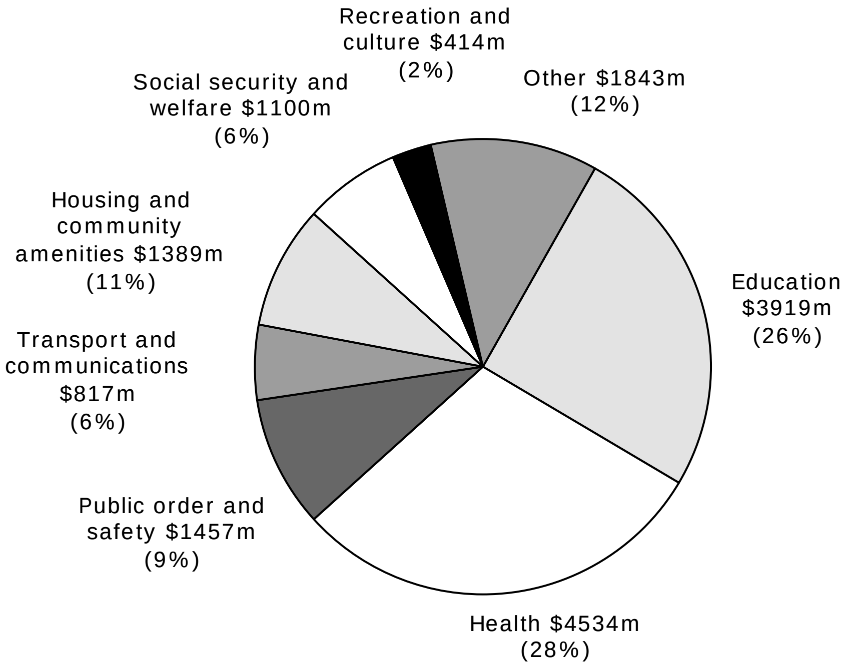
Asset sales for 2009-10 are estimated to be $245 million, $98 million less than targeted in the 2009-10 Budget, Nevertheless, asset sales are projected to increase over the forward estimates, peaking at $387 million in 2012-13. Proceeds from the sale of the South Australian Forestry Corporation's assets have not been disclosed so as to avoid prejudicing the sales process.

Inquiries with DTF during 2009-10 indicated that for the forestry, building and housing assets, relevant expertise was being seconded as required to implement sales processes with DTF. The sales process would include scoping studies, due diligence and marketing to obtain the best possible price.

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 2010-11 Budget expenses and demonstrates the extent to which the health and education sectors dominate the overall expenditure by the State.

Chart 8.4 — General government sector expenses by function[16] ($'million)



8.4 RISKS TO EXPENSES

8.4.1 Overview

As with revenue, the 2010-11 Budget provides detailed consideration of various risks to the expenditure budget and acknowledges the management task for achieving budgeted outcomes.[17]

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 $180 million in 2013-14.

- ***Capital investment pressures*** — a number of departments including Transport, Energy and Infrastructure and Health have large capital investment programs over the forward estimates period. Historically there has been considerable cost escalation compared with original projections. As other states embark on significant infrastructure programs over the forward estimates period this risk increases.

---

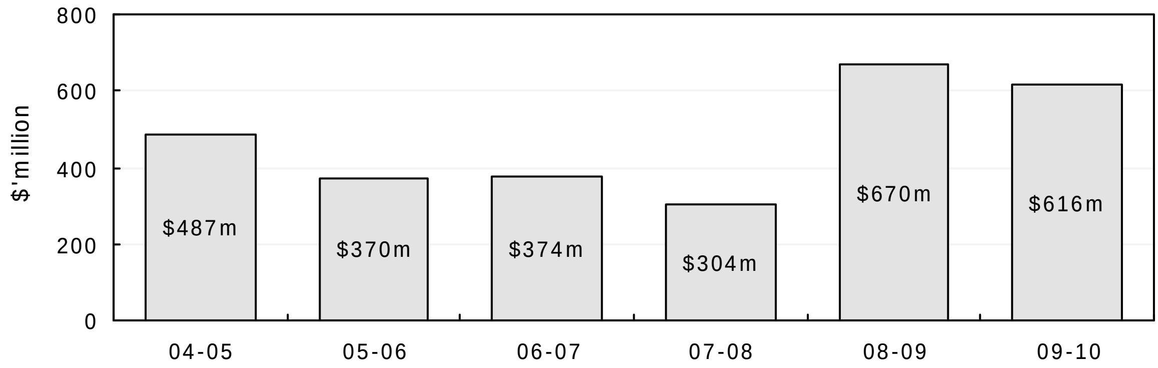
16 Budget Statement 2010-11, Budget Paper 3, Table 2.8.

17 Budget Statement 2010-11, Budget Paper 3, p 6.5

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 in the general government sector will increase expenditure by approximately $23 million in 2010-11.

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

Chart 8.5 — Difference between budget and actual expenses [(a)] [(b)]



(a) 2009-10 is the difference between budget and the estimated result.
(b) 2009-10 is influenced by Commonwealth stimulus grants.

The chart highlights that, notwithstanding classification changes, expenses consistently exceeded original budget expense targets in the four years to 2007-08 due to parameter variations and policy measures.

While 2008-09 and 2009-10 also exceeded budget, for the various reasons explained in this report, mainly to do with the global financial crisis, much of this increase was funded by Commonwealth stimulus grants.

8.4.2 Savings and revenue offsets

For a number of years large value savings targets have featured as an essential element of fiscal strategy.

The 2008-09 Budget included a savings target allocated across portfolios of $25 million in 2009-10, $75 million in 2010-11 and $150 million in 2011-12. Specific savings measures to achieve the first tranche of $25 million from 2009-10 were presented in the 2009-10 Budget.

The 2008-09 MYBR in December 2008, resulted in announced operating savings of $250 million up to 2011-12 from a package of measures.

The 2009-10 Budget included new operating savings totalling $831 million over the next four years but essentially not commencing until 2010-11 comprising:

- an additional $75 million in 2012-13 to the 2008-09 Budget savings target, taking the total of this savings target to $225 million in that year.

- a further savings target of $750 million that would require achieving savings of $150 million in 2010-11, $250 million in 2011-12 and $350 million in 2012-13. This savings target was held centrally by DTF pending the Government's consideration of budget improvement measures recommended by the Sustainable Budget Commission through reviewing revenues, operating and capital expenditures and asset sales.

8.4.3 Savings strategy 2010-11

The Sustainable Budget Commission has reported to the Government and the 2010-11 Budget includes savings measures that address and consolidate past savings with new savings. The Government states that specific measures announced in the 2010-11 Budget achieve remaining unspecified savings of over $700 million per annum by 2013-14. The 2010-11 Budget also includes new operating savings totalling $1526 million over the next four years. The following table summarises the total savings now incorporated in the 2010-11 Budget. Revenue measures are excluded.

Table 8.2 — Summary of 2010-11 budget operating savings

	2010-11 $'million	2011-12 $'million	2012-13 $'million	2013-14 $'million	4 year total $'million
New budget improvement savings					
Expenditure savings	99.0	254.1	389.8	474.6	1 217.5
Across government initiatives	25.8	73.1	101.4	108.1	308.5
Total new budget improvement savings	124.8	327.2	491.2	582.7	1 525.9
Existing saving measures and interest savings					
FTE savings (2008-09 MYBR)	28.0	45.0	56.0	59.0	188.6
Indexation (2009-10 Budget)	27.0	47.0	46.0	47.0	166.2
Efficiency dividend (2006-07 Budget)	-	11	27	44	82.5
Interest savings	-	7	35	80	122.0
Total existing saving measures and interest savings	56.1	110.0	163.3	230.0	559.3
Total new and existing savings	180.9	437.2	654.5	812.7	2 085.2

8.4.4 Nature of savings initiatives

The savings task falls on all portfolios of Government.[18] Details of the new savings initiatives announced in the 2010-11 Budget are included in Budget Paper 6 '2010-11 Budget Measures Statement'. This provides a reference for monitoring progress of the new savings program. Given the size of the savings target, individual measures encompass a broad range of activities. To illustrate, the nature of savings and some values where directly reported, include:

- reducing the number of public servants
- savings from efficiency dividends
- departmental efficiencies
- motor vehicle fleet reform - $31.7 million
- public sector long service leave arrangements reform - $90.7 million over three years
- public sector employee recreation leave loading alternative arrangements - $46.6 million over two years
- reducing government advertising — $18 million over four years
- facilities management savings - $31.5 million.

