

**Report 8 of 2019**

State finances and related matters





# **Report of the Auditor-General**

## **Report 8 of 2019**

### State finances and related matters

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Tabled in the House of Assembly and ordered to be published, 15 October 2019

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First Session, Fifty-Fourth Parliament

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

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ISSN 0815-9157



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14 October 2019

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President  
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Parliament House  
**ADELAIDE SA 5000**

The Hon V A Tarzia MP  
Speaker  
House of Assembly  
Parliament House  
**ADELAIDE SA 5000**

Dear President and Speaker

**Report of the Auditor-General:  
Report 8 of 2019 *State finances and related matters***

As required by the *Public Finance and Audit Act 1987*, I present to each of you Report 8 of 2019 *State finances and related matters*.

**Content of the Report**

The 2019-20 State Budget was tabled in Parliament in June 2019. This Report provides our observations on the State's public finances based on our review of the Budget, in particular:

- an overview of key matters, trends and risks currently relevant to the State's public finances
- an analysis of the State's financial performance, including the estimated results for 2018-19 and the Budget and forward estimates
- a review of the State's financial position, including analysis of major assets and liabilities.

**Acknowledgements**

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

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

Yours sincerely

A handwritten signature in black ink, appearing to read "Richardson", with a long horizontal flourish extending to the right.

Andrew Richardson  
**Auditor-General**

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# 1 Executive summary

## 1.1 Introduction

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The 2019-20 State Budget (2019-20 Budget) was tabled in Parliament in June 2019. This Report provides our observations on the State's public finances based on our review of the 2019-20 Budget, in particular:

- an overview of key matters, trends and risks currently relevant to the State's public finances
- an analysis of the State's financial performance, including the estimated results for 2018-19 and the Budget and forward estimates
- a review of the State's financial position, including analysis of major assets and liabilities.

Section 2 provides further details on the objective and scope of our review. All figures in this Report are for the general government sector<sup>1</sup> unless otherwise specified.

There is a significant change in the basis on which figures are presented in the Budget from 2019-20 onwards (structural break) owing to:

- new accounting standards being implemented
- budget presentation changes to achieve full compliance with the Uniform Presentation Framework (UPF).

The impact of the structural break is highlighted where relevant in this Report. Appendix F of 2019-20 Budget Paper 3 *Budget Statement* provides further details on the changes.

## 1.2 Key overall observations

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### 1.2.1 Significant increases in the State's net debt to fund the general government sector's investing program increase the risk the SA Government will have less capacity and flexibility for expenditure on services

The State's non-financial public sector net debt is expected to increase by \$7.7 billion between 2018-19 and 2022-23 to \$21.3 billion, primarily to fund the general government sector's investing program.<sup>2</sup> As a result, South Australia's non-financial public sector net debt to revenue ratio is expected to be higher than all other States by 2022-23. Growth in net debt over the four years of the Budget is also well in excess of estimated growth in the State's gross state product and revenue base. As a result, there is an increased risk the

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<sup>1</sup> Appendix 1 provides further details on the institutional sectors for Budget reporting purposes.

<sup>2</sup> The SA Government's fiscal targets were revised in the 2019-20 Budget to broaden the focus of net debt levels from the general government sector to the non-financial public sector. DTF advised that this change was made on the basis that responsible debt management should be considered and monitored at a whole-of-government level.

SA Government will have less capacity and flexibility for expenditure on services after meeting higher borrowing costs moving towards 2022-23.

There are also several large infrastructure initiatives announced in the Budget that are expected to incur significant expenditure beyond 2022-23, which may result in net debt increasing further.

The Department of Treasury and Finance (DTF) advised that the SA Government expects growth in net debt to be sustainable, on the basis that the State has maintained operating surpluses across the forward estimates and can tailor its operating expenditure decisions over time to manage its financial position and maintain those surpluses.

Moody's credit opinion on the State, issued in August 2019, reports that it considers the increase in the State's net debt burden to be manageable within the current Aa1 rating and it maintained a stable outlook. Moody's notes that additional debt funding could be required if the State does not meet its low expenditure targets, particularly for employee expenses and the Health portfolio and/or if there are slippages in its capital program.

In late September 2019 Standard & Poor's confirmed an AA+ credit rating with a stable outlook for the State. It also commented that:

- it expects the State's disciplined approach to its expenditure measures will likely sustain its operating surpluses
- higher capital expenditure than expected has slightly weakened the State's budgetary performance
- the State's debt levels compare well with other similarly rated domestic and international peers.

Sections 3.2 and 7.3 provide further details on the State's fiscal targets, projected net debt levels and associated risks.

### **1.2.2 The 2019-20 Budget expands the State's capital program to \$9.7 billion and effective planning and management of major capital projects will be needed to mitigate risks to the Budget from increased capital outlays**

The 2019-20 Budget indicates that in response to the weaker than expected revenue outlook, the SA Government is prioritising spending to continue to deliver key services and invest in important economic infrastructure that supports the State's economic growth.

DTF advised that the expanded capital program also responds to comments made by the Governor of the Reserve Bank of Australia recommending that States increase infrastructure spending on 'shovel ready' projects to stimulate economic growth and take advantage of low market interest rates in borrowing to fund these projects.

Estimated capital expenditure from 2019-20 onwards is high compared to historical levels, being in excess of \$2 billion each year. Purchases of non-financial assets are projected to total \$9.7 billion over the four years of the 2019-20 Budget, compared to \$8.6 billion over the four years of the 2018-19 Budget.

As the capital program expands, proper planning, management and control of major capital projects becomes more critical to achieving budgeted outcomes. Section 7.2 provides further details on the expanded capital program and associated risks.

### 1.2.3 The SA Government has implemented savings initiatives and targeted revenue increases to meet the challenge of significant write-downs in GST revenue and conveyance duties

GST revenue and conveyance duty for the period 2018-19 to 2021-22 were revised downwards by \$2.1 billion and \$291 million respectively since the last budget. The 2019-20 Budget introduces new operating savings measures (\$362 million) and new revenue policy measures (\$671 million) over the four years of the Budget to partially offset the reductions in these revenues. Sections 4.2 and 4.3 provide further details on the variations from the prior year budget and the new policy measures.

Implementing new revenue accounting standards also results in recognising additional revenue over the four years of the Budget (\$850 million), which further offsets the revenue write-downs. Section 3.3 provides more information on these accounting standard changes and their impacts on key fiscal aggregates.

### 1.2.4 The SA Government has taken steps to address budget overruns in Health but faces ongoing challenges in meeting its cumulative Health and Wellbeing savings task of \$1.173 billion over the four years of the Budget

The 2019-20 Budget outlines the steps the SA Government took in 2018-19 to achieve savings in the Health and Wellbeing portfolio and improve its budget performance, including implementing an organisational and financial recovery plan for the Central Adelaide Local Health Network Incorporated (CALHN) with the support of KordaMentha.

Despite these steps, the Department for Health and Wellbeing (DHW) did not achieve its savings target in 2018-19 and has an estimated overspend in 2018-19 of \$238 million. DHW was the only portfolio to receive funding in 2018-19 due to not achieving savings targets.

A significant savings task also remains, totalling \$1.173 billion over the four years of the Budget. We expect the Health and Wellbeing savings task to remain a challenge until there is a demonstrated history of achieving savings goals. Section 6.6 provides further details on Health savings.