[18] Budget Statement 2010-11, Budget Paper 3, Table 2.4

A number of issues arise that are relevant to achieving future savings.

Audit review of savings in this and past years shows that some areas of savings are more difficult to achieve than originally estimated. It is well known that health and, to a lesser but nonetheless substantial degree, families and community service areas, have had continuing budget pressure in recent years. The Department of Health has found savings targets difficult to meet over time as have other areas. I have also reported that various factors have meant that savings from the shared services initiative may be lower than currently factored into the Budget. For example, in 2009-10 savings are expected to fall $28 million short of the budgeted savings of $60 million. Shared Services SA advised that, as part of the 2010-11 Budget, savings targets were revised downwards from $60 million for each of the three years to 2012-13. The extent of the savings in subsequent years will depend on the success of the reform activities within Shared Services SA. The shared services initiative is discussed in Part A of my recent 2009-10 Auditor-General's Annual Report to Parliament.

An inherent risk of the saving strategy is its sheer size and breadth. Achieving the task will require significant discipline. Agencies have developed some experience with implementing savings strategies over recent years. Nonetheless the announced task is at an unprecedented scale. It introduces risks including industrial action, public demand to maintain services and administrative delays. Some anecdotal evidence of these risks is found in various media articles reported since the Budget was presented.

8.4.5 Reduction of full-time equivalents

A key part of the savings strategy is to further reduce the number of FTEs. The new savings measures combined with ongoing savings requirements retained in agency budgets are estimated to result in the reduction of 3743 FTEs from the public sector by 2013-14. This reduction will be partially offset by an additional 1981 FTEs by 2013-14 resulting from 2010 election commitments and other expenditure initiatives in the 2010-11 Budget. The net reduction of 1762 FTEs is around 2 percent of the general government sector workforce.

Table 8.3 — Full-time equivalent impacts of new initiatives in 2013-14

	Savings initiatives	Expenditure initiatives	Total
Health	(957)	1 277	320
Education and Children's Services	(350)	66	(284)
Transport, Energy and Infrastructure	(213)	-	(213)
Justice	(206)	349	142
Primary Industries and Resources	(186)	7	(179)
Further Education, Employment, Science and Technology	(183)	127	(56)
Families and Communities	(108)	140	32
Others	(470)	15	(454)
Total 2010-11 initiative FTEs	(2 673)	1981	(692)
Previously announced savings requirements			
2009-10 Budget indexation savings	(342)		
Efficiency dividend	(328)		
FTE reduction target in 2008-09 MYBR	(400)		
Total previously announced savings requirements			(1 070)
Total FTEs			(1 762)

The 1070 FTE savings requirements were allocated to agencies in previous budgets and the 2008-09 MYBR. DTF advise that the FTE savings requirement associated with the

2009-10 Budget Indexation Savings and Efficiency Dividend is indicative only, being based on a standard distribution of the total budget savings between employee expenses and supplies and services. Agencies may implement savings strategies to achieve these measures that results in different FTE outcomes. The 400 FTEs in Table 8.3 is the last two years of the FTE reduction target announced in the 2008-09 MYBR.

The timetable for achieving the FTE reductions or value equivalent is set out in the following table.

Table 8.4 — Full-time equivalent reduction 2010-11 to 2013-14

	2010-11	2011-12	2012-13	2013-14	Total
Total FTE reductions	(1 011)	(1 373)	(862)	(497)	(3 743)

8.4.6 Targeted voluntary separation program

To support its savings target strategies, the Government has approved a Targeted Voluntary Separation Package (TVSP) scheme for employees who are or become excess to requirements as a consequence of savings measures or organisational changes and who are not assigned to other public sector employment. An offer of a TVSP can only be made to an employee who an agency has decided is excess to requirements because their assigned duties/role or position has or is to be abolished.

TVSPs became available from November 2010. The 2010-11 Budget contains various initiatives including ongoing savings requirements which are scheduled to occur progressively over the next four years. Although agencies may realise savings early, the timing of employees becoming excess will largely reflect the timing of savings initiatives. On this basis, the Government anticipates that separation packages will be available until 2013-14.

Agencies will be centrally reimbursed for TVSP payments made to achieve savings measures announced in the 2010-11 Budget, existing savings measures, and TVSPs made to existing redeployees.

Funding provided and the estimated timetable for the scheme is provided in the following table.

Table 8.5 — TVSP scheme costs

	2010-11 $'million	2011-12 $'million	2012-13 $'million	2013-14 $'million	Total $'million
Operating expenses	94.9	86.7	123.9	48.3	353.8

This initiative provides $353.8 million over four years for the cost of TVSP payments in support of employee separations underpinning savings initiatives contained in the 2010-11 Budget. This cost is based on the provision of 3000 TVSPs over the four year period.

To encourage early success of offers, an enhanced package operates where acceptance occurs within six months of an offer being made. A non-executive employee to whom an offer of a TVSP is made will be eligible to have a separation payment, calculated at the rate of 20 weeks pay, plus an additional 3 weeks pay for each completed year of service, up to a maximum of 116 weeks (equivalent to 32 completed years of service).

After six months from the date of the first offer of a TVSP, separation payments will be calculated at the rate of 10 weeks, plus an additional three weeks pay for each completed year of service, up to a maximum of 88 weeks (equivalent to 26 years of service).

8.4.7 Administering targeted voluntary separation packages

Part A of my recent Annual Auditor-General's Report to Parliament included comments on a range of issues arising from the TVSP scheme that operated in early 2009-10. I note in the guidelines accompanying the new scheme that those issues are addressed. Certain other risks for the scheme are also brought to the attention of agencies.

8.4.7.1 Abolished positions

Audit observed of the 2009 TVSP Scheme, that due to differing structures and systems for payroll management, it was not always clear that management arrangements and systems made it possible for agencies to demonstrate that duties/roles or positions were abolished, commensurate with TVSPs accepted, and this area needed to be addressed in future schemes.

It is now emphasised to agencies that TVSPs are only to be made to employees who are deemed to be excess to requirements because their assigned duties/role or position has been or is to be abolished. Agencies are advised they must ensure their internal systems are able to provide evidence of this requirement.

It is also emphasised to agencies that they cannot 'cross-match' existing underutilised, unassigned or unattached employees into roles that may be vacated by employees who indicate they would accept an offer of a TVSP. Cross-matching to fill a role, duties or a position that was performed by an employee who has accepted an offer of a TVSP, is inappropriate because the role/duties or position must be abolished.

8.4.7.2 Accuracy of payments

Audit had noted that clarity was needed on whether recovery of overpayments is pursued. TVSP agreements now contain a clause that ensures recipients of TVSPs are liable to repay any overpaid amount, howsoever the overpayment was caused.

8.4.7.3 Three year rule

Employees who accept and are paid a separation package are not eligible to be re-employed in the South Australian public sector for three years from the date of their separation. Restrictions also apply to them being contracted by the South Australian public sector directly or through a third party.

A central database will record details of all employees who accept a TVSP and end their employment. To ensure compliance to the 'three year rule' agencies are advised to check this database when recruiting new employees.

8.4.7.4 Monitoring eligibility

The scheme is intended to operate until 2013-14. The scheme also has different entitlements depending on when an offer is accepted. I note that the guidance informs agencies that due to the varying terms and timeframes applying to an individual on becoming excess to requirements and being made an offer of a TVSP, agencies will need to be vigilant in tracking an individual's eligibility status throughout the scheme.

8.4.7.5 Redeployment management processes

Agencies were advised that the FTE reduction management strategy requires thorough and rigorous management of excess employees to maximise the matching of employees with ongoing vacancies. Reasonable efforts should be taken to achieve the redeployment of an employee who has particular skills or capabilities likely to be required within the public sector. Agencies are also required to accept suitable excess employees into vacant positions unless there is a clearly justifiable reason as to why the excess employee is unsuitable.

This will reduce the need for TVSPs and, if applicable, the requirement for non-voluntary redundancies.

8.4.8 Budget monitoring and reporting

Monitoring progress against Budget targets to enable a timely response to any significant issues arising, is a vital element in managing budget risk. Past Audit Reports have consistently emphasised the need for strong monitoring of budget progress and provided details of processes that applied in those years. Following the 2010-11 Budget, I asked DTF for details of any changes to capital, operating expenditure and saving/revenue monitoring processes for 2010-11.

DTF advised that the regular monitoring regime coordinated by DTF includes monthly monitoring of financial performance against approved budget, monitoring capital projects, budget initiatives and fulltime equivalents on a quarterly basis. Reports on each aspect of the monitoring regime based on information supplied by agencies and an analysis prepared by DTF is provided to the Sustainable Budget Cabinet Committee (SBCC).

DTF further advised that given the size of the savings target and the importance of achieving the fiscal outlook, an enhanced monitoring process would be introduced. This includes requiring chief executives to write to and then appear before the SBCC with their implementation plans and discuss their progress. Subsequent appearances are based on a risk assessment as part of the regular return monitoring.

The enhanced approach requires chief executives to present how they will achieve savings and how achievement will be measured. These measures aim to ensure attention is given to the task and provide confidence to the SBCC on progress or highlight where issues arise.

Monitoring of progress against specific individual savings initiatives forms part of the initiative monitoring which covers operating expenditure, savings, revenue and asset sales and will include all initiatives disclosed in the Budget Papers. From the 2010-11 Budget this will include all items in the Budget Measures Statement. It will also include initiatives scheduled to commence in 2010-11, or that were not fully implemented from previous Budgets.

Audit noted last year that the overall end of year net operating projection for 2008-09 was mainly affected by an estimated significant year-end deterioration in the budget position of the Department of Health. For 2009-10, DTF advised that two agencies had large deteriorations against the net operating balance result. The net operating deterioration for the Department of Health was about $128 million. The net operating deterioration for the Department for Transport, Energy and Infrastructure was about $60 million. The Department of Health was the only agency reported to not meet the budget savings arising from the 1200 FTE reduction target in 2009-10 required as part of the 2008-09 MYBR.

Audit review of FTE monitoring data to 30 June 2010 showed that agencies were collectively close to the total approved cap for all agencies of 77 232 FTEs, exceeding this by 230 FTEs. However, the Department of Health was 887 (3.1 percent) above its cap primarily due to overspending, not achieving savings and early employment of nursing and medical staff. The Department of Further Education, Employment, Science and Technology was 70 (2.1 percent) above its cap due to additional demand for fee for service activity. These outcomes were largely offset by a number of agencies being under their caps.

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 principally to 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, the South Australian Forestry Corporation and TransAdelaide).[19]

9.2 OVERVIEW OF THE STATE'S FINANCIAL POSITION

The following summarises the financial position information for South Australia for the general government and non-financial public sectors.

9.2.1 General government sector financial position

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

Table 9.1 — General government sector financial position (nominal terms)

	2006-07 Actual $'million	2007-08 Actual $'million	2008-09 Actual $'million	2009-10 Estimated result $'million	2010-11 Estimate $'million	2011-12 Estimate $'million	2012-13 Estimate $'million	2013-14 Estimate $'million
Financial assets	19 311	20 539	22 449	23 144	23 128	23 102	23 917	25 306
Non-financial assets	14 018	16 161	18 595	20 037	21 494	22 445	22 944	23 280
Total assets	33 329	36 700	41 045	43 181	44 622	45 547	46 861	48 586
Total liabilities	11 201	12 959	16 898	17 990	19 230	19 385	19 616	20 207
Net worth	22 128	23 741	24 146	25 192	25 392	26 162	27 245	28 379
Net financial worth	8 110	7 580	5 551	5 155	3 898	3 717	4 301	5 099
Net debt	(24)	(276)	475	1 587	3 335	3 633	3 864	3 847

Note: Totals may not add due to rounding.

Of note is the expectation that:

- financial assets increase by $2162 million across the forward estimates. This is due mainly to investments in other public sector entities, up $2778 million
- non-financial assets increase by $3243 million over the forward estimates. This is mainly from the purchase of non-financial assets offset by asset sales
- net worth (assets less liabilities) increases across the forward estimates. This is due to asset growth
- net debt increases across the forward estimates to $3847 million in 2013-14 due mainly to increased borrowing to fund major capital investment programs.

9.2.2 Non-financial public sector financial position

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

[19] Budget Statement 2010-11, Budget Paper 3, Appendix D details agencies within the respective sectors.

Table 9.2 — Non-financial public sector financial position (nominal terms)

	2006-07 Actual $'million	2007-08 Actual $'million	2008-09 Actual $'million	2009-10 Estimated result $'million	2010-11 Estimate $'million	2011-12 Estimate $'million	2012-13 Estimate $'million	2013-14 Estimate $'million
Financial assets	4 084	4 259	4 316	4 287	3 866	3 940	4 095	4 703
Non-financial assets	30 922	34 227	39 067	42 360	44 890	45 784	46 990	48 317
Total assets	35 006	38 486	43 384	46 646	48 756	49 724	51 085	53 021
Total liabilities	12 878	14 745	19 237	21 455	23 364	23 562	23 840	24 642
Net worth	22 128	23 741	24 146	25 192	25 392	26 162	27 245	28 379
Net financial worth	(8 795)	(10 487)	(14 921)	(17 168)	(19 499)	(19 623)	(19 745)	(19 939)
Net debt	1 989	1 611	2 872	4 864	7 101	7 209	7 360	7 545

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 $3293 million in 2009-10 to $42.4 billion. The value of non-financial assets is estimated to increase by $5957 million by 2013-14. This increase mainly arises from the purchase of new assets and to a lesser extent asset revaluations, offset by asset sales and depreciation.
- 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.

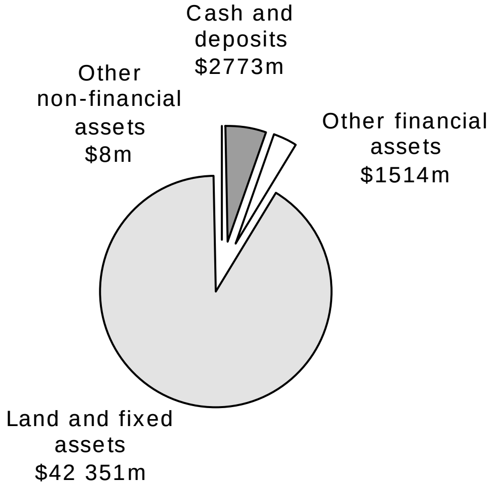
9.3 ASSETS

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 Non-financial public sector assets

The following chart shows the estimated composition of assets under the control of the State as at 30 June 2010 for the non-financial public sector.

Chart 9.1 — Non-financial public sector assets at 30 June 2010



Other financial assets includes equity of $457 million. This comprises $723 million in equity holdings offset by negative $266 million equity investment in other public sector agencies.

Non-financial assets clearly represent the vast majority of State assets being 91 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.

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 actual asset value changes over the four year period 2006-07 to 2009-10 for the major agencies in the general government and public non-financial corporations sectors.

Table 9.3 — Revaluation of non-financial assets (actuals)

	2006-07 $'million	2007-08 $'million	2008-09 $'million	2009-10 $'million	Total $'million
General government	240	961	1 142	9 702	12 045
Public non-financial corporations	947	863	1 729	1 178	4 717
Total	1 187	1 824	2 871	10 880	16 762

Revaluation of the assets of the major agencies added $16.8 billion to the total value of non-financial assets over the four year period to 2009-10.

During 2009-10 the value of the State's road network increased by $9.1 billion and reflects an internal revaluation undertaken by the Department for Transport, Energy and Infrastructure. A key assumption of the revaluation model adopted by the Department is that the road network would be replaced by a modern equivalent asset rather than replacing the existing 'as constructed' network. Further commentary is included under 'Department for Transport, Energy and Infrastructure' in Part B of my recent 2009-10 Auditor-General's Annual Report to Parliament.