### 1.2.5 The operating surplus projected in the 2018-19 estimated result is mainly due to the carry forward of Commonwealth capital grants offset by a once-off \$602 million grant payment to the SAHT

The \$101 million operating surplus projected in the 2018-19 estimated result has improved by \$53 million compared to the original Budget. This is largely due to Commonwealth national partnership infrastructure grant funding being brought forward to 2018-19 (\$738 million), offset largely by a once-off grant payment of \$602 million to the South Australian Housing Trust (SAHT) to restructure its operations and support its viability.

Sections 3.1.1 and 3.1.2 provide further details on the 2018-19 estimated result and re-profiling of Commonwealth capital grant revenue.

### 1.2.6 Robust budget management is required to achieve the fiscal target of consistent operating surpluses

The SA Government sets out its fiscal strategy and fiscal targets in the Budget, and its performance against those targets. The fiscal targets include achieving a net operating surplus in the general government sector every year. This target is expected to be met for all four years of the 2019-20 Budget, with operating surpluses ranging from \$94 million in 2019-20 to \$251 million in 2022-23.

As the net operating surpluses over the four years of the Budget are modest, there are many risks and variables to be managed. These may influence the final outcome each year, and in particular may prevent the fiscal target of consistent operating surpluses being achieved. Risks that have historically affected outcomes include:

- GST revenue growth being less than expected owing to downward revisions to the national GST pool and South Australia's share of that pool
- lower than expected growth in conveyance duties and write-downs being required between budgets
- Health and Wellbeing portfolio savings targets not being achieved
- growth in employee expenses exceeding that allowed for in the forward estimates due to enterprise agreement negotiation outcomes and not achieving budgeted FTE reductions
- agency efficiency (savings) dividends not being achieved.

In the event these risks materialise, other aspects of the Budget will need to be managed to achieve Budget results. Enterprise agreement negotiation outcomes are particularly important for achieving the 2019-20 Budget as the agreements under negotiation in the budget year cover almost half of total general government sector employees.

Sections 5.2 and 5.3 provide further details on GST revenue and conveyance duty risks, with further information on risks attributable to employee expenses and agency savings targets outlined in sections 6.2 and 6.7.

### 1.2.7 SA Water is projected to provide 76% of total budgeted dividend and income tax equivalent income by 2022-23

The South Australian Water Corporation (SA Water) is expected to become the State's main source of dividend and income tax equivalent (ITE) income over the forward estimates, with its share of the total increasing from 33% in 2017-18 to 76% in 2022-23. As a result, the SA Government will have increased exposure to SA Water operations in meeting its budgeted outcomes. Section 5.5 provides further details on dividend and ITE income.



## 2 Review mandate, objective and scope

### 2.1 Our mandate

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

### 2.2 Our objective

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The objective of this Report is to provide independent commentary and analysis on the 2019-20 Budget to highlight key matters, trends and risks associated with the State's public finances.

### 2.3 What we reviewed and how

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We reviewed the 2019-20 Budget to identify key matters, trends and risks currently relevant to the State's public finances. This involved:

- reviewing the Budget against the SA Government's stated fiscal strategy
- reviewing credit rating agency reports on the State
- examining the estimated results for the past year, the Budget and the forward estimates included in the Budget Papers
- analysing major assets and liabilities.

Our analysis is based on data provided in the 2019-20 Budget Papers supplemented with information provided by DTF. Our work also included analytical procedures to ensure the reasonableness of key trends and underlying assumptions in the 2019-20 Budget.

We expect to table a separate report on the 2018-19 Consolidated Financial Report, including the actual results for the whole of SA Government, in 2020.

### 2.4 What we did not review

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This Report primarily comments on Budget information. The data and assumptions underlying this information are not subject to audit and no audit opinion is provided on the accuracy of either the historical or prospective figures presented in the 2019-20 Budget. We have not performed work to provide an opinion on the effectiveness of the SA Government's budgetary control.

## 3 Key fiscal aggregates

### Key points

- The 2018-19 net operating surplus is expected to improve by \$53 million compared to the original Budget largely due to Commonwealth infrastructure grant funding being brought forward, partially offset by a once-off grant payment to the SAHT.
- The net operating balance fiscal target of achieving consistent net operating surpluses in the general government sector is expected to be met for all four years of the 2019-20 Budget, with modest surpluses in each year.
- The net debt fiscal target was broadened to include non-financial public sector debt.
- New accounting standards impact reported key fiscal aggregates from 2019-20 and primarily involve changes in the timing of revenue recognition and treatment of leases.
- Non-financial public sector net debt as a percentage of revenue is projected to increase from 78% in 2019-20 to 91% in 2022-23.

### 3.1 2018-19 estimated results

#### 3.1.1 2018-19 net operating surplus expected to improve by \$53 million compared to the original Budget

The 2018-19 estimated result for the net operating balance<sup>3</sup> is a surplus of \$101 million, compared to a budgeted surplus of \$48 million in the 2018-19 Budget.

Figure 3.1 shows the revisions made to the estimated 2018-19 net operating balance since the 2018-19 Budget.

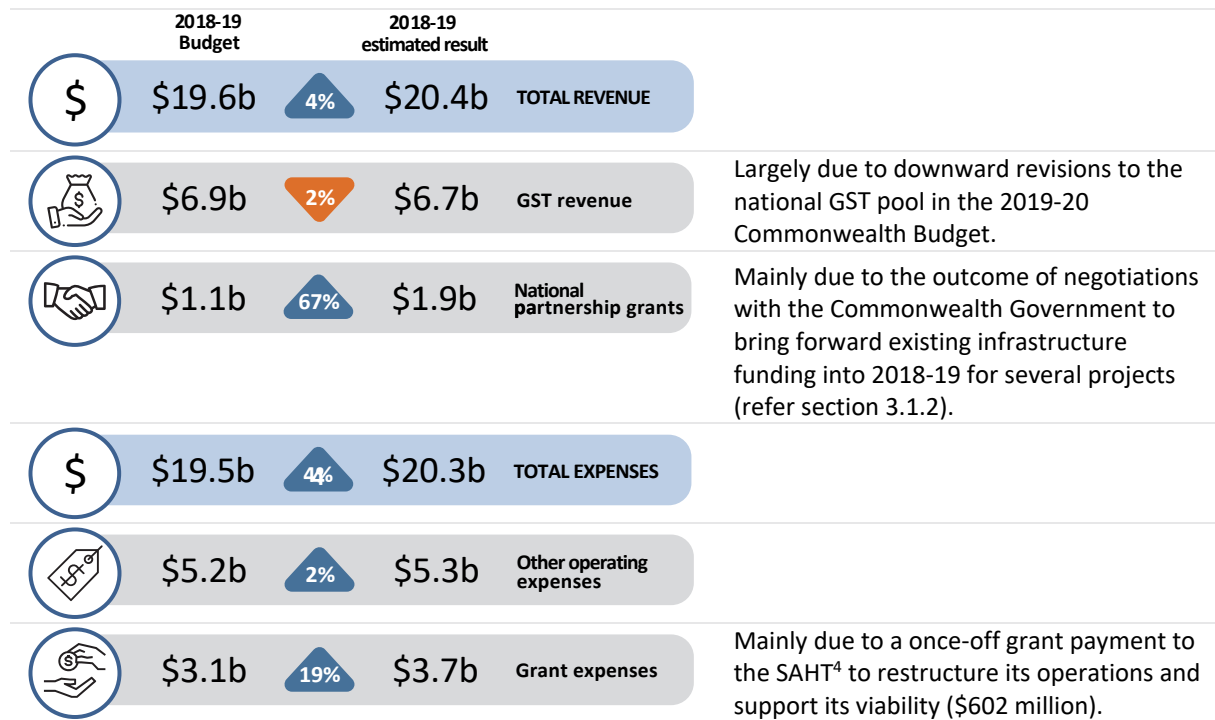
**Figure 3.1: Revisions made to 2018-19 net operating balance**

2018-19 net operating balance	Amount
2018-19 Budget estimate	\$48 million surplus
2018-19 MYBR estimate	\$40 million surplus
2019-20 Budget estimate	\$101 million surplus

Figure 3.2 summarises the key factors contributing to the \$53 million improvement in the estimated 2018-19 net operating balance since the 2018-19 Budget.