9.3.2 Public financial corporations financial assets

The majority of the Government's financial assets are held by 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 2010:

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

	Domestic equities $'million	International equities $'million	Fixed interest $'million	Other investments $'million	Total $'million
2009	3 236	2 554	1 421	5 406	12 617
2010	3 798	3 267	1 509	6 196	14 770

(a) Market values have been used in determining the above amounts.
(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 gain from investing activities in 2009-10 of $1517 million reflecting the recovery of financial markets during the year. As the majority of managed funds are superannuation assets, much of this gain is reflected in an improvement in the unfunded superannuation liability. This net gain partially offsets the $1993 million net loss from investing activities experienced in 2008-09.

The positive market returns contributed to an improvement in the Motor Accident Commission's statutory solvency level, calculated in accordance with a formula determined by the Treasurer. As at 30 June 2010 the Commission had net assets of $239 million. The assets of the compulsory third party fund as at that date were 97.1 percent of the target level of solvency compared to 91.3 percent the previous year.

WorkCover also incurred a gain on investments that contributed to an improvement in its net liability position to $982 million.

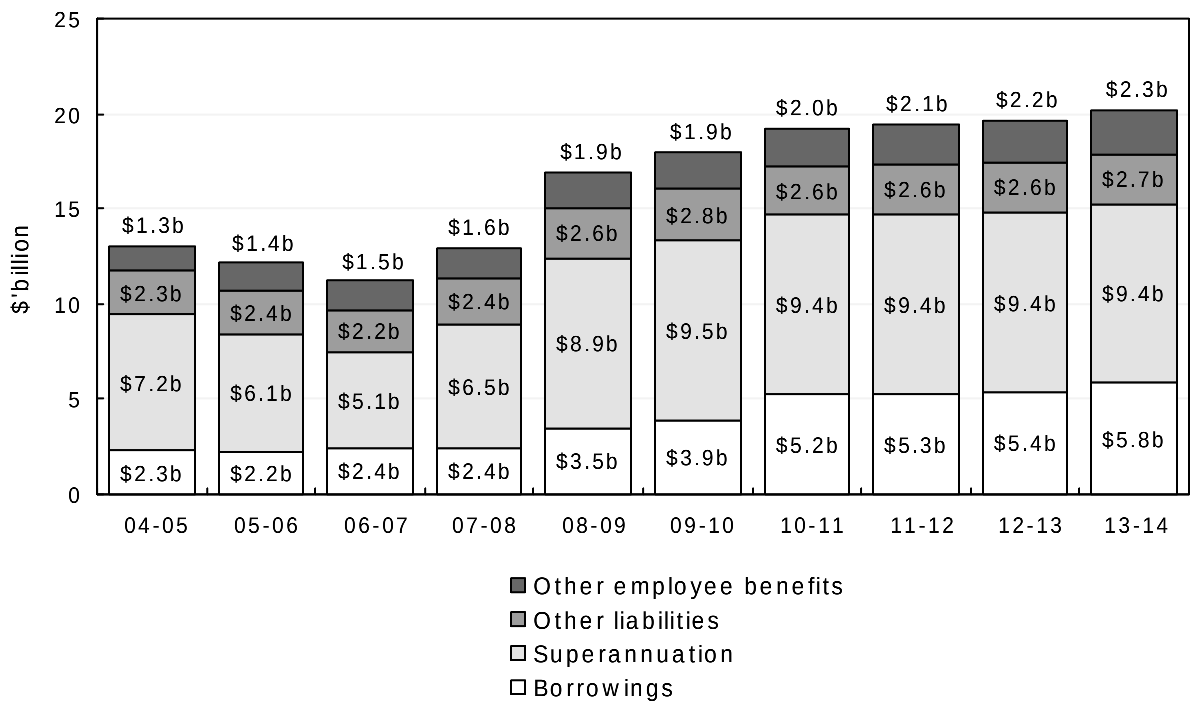
Further commentary is included under 'Motor Accident Commission', South Australian Government Financing Authority', 'Superannuation Funds Management Corporation of South Australia' and 'WorkCover Corporation of South Australia' in Part B of my recent 2009-10 Auditor-General's Annual Report to Parliament.

9.4 LIABILITIES

9.4.1 General government sector liabilities

The following chart shows trends in the main elements of total liabilities for the 10 years to 2013-14.

Chart 9.2 — General government sector liabilities (nominal terms)



Total liabilities are estimated to increase by $1091 million or 6.5 percent to $18 billion in 2009-10. This is due mainly to increases in the unfunded superannuation liability and borrowings. The variability in the unfunded superannuation liability in the five years to 2009-10 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 by $2219 million or 12 percent to $20.2 billion over the period of the forward estimates. This is due mainly to increases in borrowings, up $1965 million and other employee benefits, up $443 million, over the four years to 2013-14.

9.4.2 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 $3188 million or 15 percent to $24.6 billion over the period of the forward estimates. A $2216 million or 12 percent increase in total liabilities in 2009-10 is due to an increase in borrowings, up $1386 million or 24 percent, superannuation liabilities, up $537 million or 6 percent and other liabilities $288 million or 11 percent.

9.5 UNFUNDED SUPERANNUATION

9.5.1 Background to unfunded superannuation liabilities

The unfunded superannuation liabilities are the net difference between the estimated value of accrued superannuation liabilities and the value of assets set aside to meet the liabilities.

Superannuation liabilities are determined on long-term estimates of total liabilities. This is a liability to current and past members of closed defined benefit superannuation schemes. 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 2010

Unfunded superannuation liabilities are estimated to increase by $537 million to $9476 million as at 30 June 2010 compared to the value at 30 June 2009. This increase is explained in table 9.5 and includes the effect of past service superannuation payments of $406 million and higher than expected returns on investment of $219 million, offset by the impact of an increase in the discount rate used to measure the liability.

A discount rate of 5.3 percent (effective annual rate) was used for the 2010-11 Budget compared with 5.2 percent for the 2009-10 Budget. This marginal increase in the discount rate resulted in a $150 million decrease in the liability over the year compared to the estimate as at 30 June 2009 and highlights the sensitivity of the valuation of the superannuation liability to movements in the discount rate. Should interest rates increase in the future, the value of the liability will reduce as discussed later.

The following table sets out the major elements that comprise the movement from the estimated unfunded superannuation liabilities at 30 June 2009 to the 30 June 2010 estimated liability.

Table 9.5 — Estimated unfunded superannuation liabilities as at 30 June 2010

	$'million	$'million
Estimated unfunded liability 30 June 2009		
(2009-10 Budget)		9 748
Add: Lower than expected returns on investments	31	
Independent review of economic assumptions	-	
Movement in discount rate	(841)	
Other	1	
Total changes		(809)
Actual 30 June 2009		8 939
Add: Superannuation interest cost	455	
Past service superannuation payments	(406)	
Higher than expected returns on investments	(219)	
Movement in discount rate	691	
Other movements	17	
Total changes		537
Estimated closing balance June 2010		9 476

Note: Totals may not add due to rounding.

9.5.2.1 Superannuation discount rate

As required by Australian Accounting Standards, the unfunded superannuation liability is estimated at a point in time by discounting future superannuation benefit payments by a discount rate that reflects the risk-free interest rate. The reference rate used is the longest dated Commonwealth Government nominal bond. Due to the high value of the expected payments to beneficiaries and the long term of the liabilities, valuation of the superannuation liability is sensitive to movements in the discount rate. The following table provides examples of the possible values by varying the discount rate from the current rate of 5.3 percent.

Table 9.6 — Sensitivity analysis of unfunded superannuation liabilities to discount rate movements as at 30 June 2010

Discount rate	Unfunded superannuation liability	Increase (decrease)
Percent	$'billion	$'billion
6.3	7.9	(1.6)
5.3	9.5	-
4.3	11.5	2.0

Table 9.6 shows how significantly the value of the liability can change with movements in interest rates alone. For example, should the longest dated Commonwealth Government nominal bond rate increase to 6.3 percent, the value of the unfunded liability will reduce by $1.6 billion to $7.9 billion. The Budget records that while financial market volatility in the recent past has resulted in multibillion dollar revisions to the value of the liability recorded on the balance sheet, there has been no material change in the actual expected payments to beneficiaries underlying the liability.

9.5.2.2 Superannuation funding

In 2010-11, total superannuation funding is budgeted to be $1167 million (down $39 million or 3 percent on 2009-10). It is a significant part of cash outlays. Payments comprise amounts paid from agencies as contributions to current employment for 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 2010-11 is estimated to be $407 million.[20] This estimate is similar to that included in the 2009-10 Budget.

9.5.2.3 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 of South Australia’ in Part B of my recent 2009-10 Auditor-General’s Annual Report to Parliament,.

An earnings rate of 12.2 percent was estimated for 2009-10. Previous years have benefited 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 2010-11 Budget, with the position as at 30 June 2010 remaining consistent with the plan to eliminate unfunded superannuation liabilities by 2034.

Due to the improved investment performance in 2009-10 and the increase in the discount rate, reduced past service superannuation liability cash payments are forecast until 2034. Assuming no change in the discount rate and a return to long term earnings, unfunded liabilities are expected to increase until peaking around the period 2011-12. It is estimated that benefit payments will peak in 2024-25.

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

9.6 NET DEBT

The achievements over a number of years of restructuring the State’s finances reduced net debt to historically low levels to the point that the general government sector had net financial assets rather than net debt for the three years to 2007-08.

---

[20] Budget Statement 2010-11, Budget Paper 3, Table 4.6

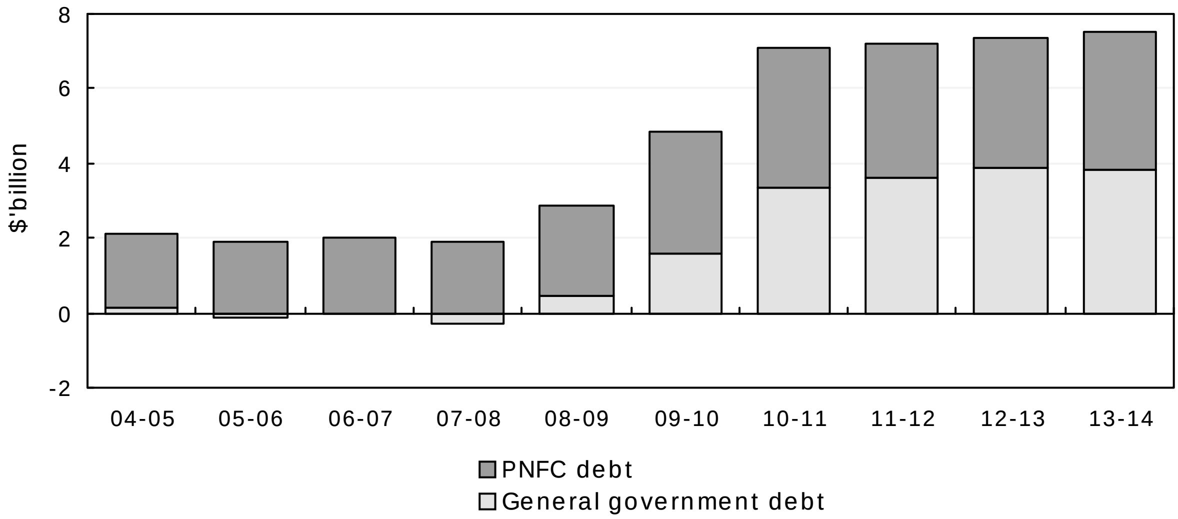
9.6.1 Definition of net debt

Net debt[21] 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 increased by $746 million to $2872 million (3.6 percent of South Australia's Gross State Product) in the period 2004-05 to 2008-09. In 2009-10 net debt has increased by $1992 million to $4864 million (6 percent of South Australia's Gross State Product). Forward estimates show that net debt is projected to rise to $7545 million in 2013-14 (7.5 percent of South Australia's Gross State Product).

Chart 9.3 — South Australian public sector net indebtedness 2005 to 2014



General government sector is estimated to have net debt of $1587 million at the end of 2009-10. Over the forward estimates net debt increases in this sector by $2260 million to $3847 million due to projected net lending deficits (borrowing) resulting from the Government's significant capital investment program and a net operating deficit in 2010-11.

Net debt of the public non-financial corporations increases by $422 million over the same period to $3698 million.

The chart highlights that most debt currently resides with the public non-financial corporations sector. From 2011-12 debt in the general government sector is expected to increase to levels consistent with that found in the public non-financial corporations sector. The main holder of debt in the public non-financial corporations sector is the South Australian Water Corporation. The South Australian Water Corporation is a commercial business servicing its debt from business revenues.

---

21 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 increase in South Australian Water Corporation's debt is mainly attributable to water security projects including the building of the $1824 million Adelaide Desalination Plant (ADP). Funding for the ADP includes Commonwealth Government funding of $328 million which is subject to various conditions. These Commonwealth funding arrangements were subject to Audit review during 2009-10. Further commentary on this matter is included in Part B of my recent 2009-10 Auditor-General's Annual Report to Parliament.

The 2010-11 Budget Papers state that PPP (capital component) arrangements for hospitals and schools are recognised as finance leases in the balance sheet and consequently have an impact on net debt and net financial liabilities.

Table 9.7 explains the expected movements in net debt for the general government sector at the time of the 2009-10 Budget.

Table 9.7 — Reconciliation of movements in general government net debt as at the 2010-11 Budget

	2009-10 Estimated result $'million	2010-11 Budget $'million	2011-12 Budget $'million	2012-13 Budget $'million	2013-14 Budget $'million
Opening net debt	475	1 587	3 335	3 633	3 864
General government net lending (a)	(1 124)	(1 791)	(841)	(194)	126
Add back: Accrued expenses	(19)	33	64	66	52
Less: Accrued revenue	(22)	16	16	11	15
GFS cash surplus/deficit	(1 121)	(1 774)	(793)	(139)	163
Add back: Other adjustments	9	26	495	(92)	(146)
Improvement/(deterioration) in GG net debt	(1 112)	(1 748)	(298)	(231)	17
Closing net debt	1 587	3 335	3 633	3 864	3 847

Note: Totals may not add due to rounding.
(a) 2010-11 includes schools PPP capital component

9.6.3 Debt affordability and servicing

Chart 9.3 clearly highlights the increase in net debt over the period 2009-10 to 2013-14. At the end of 2009-10 total public sector net debt is estimated to represent 6 percent of Gross State Product compared to 7.5 percent in 2013-14.

I note that the increase in net debt forecast is not comparable to the increase experienced in years immediately following 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 33.3 percent of gross state product in 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 2009-10 financial year is between 1 to 1.5 years. Lower duration benchmarks offer lower average interest costs over the long-term but with possible higher short-term budget volatility.

For further details on SAFA refer to the section 'South Australian Government Financing Authority' in Part B of my recent 2009-10 Auditor-General's Annual Report to Parliament.

9.7 OTHER NON-FINANCIAL PUBLIC SECTOR LIABILITIES

Other non-financial public sector liabilities estimated as at 30 June 2010 comprise other employee benefits ($1949 million), payables ($1090 million), advances ($610 million), deposits ($210 million) and other liabilities ($1056 million).

Other employee benefits include long service leave provisions ($1342 million estimate result for 2009-10), workers compensation liabilities ($391 million estimate result for 2009-10) and outstanding insurance claims ($301 million actual in 2009-10).

Significant balances in this class of 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 $1342 million as at 30 June 2010 and budgeted to increase to $1438 million by 30 June 2011. Long service leave is calculated by an estimation process in accordance with AASBs.
- estimated workers compensation totalling $391 million are estimated as at 30 June 2010, increasing to $403 million at 30 June 2011
- actual outstanding insurance claims payable to entities external to SAFA amount to $340 million for 2008-09 and $301 million in 2009-10. Details of SAFA's insurance operations are included in Part B of my recent 2009-10 Auditor-General's Annual Report to Parliament.

9.8 CONTINGENT LIABILITIES

As reported in the Budget Papers[22] contingent liabilities are those that have not been recognised in the balance sheet, but rather are disclosed in notes to the accounts.

Reasons for this are:

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

Contingent liabilities of the Government can arise from:

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

[22] Budget Statement 2010-11, Budget Paper 3, pp 6.9 and 6.10 provides a summary of contingent liabilities.

Guarantees and contingent liabilities of the Government of South Australia as at 30 June 2009 were valued at $717 million ($675 million as at 30 June 2008). Guarantees are valued at nominal values without adjustment for the probability of actual liabilities occurring.

The $42 million increase is due mainly to an 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 this 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, these indicators are influenced by varying valuation approaches between states for both assets and liabilities, 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 2014.