<sup>3</sup> The net operating balance is the net result of revenue and expenses from transactions. It is a summary measure of the sustainability of operations that shows whether the SA Government has to borrow money to cover operating activities. If this measure is in surplus then operating revenue is sufficient to fund operating expenses.

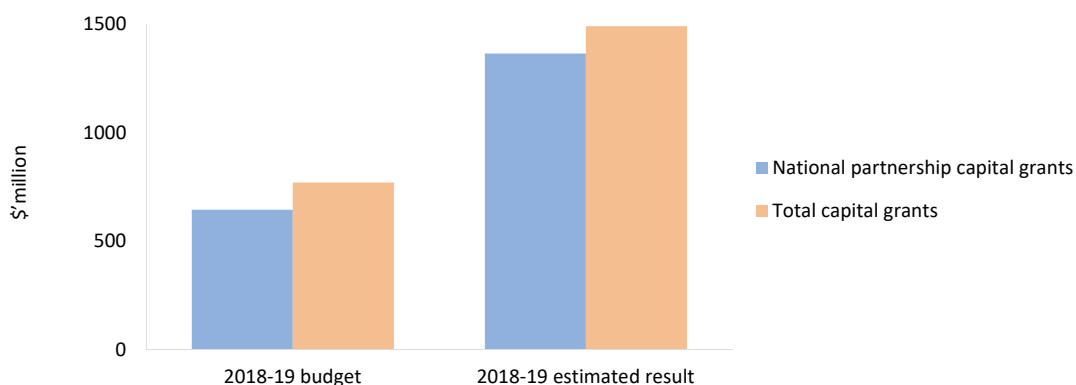
**Figure 3.2: Key account balances contributing to variance between 2018-19 budget and estimated result for net operating balance**



### 3.1.2 Re-profiling Commonwealth capital grant revenue significantly impacts the 2018-19 operating surplus

Figure 3.3 shows the large upward revision to Commonwealth capital grant funding between the 2018-19 Budget and 2018-19 estimated result.

**Figure 3.3: Commonwealth capital grant funding**



Most of this funding reflects national partnership grants for road and rail transport infrastructure projects.

<sup>4</sup> The SAHT operated under the name South Australian Housing Authority from 1 July 2018.

Upward revisions to Commonwealth Government national partnership grants<sup>5</sup> mainly reflect the Commonwealth Government’s decision to make an upfront payment for existing infrastructure funding in 2018-19. DTF advised that \$738 million of infrastructure funding was brought forward into 2018-19 for several projects including the North-South Corridor Northern Connector and Regency Road to Pym Street projects, electrification of the Gawler rail line and the duplication of the Joy Baluch AM Bridge. The change in funding profile has a significant positive impact on the 2018-19 estimated net operating balance given the relatively small operating surplus.

Most of this capital grant funding does not have a corresponding operating expenditure in the 2018-19 operating statement. Rather, the expenditure from this funding is reflected in the ‘purchases of non-financial assets’ line item, which impacts directly on the net lending balance as it is spent. The operating result is impacted once assets are complete and in use through the annual charging of depreciation expense over their useful life.

### 3.1.3 Estimated 2018-19 net lending balance is a deficit of \$579 million compared to an estimated deficit of \$866 million in the 2018-19 Budget

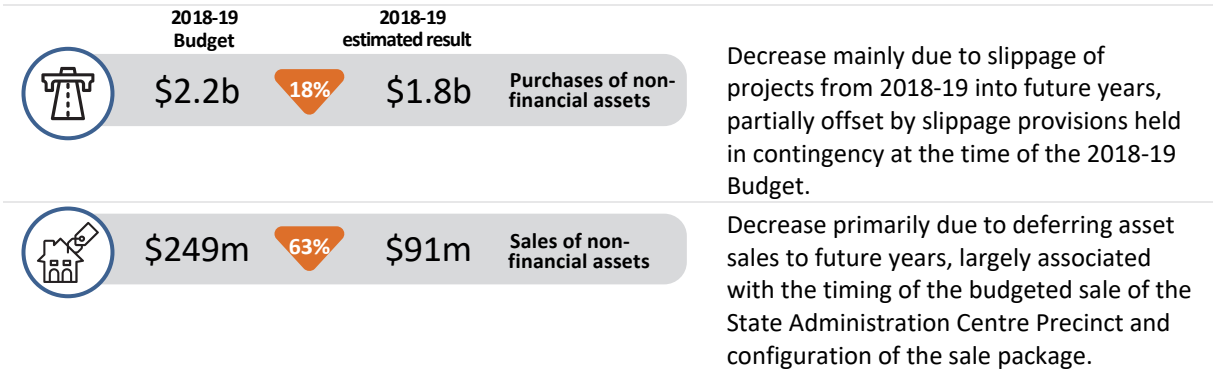
Figure 3.4 shows the revisions made to the estimated 2018-19 net lending balance<sup>6</sup> since the 2018-19 Budget.

**Figure 3.4: Revisions made to 2018-19 net lending balance**

2018-19 net lending balance	Amount
2018-19 Budget estimate	\$866 million deficit
2018-19 MYBR estimate	\$676 million deficit
2019-20 Budget estimate	\$579 million deficit

Figure 3.5 illustrates the key factors driving the \$287 million (33%) improvement in the estimated 2018-19 net lending balance during the year.

**Figure 3.5: Key account balances contributing to variance between 2018-19 budget and estimated result for net lending balance**



<sup>5</sup> Payments from the Commonwealth to support specific projects, facilitate major reforms and/or reward States that deliver on nationally significant reform.

<sup>6</sup> The State’s financing requirement, calculated as the net operating balance less the net acquisition of non-financial assets. A positive result (surplus) reflects a net lending position and a negative result (deficit) reflects a net borrowing position.

### 3.1.4 Unfunded superannuation liability is estimated to be \$2.1 billion higher than budget

The State's unfunded superannuation liability is estimated to be \$12.9 billion at 30 June 2019, \$2.1 billion higher than the estimate at the time of the 2018-19 Budget. The increase is largely due to the use of a lower discount rate to value the liability (2.9% in the 2018-19 Budget compared to 2.1% in the 2019-20 Budget).