The following table shows 2010-11 budgeted total revenue for each State.

Table 10.1 — 2010-11 Budgeted general government total revenue by State

State	NSW	VIC	QLD	WA	SA	TAS
	$'million	$'million	$'million	$'million	$'million	$'million
Total Revenue	57 669	45 759	40 606	22 591	15 086	4 563

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

10.2 OPERATING STATEMENT

The following charts compare some trends in the GFS information with other states using 2010-11 budget data.

Chart 10.1 — General government sector net operating balance as a proportion of total revenue

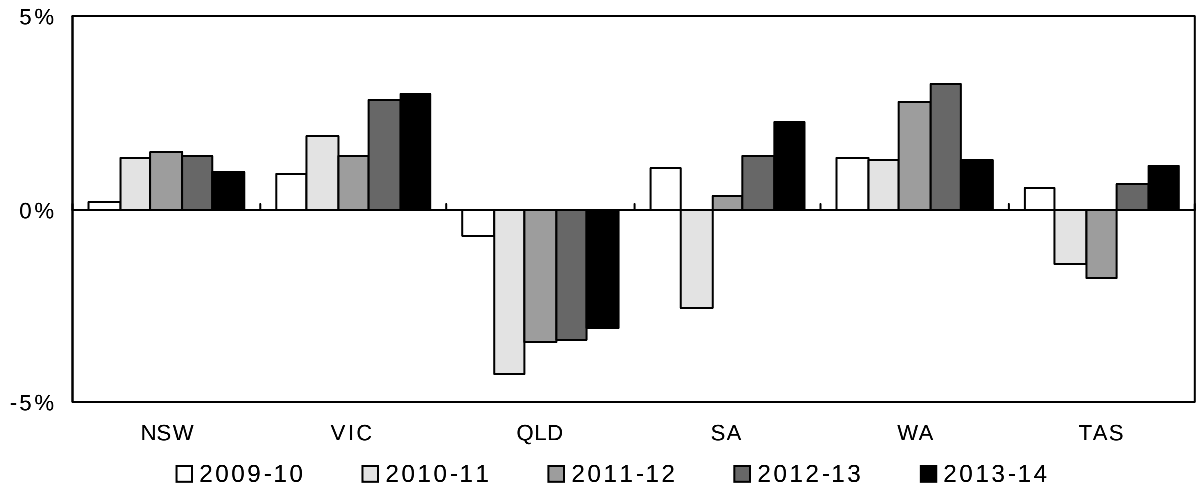
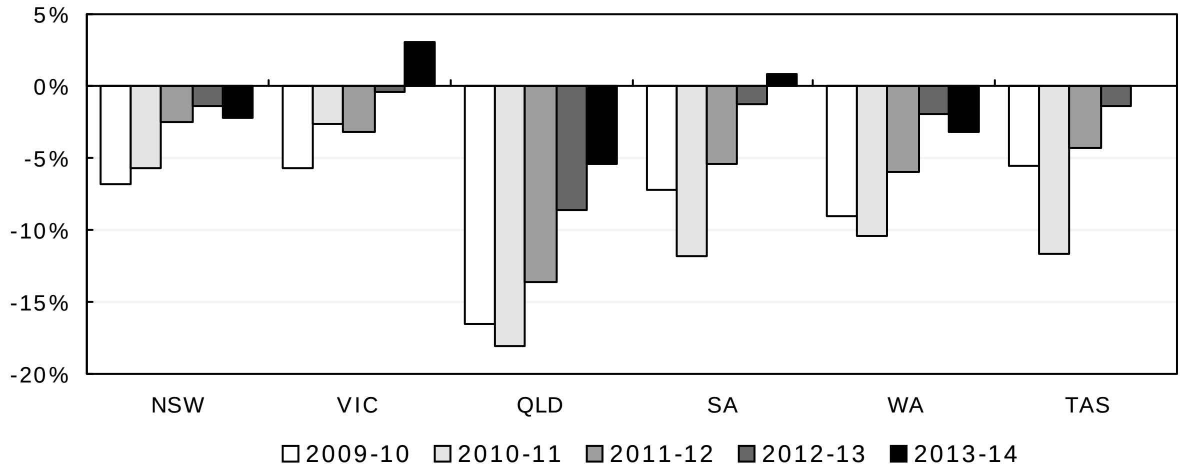


Chart 10.1 shows that projections for South Australia's net operating balance as a ratio to total revenue compares reasonably favourably with other states from 2011-12 onwards. South Australia, Queensland and Tasmania each have projected negative ratios for the 2010-11 financial year.

Chart 10.2 — General government sector net lending (borrowing) as a proportion of total revenue



As detailed in chart 10.2, most states (except for Victoria, South Australia and Tasmania) are estimating net lending deficits (borrowing) outcomes for all or most of the four years to 2013-14.

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

10.3 BALANCE SHEET

10.3.1 Ratio of net financial liabilities to revenue

The 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. This ratio is sensitive to the interest rate used to value unfunded superannuation liabilities. The rate used by each State may vary.

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

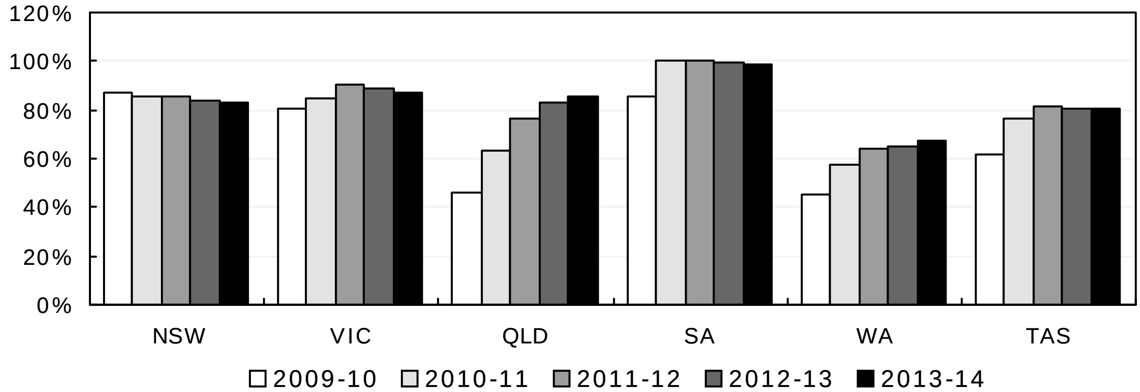


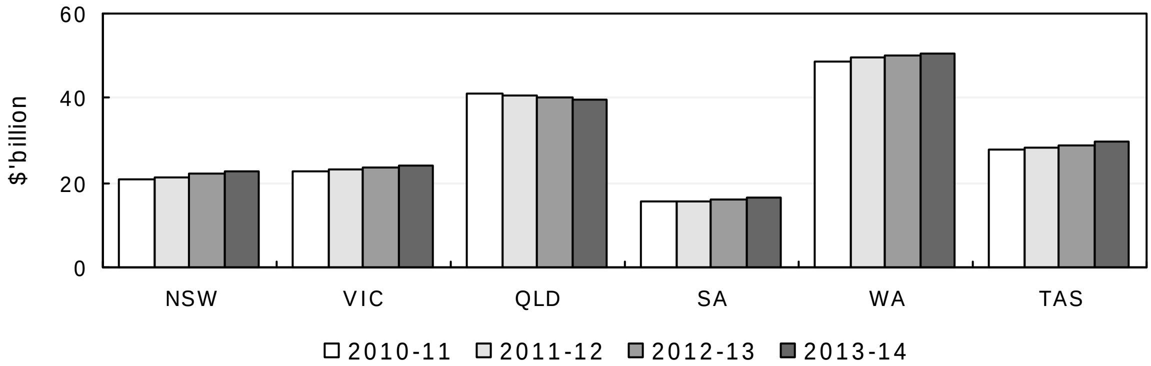
Chart 10.3 shows the 2010-11 budget settings result in the ratio for South Australia remaining relatively steady over the next four financial years. It is evident that a similar situation exists for New South Wales, Victoria and Tasmania, whilst Queensland and Western Australia show a steady ratio incline.

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 arises from transactions, the operating result and from revaluations of assets and liabilities. As mentioned, comparison between states is affected by varying valuation and recognition policies. One significant difference is that South Australia is the only State not to value all land under roads.

The following chart plots the Budget data for all states.

Chart 10.4 — General government sector net worth per capita



The chart shows a slight increase in net worth in this State through to 2013-14 based on current budget settings. This is consistent with the projections for other states except for Queensland.

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* 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 *Public Finance and Audit Act 1987*.

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 statements 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 the Appendix to Volume V of Part B of my recent 2009-10 Auditor-General's Annual Report to Parliament.

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 generally operating satisfactorily, there were a number of minor areas where improvements could be made. Review findings are provided under the Audit Findings and Comments heading for the Department of Treasury and Finance in Part B of my recent 2009-10 Auditor-General's Annual Report to Parliament.

11.3 THE CONSOLIDATED ACCOUNT OUTCOME

The following table sets out total appropriation authority and actual payments for the Consolidated Account in 2009-10.

Table 11.1 — 2009-10 appropriation authority and payments

	Appropriation authority $'million	Actual payments $'million
Appropriation Act 2009	11 578.4	11 407.9
Public Finance and Audit Act 1987, section 15	70.3	70.3
Governor's Appropriation Fund	279.4	126.4
Specific appropriations authorised in various Acts	137.6	137.6
Total	12 065.7	11 742.2

The result on the Consolidated Account and variations from budget for 2008-09 was as follows.

Table 11.2 — 2009-10 Consolidated Account result

	2009-10 Budget $'million	2009-10 Actual $'million	Variation $'million
Total receipts	9 733.1	10 490.0	756.9
Total payments	11 698.7	11 742.3	43.6
Consolidated Account financing requirement	(1 965.8)	(1 252.3)	713.3

The deficit of $1252 million ($1159 million deficit in 2008-09) is reflected in an increase 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 returns of surplus cash to Consolidated Account $142.3 million; Commonwealth First Home Owners Boost grants $37.7 million; return of deposit account balances $61.9 million; Council of Australian Governments funding arrangements grants $20.3 million; GST revenue grants $280.3 million; stamp duty receipts $132 million. These were slightly offset by lower than anticipated returns of super deposit account balances ($19.6 million) and interest on investments ($7.3 million).

- ***Payments*** — higher payments for administered items for DTF $70.3 million; the Department of Health $24.7 million and the Department for Families and Communities $37.5 million.

In 2009-10 significant amounts were appropriated to agencies as equity. The main items were Defence SA ($386 million), Department of Health ($579 million) and the Department for Transport, Energy and Infrastructure ($583 million). Equity funding is credited directly to an agency's Statement of Financial Position, not through the Statement of Comprehensive Income.

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 2009-10.

Table 11.3 — Appropriation flexibility

	Authority / budget $'million	Actual payments $'million
Governor's Appropriation Fund	279.4	126.4
Contingency provisions in administered items for DTF	466.9	373.2
Public Finance and Audit Act 1987, section 15	70.3	70.3
Total Flexibility	816.6	569.9

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
Department for Families and Communities	Additional funding to meet cash requirements in 2009-10 relating to cost pressure overspends associated with Families SA (alternative care) and Disability SA.	37.5
Defence SA	Funding given in the form of an equity contribution primarily to support the acquisition of the assets of Technology Park by Defence SA from the Land Management Corporation.	27.7
Department of Health	Required to support an overspend by Health in 2009-10. Funding aimed at mitigating shortfalls in cash amounts required to adequately support Health's ongoing operations.	24.7

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 Other Transfers from the Administered for the Department of Treasury and Finance'. 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	146.4
Department of Water, Land and Biodiversity Conservation	30.0
Department for Transport, Energy and Infrastructure	21.1
Department of Treasury and Finance	16.8
Department of Further Education, Employment, Science and Technology	21.6
Department of Education and Children's Services	45.4
Department for Families and Communities	23.8

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 2009-10 $70.3 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. In 2008-09 the amount appropriated by the Treasurer was $128.4 million.

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 2009-10. 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.[23]

[23] *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 shows that over $2766 million is in Special Deposit Accounts and Deposit Accounts as at 30 June 2010, up $203 million from the previous year.

Table 11.6 — Special Deposit Accounts and Deposit Accounts

	2008-09 $'million	2009-10 $'million	Increase $'million
Special Deposit Accounts	2 016.4	2 151.4	135.2
Deposit Accounts	547.4	614.8	67.4
Total	2 563.6	2 766.2	202.6

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 2010 were:

- ***Special Deposit Accounts*** — Accrual Appropriation Excess Funds ($433 million), Highways Fund ($393.5 million), Treasury and Finance administered Items – Intergovernmental Agreement on Federal Finance Relations ($258.2 million), Treasury and Finance Administered Items Account ($118.0 million) and Local Government Disaster Fund ($42.1 million)

- ***Deposit Accounts*** — South Australian Housing Trust ($135.4 million), Supreme Court Suitors Fund ($40.7 million), South Australian Government Financing Authority ($37.7 million) and Rail Transport Facilitation Fund ($37 million).

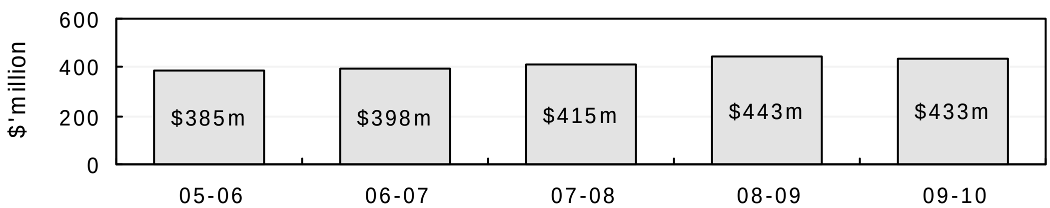
Account balances are subject to the Treasurer's Cash Alignment Policy that aims to minimise balances as discussed below.

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.

Chart 11.1 — Accrual Appropriation Excess Funds Account



11.5.2 Treasury and Finance Administered Items – Intergovernmental Agreement on Federal Financial Relations Account

The approved purpose of the Treasury and Finance Administered Items – Intergovernmental Agreement on Federal Financial Relations Account (the Account) is to receive and disburse money paid to the State pursuant to the Intergovernmental Agreement on Federal Financial Relations for the National SPP purposes listed in Schedule F of that agreement and for the NPP payments for the purposes listed in Schedule G of that agreement.

The operations of the Account are included in DTF administered financial statements, which are included in Part B of my recent 2009-10 Auditor-General's Annual Report to Parliament. The balance in the Account at 30 June 2010 was $258.2 million. This entire balance was committed to various South Australian Government agencies to fulfil requirements under the Intergovernmental Agreement on Federal Financial Relations agreements.

11.5.3 Cash alignment policy

The Government has a cash alignment policy 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 $143.9 million ($80.1 million in 2008-09) of surplus cash was returned to the Consolidated Account during 2009-10. The main amounts were as follows.

Table 11.7 — Cash alignment policy repayments

Agency	Actual payments $'million
Department of Treasury and Finance Administered Items Special Deposit Account	64.2
Department of Education and Children's Services	25.9
Department of Treasury and Finance Administered Items – Industry Financial Assistance Account	20.0
Department of Trade and Economic Development	13.9
Department of Further Education, Employment, Science and Technology	9.9
Defence SA	5.8
Department of the Premier and Cabinet	2.2

12 WHOLE-OF-GOVERNMENT/GENERAL GOVERNMENT CONSOLIDATED FINANCIAL REPORT

Up to 2007-08, Whole-of-Government (WHOG) financial reports were prepared in accordance with AAS 31 'Financial Reporting by Governments'. AASB 1049 'Whole of Government and General Government Sector Financial Reporting' replaced AAS 31 and was applicable to annual reporting periods beginning on or after 1 July 2008. Accordingly, 2008-09 was the first year in which the consolidated financial report (CFR) or whole of government report was prepared under AASB 1049.

AASB 1049 requires the preparation of both WHOG and general government (GG) sector financial reports. Accordingly, both WHOG and GG sector financial reports form one financial report and are required to be issued at the same time as the Final Budget Outcome (FBO) by DTF.

At present there is no requirement under the *Public Finance and Audit Act 1987* or other South Australian legislation to provide an independent audit opinion on the preparation of WHOG or GG sector financial reports.