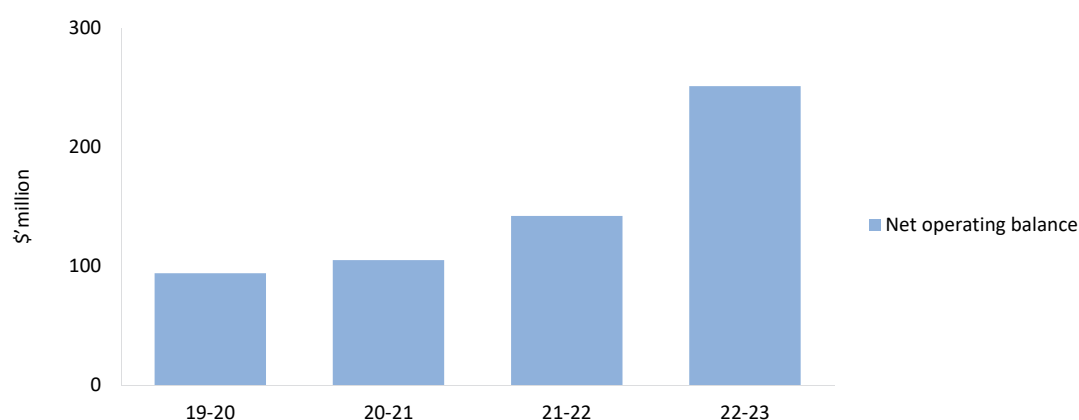
## 3.2 Trends in key fiscal aggregates

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### 3.2.1 Net operating balance target expected to be met for all four years of the 2019-20 Budget

The SA Government has a target of achieving a net operating surplus in the general government sector every year, to enable the funding of operating expenditures from operating revenues. Figure 3.6 shows net operating surpluses are forecast for all four years of the Budget consistent with fiscal targets, ranging from \$94 million in 2019-20 to \$251 million in 2022-23.

**Figure 3.6: General government sector net operating balance from 2019-20 to 2022-23**



The new revenue standards (AASB 15 and AASB 1058) have a material impact on the net operating balance from 2019-20 and contribute favourably to achieving net operating surpluses across the four years of the Budget. The impact of these standards is explained in section 3.3.

### 3.2.2 Robust budget management is essential to achieving the fiscal target of consistent operating surpluses

As the net operating surpluses over the four years of the Budget are modest, robust budget management must be maintained to achieve the fiscal target of consistent operating surpluses. This includes measures identified in the Budget to address key risks such as

limiting growth in employee expenses, achieving agency efficiency dividends and achieving budgeted savings in the Health and Wellbeing portfolio.

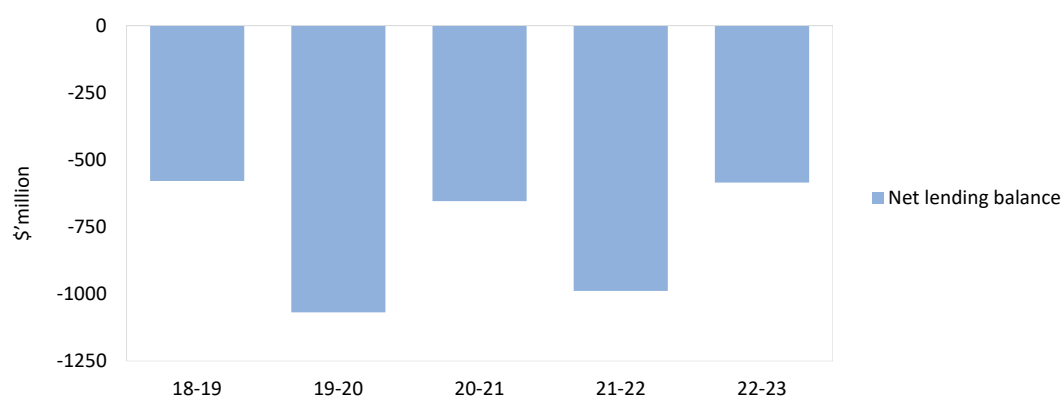
Most agencies achieved their savings targets in 2018-19 and DHW was the only agency to receive funding related to the non-achievement of savings targets.

Further detail on strategies implemented by the SA Government to manage budget risks and progress against savings targets is provided in section 6.

### 3.2.3 Large net lending deficits expected for all four years of the 2019-20 Budget due mainly to the significant capital program

Figure 3.7 shows significant net lending deficits are expected for all four years of the 2019-20 Budget. The deficit peaks in 2019-20 at \$1.069 billion before declining to \$585 million by the end of the forward estimates.

**Figure 3.7: General government sector net lending balance from 2019-20 to 2022-23**



The net lending deficits reflect the SA Government's significant capital program. The relationship between increases in net debt arising from consistent net lending deficits and the purchase of non-financial assets is highlighted in figure 3.9. Section 7 provides further detail on the State's capital program, borrowings and net debt.

### 3.2.4 Change to Fiscal Target 3 to capture NFPS debt

The SA Government sets out its fiscal strategy and fiscal targets in the Budget, along with its performance against those targets.

Fiscal Target 3 was revised from 'Achieve a level of general government net debt that is sustainable over the forward estimates' to 'Achieve a level of net debt that is sustainable over the forward estimates'. It was revised to broaden the focus of net debt levels from the general government sector to the non-financial public sector (NFPS), on the basis that responsible debt management should be considered and monitored at a whole-of-government level. The revised target now also captures net debt from the public non-

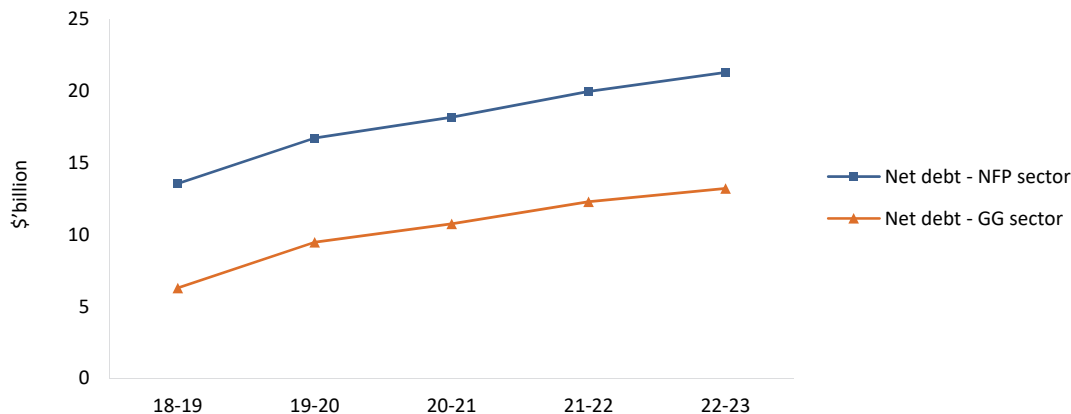
financial corporation (PNFC) sector, which includes SA Water, the Urban Renewal Authority and the SAHT.

The SA Government has not set a clear and measurable target for Fiscal Target 3 to assess its performance against. What is considered to be a sustainable level of debt over the forward estimates is subjective, and without quantitative measures it may be difficult to measure whether this fiscal target has been satisfactorily achieved.

### 3.2.5 Significant increase in net debt across the four years of the Budget

Figure 3.8 shows general government sector net debt is expected to increase by \$6.9 billion from \$6.3 billion in 2018-19 to \$13.2 billion in 2022-23, while NFPS net debt will increase by \$7.7 billion from \$13.6 billion to \$21.3 billion in that period.