Due to the timing of the preparation of the WHOG financial report, the last completed report relates to the year ended 30 June 2009, and the following commentary has therefore been kept purposely brief.

12.1 AASB 1049 KEY CONCEPTS

As specified, the South Australian CFR is prepared by the Government Accounting, Reporting and Procurement Branch (GARP) of DTF pursuant to AASB 1049.

The CFR is not a general purpose financial report. As such it is unique, and is influenced by two significant matters that affect the form and content of the report. Firstly, it is a requirement to prepare a financial report for the GG sector. Secondly, a different accounting framework applies to AASB 1049. AAS 31 financial reports were prepared consistent with generally accepted accounting principals (GAAP). However, AASB 1049 requires financial reports to be prepared consistent with the principles and rules in the Australian Bureau of Statistics (ABS) publication 'Australian System of Government Financial Statistics: Concepts, Sources and Methods' (GFS Manual). There are considerable differences between the GAAP and GFS frameworks.

12.2 AASB 1049 AND THE REPORTING ENTITY CONCEPT

The reporting entity adopted is reflective of the 'enterprise unit' concept, where a reporting entity is an enterprise unit which can comprise one or more legal bodies. The WHOG reporting entity includes government departments (general government sector), non-financial corporations, financial corporations and other government-controlled entities. The GG sector reports from only one perspective, detailing that sector's transactions with non-financial corporations, financial corporations, and non-South Australian sector entities.

12.3 SCOPE OF CONSOLIDATED FINANCIAL REPORT AUDIT

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

- the principles adopted in the definition of the economic entity for CFR purposes
- controls and procedures within DTF for evaluating the reliability and validity of data forwarded by agencies
- the adequacy and reliability of the Hyperion database as a medium for the preparation of the CFR
- the preparation of the CFR
- 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.

12.3.1 Audit findings and comments

Following the Audit review of the financial report for 2008-09, a management letter was forwarded to DTF in December 2009 that contained reporting and operational considerations that would need to be addressed in order to provide an unqualified audit opinion for the CFR. This would, of course, require legislation changes requiring such an opinion to be issued. The Audit management letter was reproduced in full in the CFR report published by DTF.[24]

The matters raised included:

- Completeness and accuracy of CFR items
- The use of unaudited data in the preparation of the WHOG financial report

Departmental response

DTF responded positively to each of the issues raised.

In particular, DTF noted the suggestions by Audit, specifying that they were 'noted and have been taken on board in the planning for the 2009-10 Consolidated Financial Report'.

12.4 CONSOLIDATED FINANCIAL REPORT FINANCIAL PERFORMANCE

The following briefly discusses the financial performance result of the CFR report as at 30 June 2009. 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.[25] 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.

[24] Government of South Australia, Consolidated Financial Report for the year ended 30 June 2009.

[25] Government of South Australia, Consolidated Financial Report for the year ended 30 June 2009.

The following table summarises the financial result for the WHOG for the year ending 30 June 2009, with a comparative amount included for the prior year only. This table reflects the reporting and presentation requirements of AASB 1049 only. Given the major differences in reporting and presentation requirements between the current and predecessor frameworks, Audit has elected not to include the financial performance data for the period 2004-05 to 2006-07. Please refer to prior year versions of this report for that information.

Table 12.1 — CFR financial performance

	2009	2008
Revenue from transactions	**$'million**	**$'million**
Taxation revenues	**3 253**	3 353
Grant revenue	**7 503**	6 814
Charges for goods and services	**4 135**	3 949
Interest income	**620**	907
Dividends and income tax equivalents	**32**	36
Other revenues	**624**	611
Total revenue from transactions	**16 166**	15 672
Expenses from transactions		
Employee expenses	**5 869**	5 373
Superannuation interest cost	**383**	276
Other superannuation expenses	**608**	572
Depreciation and amortisation	**853**	799
Use of goods and services	**4 146**	3 637
Interest expenses	**701**	721
Grant expenses	**2 189**	1 906
Income tax expense	**-**	-
Other operating expenses	**1 791**	1 575
Total expenses from transactions	**16 539**	14 858
Net result from transactions - Net operating balance	**(373)**	814
Other economic flows - included in net result		
Net foreign exchange gains	**(473)**	191
Net gain/loss on sale of non-financial assets	**36**	54
Net gain/loss on financial assets or liabilities at fair value	**310**	(648)
Net actuarial gains/(losses) of superannuation defined benefit plans	**(2 379)**	(1 353)
Other net actuarial gains/(losses)	**(95)**	(256)
Other economic flows	**(87)**	(29)
Total other economic flows included in net result	**(2 688)**	(2 041)
Net result	**(3 061)**	(1 227)
Other economic flows - other non-owner movements in equity		
Changes in property, plant and equipment asset revaluation reserve	**3 562**	2 063
Net gain on financial assets at fair value	**(12)**	-
Total other economic flows - non-owner movements in equity	**3 550**	2 063
Comprehensive result - change in net worth	**490**	836
Total change in net worth	**490**	836

The main variations in revenues in 2008-09 were as follows:

- ***Grants*** — increased by 10 percent or $689 million. Commonwealth general purpose grants reduced by $103 million to $3820 million. This reduction was mainly offset by a $717 million increase in Commonwealth national partnership payment and specific purpose grants.

- ***Charges for goods and services*** — increased by $186 million or 4.7 percent due mainly to an increase in water related charges ($63 million), compulsory third party payments ($33 million) workers' compensation levies ($30 million) and driver's license registrations ($16 million). Offsets were noted with declines in forestry products and land sales.

The main variations in expenses in 2008-09 were as follows:

- ***Grants and Subsidies*** -increased by $283 million or 15 percent due mainly to increases in recurrent grants ($105 million), subsidies ($87 million) and other current transfer payments ($101 million).
- ***Use of Goods and Services*** - increased by $509 million or 14 percent due mainly to and increase contract service expenses ($126 million) and other use of goods and services ($323 million).

12.5 CONSOLIDATED FINANCIAL REPORT FINANCIAL POSITION

The following table summarises the financial position result for the WHOG for the year ending 30 June 2009, with a comparative amount included for the prior year only. This table reflects the reporting and presentation requirements of AASB 1049 only. Given the major differences in reporting and presentation requirements between the current and predecessor frameworks, Audit has elected to not include the financial position data for the period 2004-05 to 2006-07. Please refer to prior year versions of this report for that information.

Table 12.2 — CFR financial position

	2009	2008
Assets	**$million**	**$million**
Financial assets		
Cash and deposits	**576**	518
Receivables	**768**	743
Advances paid	**1 447**	1 309
Investments, loans and placements	**8 217**	7 152
Investments - other	**11 196**	13 159
Interest in joint venture	**681**	665
Financial assets held for sale	**-**	-
Other financial assets	**-**	-
Total financial assets	**22 885**	23 546
Non-financial assets		
Produced assets:		
Inventories	**411**	367
Machinery and equipment	**2 097**	1 705
Buildings and structures	**26 069**	23 150
Heritage assets	**860**	857
Biological assets	**689**	617
Intangibles	**102**	93
Non-financial assets held for sale	**16**	18
Other non-financial assets	**122**	80
Non-produced assets:		
Land	**8 941**	7 498
Intangibles	**51**	25
Non-financial assets held for sale	**29**	26
Total non-financial assets	**39 387**	34 438
Total assets	**62 271**	57 983

	2009 $million	2008 $million
Liabilities		
Deposits held	**382**	371
Advances received	**—**	—
Borrowing	**7 427**	5 169
Payables	**1 187**	965
Employee benefits	**1 947**	1 722
Superannuation	**8 939**	6 468
Superannuation fund deposits	**12 606**	14 161
Provisions (other than employee benefits)	**5 092**	4 919
Liabilities associated with non-financial assets held for sale	**—**	—
Other liabilities	**1 186**	1 192
Total liabilities	**38 766**	34 968
Net assets (liabilities)	**23 505**	23 016

The $489 million increase in net assets for 2008-09 was represented by increases in machinery and equipment ($392 million) and buildings and structures ($2919 million) and a decrease in investments ($1963 million) offset by an increase in borrowings ($2258 million) and superannuation liabilities ($2471 million).