Figure 3.8: Net debt from 2018-19 to 2022-23

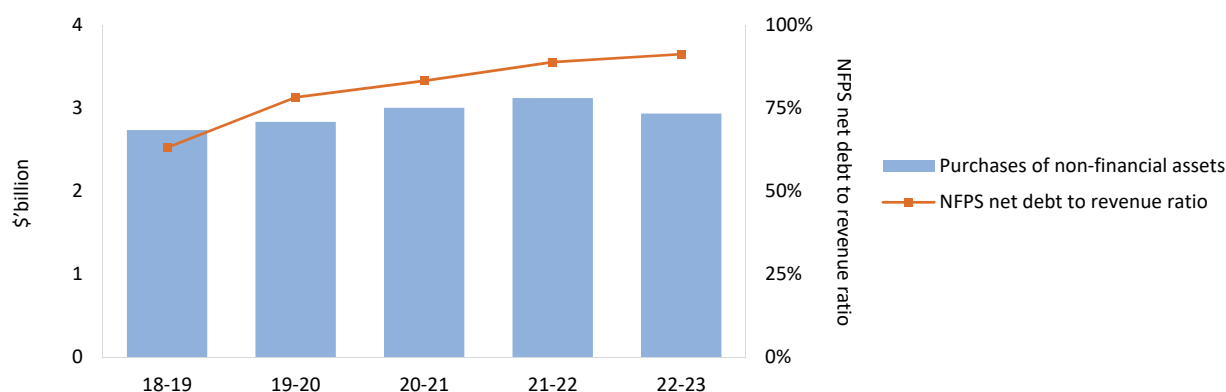


The substantial increase in net debt over the four years of the Budget largely reflects increased borrowings to fund the SA Government’s significant infrastructure program in the general government sector, as well as the impact of reporting changes due to the new leases accounting standard. This new standard aims to provide a more fair and accurate representation of lease transactions by bringing operating leases to account on the balance sheet. Its impact is further explained in section 3.3.

### 3.2.6 NFPS net debt to revenue is projected to increase from 78% in 2019-20 to 91% in 2022-23

Figure 3.9 shows a consistent upward trend in the NFPS net debt to revenue ratio over the four years of the Budget, climbing from 78% in 2019-20 to 91% in 2022-23. This reflects expected net lending deficits for all four years of the Budget due to a significant capital expenditure program. Purchases of non-financial assets average \$3 billion annually over the four years of the Budget.

**Figure 3.9: NFPS net debt to revenue ratio and purchases of non-financial assets from 2018-19 to 2022-23**



Despite the significant growth in net debt, the SA Government expects this growth to be sustainable on the basis that the State has maintained operating surpluses across the forward estimates and it can tailor its operating expenditure decisions over time to manage its financial position and maintain those surpluses.

The Budget also highlights that South Australia's net debt is in line with other jurisdictions with similar if not higher credit ratings.

Section 7.3 provides further details on the State's projected net debt levels and associated risks.

### 3.3 Accounting standards and budget presentation changes

#### 3.3.1 The 2018-19 estimates are not prepared on the same basis as the budget and forward estimate years due to new accounting standards

The following new accounting standards issued by the Australian Accounting Standards Board were applied for the first time in the 2019-20 Budget from 2019-20:

- AASB 15 *Revenue from Contracts with Customers*
- AASB 1058 *Income of Not-for-Profit Entities*
- AASB 16 *Leases*.

As the new accounting standards are effective from 1 July 2019 they do not apply to the 2018-19 estimates.

The transitional impacts of the new accounting standards are reflected in Appendix F of 2019-20 Budget Paper 3.



### 3.3.2 Structural presentation break in 2019-20 complicates comparisons with prior years

In addition to the new accounting standards, presentation changes have been applied from 2019-20 to achieve full compliance with the UPF.

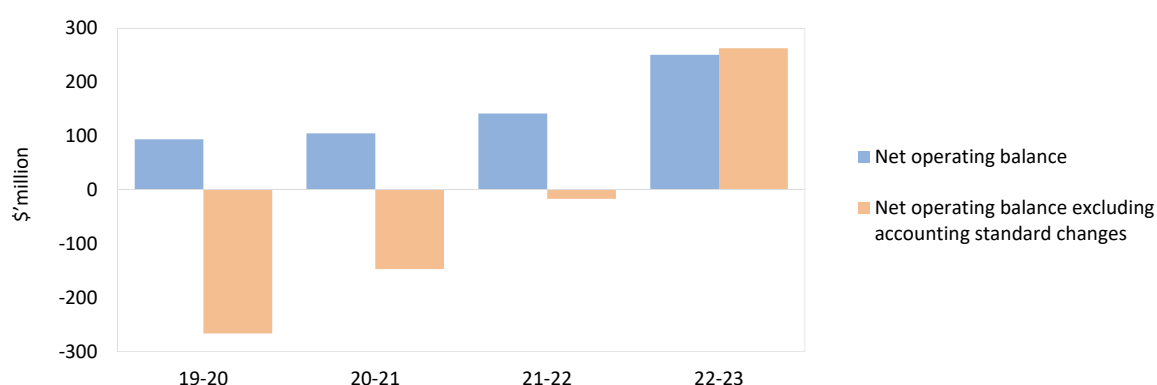
These accounting and budget presentation changes result in a structural break<sup>7</sup> in 2019-20 and therefore figures presented in the 2019-20 Budget are not directly comparable with Budgets from previous years.

### 3.3.3 Changes to accounting standards significantly impact key fiscal aggregates

Changes to the revenue and leases accounting standards have a material impact on the presentation of budget and forward estimates from 2019-20. The impact of the new standards on key fiscal aggregates is quantified in Appendix F of 2019-20 Budget Paper 3.

Figure 3.10 illustrates the significant favourable impact of the new accounting standards on net operating surpluses from 2019-20 to 2021-22, mostly due to the new revenue accounting standards.

**Figure 3.10: Impact of new accounting standards on general government net operating balance**

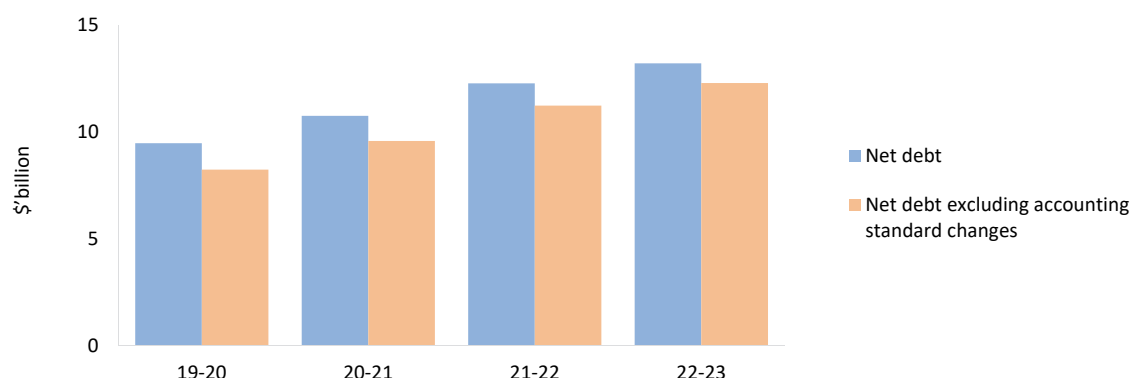


	2019-20 \$'million	2020-21 \$'million	2021-22 \$'million	2022-23 \$'million
General government sector				
Net operating balance	94.0	105.0	142.0	251.0
Less:				
Impact of new revenue accounting standards	(393.1)	(275.8)	(178.4)	(3.0)
Impact of new leases accounting standard	32.5	23.7	19.9	15.2
Net operating balance excluding accounting standard changes	(266.6)	(147.1)	(16.5)	263.2

<sup>7</sup> Discontinuity in the consistency of budget data over time due to structural changes such as measurement methods, definitions, presentation requirements and administrative transfers.

As noted in section 3.2.5, the substantial increase in net debt over the four years of the Budget is partly driven by the impact of the new leases accounting standard, which increases general government net debt by \$1.2 billion in 2019-20, reducing to a \$900 million increase by 2022-23. The impact of this standard on net debt is shown in figure 3.11.

**Figure 3.11: Impact of new accounting standards on general government net debt**



	2019-20 \$'billion	2020-21 \$'billion	2021-22 \$'billion	2022-23 \$'billion
General government sector				
Net debt	9.47	10.75	12.28	13.21
Less:				
Impact of new revenue accounting standards	-	-	-	-
Impact of new leases accounting standard <sup>(1)</sup>	(1.23)	(1.17)	(1.05)	(0.92)
Net debt excluding accounting standard changes	8.23	9.58	11.23	12.29

Note: Totals may not add due to rounding.

<sup>(1)</sup> An increase in net debt of \$1.23 billion was initially recognised in 2019-20 and this debt remains on the balance sheet over the ensuing years of the budget. The amount of the lease liability declines over the forward estimates as the leases are amortised in line with the accounting standard.

## New revenue standards

The Australian Accounting Standards Board has introduced new revenue recognition models for contracts with customers (AASB 15) and not-for-profit entities (AASB 1058).

The new standards aim to align when revenue is recognised more closely with the timing of related expenditure. Appendix F of 2019-20 Budget Paper 3 explains the nature of the revenue standard changes.

An assessment by DTF identified national partnership Commonwealth grants as being the main revenue type affected by the transition to the new standards.

Effectively, \$850 million in grant revenue for certain obligations has been recognised in the 2018-19 estimated result or prior years, as well as in the four years of the Budget. This approach is in keeping with the transitional arrangements of the new accounting standards.

Figure 3.12 shows the profiling of revenue impacted by the transitional arrangements over the four years of the Budget, which flows through to the net operating balance and net lending result.

**Figure 3.12: Revenue impacted by the transitional arrangements**

General government sector	Revenue recognised under old accounting standards in 2018-19 and/or prior years \$'million	Revenue recognised under the new accounting standards			
		2019-20 \$'million	2020-21 \$'million	2021-22 \$'million	2022-23 \$'million
Revenue impacted by transitional arrangements	850	393	276	178	3
		850			

Most of this revenue is infrastructure related grants expended by the Department of Planning, Transport and Infrastructure. The budget from 2019-20 reflects revenue being earned in line with when project costs are expected to be incurred. Significant judgement is required in determining when costs are expected to be incurred. Further, when actual revenue is recognised may vary as construction programs and the timing of associated costs change. A contract liability has been recognised on the balance sheet where grants are received prior to related expenditure being incurred. The liability reduces as revenue is earned (in line with when expenditure is incurred).

Under the transitional arrangements, comparative figures are not required to be restated. Instead, the cumulative effect of the new standards has been applied as an adjustment to opening net worth as at 1 July 2019. This is reflected in table 4.9 of 2019-20 Budget Paper 3 as an \$856 million decrease to net worth as at 1 July 2019.

### New leases standard

The new leases standard (AASB 16) requires certain leases that were previously classified as operating lease commitments to be recognised on the balance sheet from 2019-20, resulting in a substantial increase in reported net debt from 1 July 2019.

AASB 16 aims to improve the transparency of financial information by providing better information that more faithfully represents lease transactions.

The new leases standard results in:

- recognising a right-of-use asset and lease liability
- changes to the pattern and timing of lease related expenses, with higher upfront expenses and expenses now shown as interest and depreciation expenses.

The increase in net debt from the change in accounting treatment is a reporting change rather than an actual deterioration in the State's financial position relating to new borrowing activity.

Appendix F of 2019-20 Budget Paper 3 compares the treatment of leases under the old and new accounting standards.

## Budget presentation changes

The presentation of the 2019-20 Budget has changed to achieve full compliance with the UPF. These presentation changes, which are reflected from 2019-20, align more closely with other reports produced using Australian Accounting Standards.<sup>8</sup> Appendix F of 2019-20 Budget Paper 3 indicates that the budget presentation changes have no impact on key budget indicators. The impacts largely relate to certain assets no longer being offset by related liabilities (eg Treasurer's deposits and borrowings with/from the South Australian Government Financing Authority (SAFA)), and certain revenues no longer being offset by related expenses (eg interest revenues and expenses). The reclassification amounts disclosed in table F.5 of Appendix F of 2019-20 Budget Paper 3 are based on balances at the time of the 2018-19 mid-year budget review (MYBR) and therefore may differ from the balances for relevant line items published in the 2019-20 Budget.

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<sup>8</sup> 'Australian Accounting Standards' means accounting standards issued by the Australian Accounting Standards Board that are in force in relation to the reporting period to which the financial report relates.

## 4 Major policy and parameter variations since the 2018-19 Budget

### Key points

- Modest operating surpluses are expected for all four years of the Budget.
- Commonwealth GST revenue grants were revised significantly downwards (\$2.1 billion) compared to the previous year's Budget.
- Commonwealth Government national partnership grants were revised up in 2018-19 (\$855 million) and down in all future years (\$1.183 billion between 2019-20 and 2021-22).
- Significant revenue policy initiatives introduced in the 2019-20 Budget are expected to raise \$670.9 million over the four years of the Budget.
- A once-off grant payment of \$602 million was made to the SAHT in 2018-19 to restructure its operations and support its viability.
- \$95 million was budgeted for 2018-19 and \$356 million over the four years of the Budget for the policy measure in the Health and Wellbeing portfolio to establish a sustainable and efficient health system. This measure effectively reduces the Health and Wellbeing savings targets from past budgets.
- The 2019-20 Budget introduces new operating savings measures totalling \$361.6 million over the four years of the Budget.

### 4.1 Budget variations since the 2018-19 Budget

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Each year the Budget Papers include a reconciliation of the current budget estimates with the corresponding estimates for the previous year. This explains differences between Budgets arising from the SA Government's two key budget variation categories:

- Policy changes – decisions made by the SA Government to increase or decrease taxation, fees and charges and spending.
- Parameter changes – variations that do not flow from policy choice changes. Revenue parameter changes include changes in taxation driven by economic activity and changes in grant revenue received from the Commonwealth. Expense parameter changes include carryovers between years to reflect timing differences, reclassifications and corrections.

Figure 4.1 summarises all policy and parameter changes made since the 2018-19 Budget that affect the net operating balance.<sup>9</sup>

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<sup>9</sup> Sourced from 2019-20 Budget Paper 3 *Budget Statement*, table 1.6.

**Figure 4.1: Reconciliation of general government sector net operating balance**

	2018-19 Estimated result \$'million	2019-20 Budget \$'million	2020-21 Estimate \$'million	2021-22 Estimate \$'million
2018-19 Budget estimated net operating balance	48	105	166	211
Parameter and other variations:				
Revenue – taxation	(23)	(211)	(225)	(228)
Revenue – other	767	285	40	(54)
Operating expenses	(488)	(107)	(110)	(121)
Net effect of parameter and other variations	256	(33)	(295)	(403)
Policy measures:				
Revenue – taxation	-	36	76	76
Revenue – other	28	84	105	109
Revenue – offsets	7	20	9	10
Revenue investing offsets	-	54	156	267
Operating expenses	(239)	(252)	(205)	(221)
Operating savings	-	80	92	94
Net effect of policy measures	(204)	22	233	335
2019-20 Budget estimated net operating balance	101	94	105	142

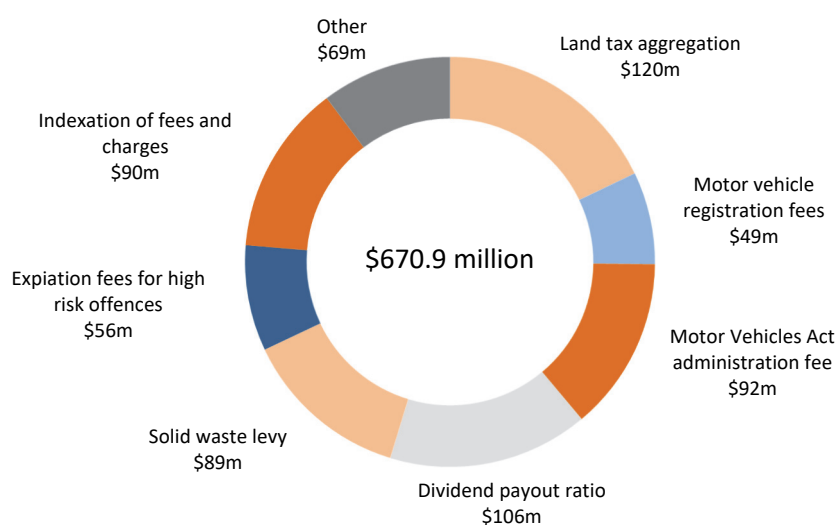
Note: Totals may not add due to rounding. Brackets mean an unfavourable change.

## 4.2 Revenue policy and parameter variations

### 4.2.1 Revenue policy variations

The SA Government has introduced significant revenue measures in the 2019-20 Budget that are expected to raise \$670.9 million over the four years of the Budget. Figure 4.2 shows the quantum of major revenue measures.

**Figure 4.2: Revenue policy measures in the 2019-20 Budget**



The revenue policy measures include increases such as:

- motor vehicle registration fee increases above standard indexation
- Motor Vehicles Act administration fee increases
- changes to the dividend payout ratio for government businesses where the payout ratio will increase from 95% to 100% of profit after tax
- increases to the solid waste levy
- an increase in expiation fees for high risk offences
- above standard indexation of a range of government fees and charges. A 5% increase to most government fees and charges will apply from 2019-20.

The SA Government has also flagged land tax reforms in the 2019-20 Budget that will commence from 2020-21, including:

- land tax aggregation and introducing a surcharge on land held within specific trusts
- progressively reducing the existing top land tax rate for ownerships above \$5 million.

These reforms are on top of changes to land tax thresholds and rates introduced in the 2018-19 Budget that reduce land tax revenues. The impact of the land tax reforms in the 2018-19 and 2019-20 Budgets is summarised in figure 4.3.

**Figure 4.3: Expected impact of recent land tax revenue reforms**

Land tax revenue measure	2019-20 \$'million	2020-21 \$'million	2021-22 \$'million	2022-23 \$'million
2018-19 Budget land tax reform	-	(47.2)	(48.7)	n/a
2019-20 Budget phased reduction in top marginal tax rate	-	(2.7)	(5.6)	(8.6)
2019-20 land tax aggregation	-	40	40	40

DTF advised that it estimated collections from the land tax aggregation measure based on information available at the time. As this information was based on taxpayer data collected by RevenueSA under the current land tax aggregation regime, the ability to forecast the impact of a substantially different aggregation system was limited. As a result, a range of broad estimation methods were adopted, reflecting that a number of different aggregation models/options were still being considered by the SA Government and would be informed by a consultation process before introducing legislation into Parliament.

In September 2019, the SA Government announced further changes to the land tax reform package. DTF advised that these changes will reduce revenue by around \$27 million over the period 2020-21 to 2022-23 compared to that included in the 2018-19 and 2019-20 Budgets.

DTF also advised that the 2019-20 Budget estimates include an expected increase in land tax revenue of around \$19 million by 2022-23 as a result of the Valuer-General's revaluation initiative. DTF indicated that this is consistent with provisions made in previous budgets.

Table 3.1 of 2019-20 Budget Paper 3 summarises the revenue measures in the budget.

## 4.2.2 Revenue parameter variations

Figure 4.4 shows the components of revenue parameter changes.<sup>10</sup>

**Figure 4.4: Revenue parameter changes since the 2018-19 Budget**

	2018-19 Estimated result \$'million	2019-20 Budget \$'million	2020-21 Estimate \$'million	2021-22 Estimate \$'million
State taxation:				
Conveyances	(43)	(76)	(82)	(90)
Budget presentation changes	-	(158)	(162)	(162)
Other	20	23	19	24
GST revenue grants	(171)	(517)	(667)	(719)
Other Commonwealth grants:				
Special purpose	55	149	149	181
National partnership	798	(337)	(401)	(404)
Sales of goods and services	41	24	(1)	(2)
Other contributions and grants	5	6	(1)	(1)
Dividends and income tax equivalents	18	(88)	5	19
Interest income	(2)	(64)	(75)	(120)
Royalties	24	30	29	22
Other	(1)	56	44	23
Budget presentation changes	-	647	698	784
Accounting standard changes	-	378	261	164
<b>Total</b>	<b>744</b>	<b>73</b>	<b>(184)</b>	<b>(281)</b>

Note: Totals may not add due to rounding.

### Commonwealth GST revenue grants revised significantly downwards

GST revenue grants were revised down by \$171 million in 2018-19 and a further \$1.9 billion over the period 2019-20 to 2021-22. The downward revisions reflect the impact of both lower forecasts for the national GST pool and South Australia's estimated share of the pool. South Australia's GST distribution relativity changed from 1.47727 in 2018-19 to 1.46552 in 2019-20.

GST revenue grants, including the Commonwealth framework for calculating the grants, are discussed further in section 5.

### Other Commonwealth grants revisions

Commonwealth Government ongoing tied grants were revised up by \$479 million between 2019-20 and 2021-22, primarily reflecting additional funding for non-government schools under the National School Reform Agreement. From 2019-20, revisions also reflect higher forecast funding for health services as a result of additional activity.

<sup>10</sup> Sourced from 2019-20 Budget Paper 3 *Budget Statement*, table 1.8 and 2018-19 MYBR, table 1.7.



Commonwealth Government national partnership grants were revised up in 2018-19 (\$855 million) and down in all future years (\$1.183 billion between 2019-20 and 2021-22), mainly reflecting the outcome of negotiations with the Commonwealth Government to pull forward existing infrastructure funding into 2018-19 for several projects and updated estimates of future Commonwealth funding.

### Budget presentation and accounting standard changes

The 2019-20 Budget<sup>11</sup> also identifies large parameter variations associated with budget presentation and accounting standard changes.

While the budget presentation changes are significant, they largely offset each other in the revenue and expense lines and have no material impact on the net operating balance. Accounting standard changes, however, do affect the net operating balance. This impact is explained in Appendix F of 2019-20 Budget Paper 3.

These changes are discussed further in section 3.3.

### 4.2.3 Conveyance duty largely depends on residential property market activity

Conveyance duties are sensitive to both transaction levels and property prices. The Budget assumes property prices will grow moderately by about 3% p.a. over the forward estimates and that underlying property transfers will grow moderately over the forward estimates and return to long-term levels.

The Budget comments on the difficulty in predicting trends in property market values and activity levels, particularly transaction numbers which can change significantly from year to year. This makes forecasting conveyance duties difficult. Since 1999-2000 the annual growth in conveyance duty revenue has ranged from negative 20% to positive 42%.

For the years from 2018-19 to 2021-22 conveyance duty revenue was revised down by \$184 million in the 2019-20 Budget. This mainly reflects lower than expected growth in residential property transfers in 2018-19 which flows through to future years. The 2018-19 MYBR also revised down conveyance duty revenue over the same four year period by \$107 million.

## 4.3 Expense policy and parameter variations

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### 4.3.1 Operating expense parameter variations

The major expenditure parameter variations impacting the net operating balance in the 2019-20 Budget include the following:

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<sup>11</sup> See 2019-20 Budget Paper 3 *Budget Statement*, table 1.8.

- The nominal superannuation interest expense was revised down by around \$50 million per year since the 2018-19 MYBR due to a lower discount rate used to calculate the expense. The discount rate used to calculate the superannuation interest expense in the 2019-20 Budget is 2.1% compared with 3% assumed in the 2018-19 MYBR.
- Interest expenses between 2019-20 and 2021-22 were revised down by \$219 million since the 2018-19 MYBR as a result of lower interest rates, partially offset by higher levels of debt.
- There were significant movements in other variations mainly due to the revised funding arrangements for the SAHT. This includes a once-off grant payment in 2018-19 of \$602 million to restructure its operations and support its viability. Grants are also reduced across the forward estimates as the SAHT will receive significant equity injections.

The Budget also includes significant variations for budget presentation changes between 2019-20 and 2021-22, totalling \$1.65 billion in increased expenses. However, these increased expenses are offset by equivalent increases in revenue parameter variations and therefore have no impact on the net operating balance. The adjustments relate to changes to ensure full compliance with the UPF and reflect the practice to no longer offset certain revenue against related expenses. These revenues and expenses are now presented in the Budget as gross amounts. Appendix F of Budget Paper 3 explains these changes in detail.

### 4.3.2 Operating expense policy variations

Figure 4.5 shows the value of operating expense policy measures taken in each of the past five years after presenting the Budget for the year.<sup>12</sup>

**Figure 4.5: Policy spending decisions**

	2014-15 \$'million	2015-16 \$'million	2016-17 \$'million	2017-18 \$'million	2018-19 \$'million
Policy measure operating expenses	164	272	247	470	239

Figure 4.5 shows that \$1.392 billion in total was added to spending for the past five years at an average of \$278 million per year.

Policy spending decisions since the 2018-19 Budget are expected to add a further \$917 million to operating expenses over the four years to 2021-22.

The most significant policy measure is for Health and Wellbeing to establish a sustainable, efficient health system. \$95 million was budgeted for 2018-19 and \$356 million over the four years of the 2019-20 Budget. This measure effectively reduces the Health and Wellbeing savings targets from past budgets and is discussed further in section 6.6.3.

Numerous smaller initiatives make up the remainder of the expenditure measures, and are summarised at page 20 of Budget Paper 3.

<sup>12</sup> 2019-20 Budget Paper 3 *Budget Statement*, table 1.6.

### 4.3.3 Operating savings policy variations

The 2019-20 Budget introduces new operating savings measures totalling \$361.6 million over the four years of the Budget. The Budget notes that these savings are necessary to partially offset the significant reduction to GST revenue since the 2018-19 MYBR. Table 2.5 of Budget Paper 3 summarises these operating savings by agency.

These savings are in addition to new operating savings previously introduced in the 2018-19 Budget of \$964.8 million over four years.

Savings are discussed further in section 6.7.

## 4.4 Investing policy measures

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The general government investing program is \$9.7 billion over the four years of the 2019-20 Budget, with \$2.6 billion to be spent in 2019-20. The major new investing initiatives are primarily in the transport infrastructure area and include:

- \$252 million over four years for planning and early works to complete the remaining sections of the North-South corridor. There are significant costs for this project past the forward estimates. The total project cost estimate included in Budget Paper 4 is \$5.422 billion
- \$231 million over three years for a grade separation of the Gawler rail line at the Torrens Road/Ovingham level crossing
- \$280 million over four years for seven metropolitan intersection upgrades
- an additional \$163 million over five years to 2022-23 for government high schools to address enrolment growth and other capital works, including increasing capacity at a number of schools to facilitate transition of Year 7 students into high school in 2022
- \$143 million from 2021-22 towards road safety improvements for rural roads, including additional overtaking lanes and shoulder sealing to facilitate increased speed limits.

The Commonwealth Government will provide at least 50% of the funding for the transport infrastructure upgrades detailed above.

The 2019-20 Budget also provides \$550 million to complete the planning and start construction of a new Women's and Children's Hospital and \$150 million for a new Aboriginal Art and Cultures Gallery at Lot Fourteen. The hospital funding will progress development of the preferred clinical model and the necessary scoping and design work for a fully costed business case. The total project cost for the gallery is to be determined and will depend in large part on the building design.

Section 7.2 provides further details on the expanded capital program and associated risks.

## 5 Revenue

### Key points

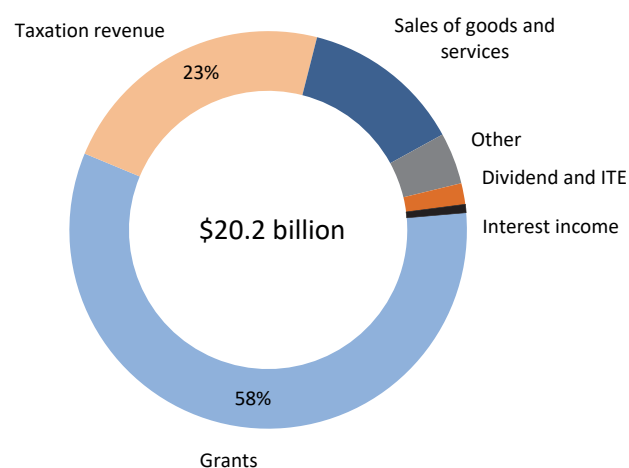
- Grant and taxation revenues are expected to comprise 81% of the State's total revenue in 2019-20.
- Most of the State's revenue is sourced from the Commonwealth Government, at an average of 57% over the four years of the Budget.
- The State has a significant risk exposure to reductions in GST revenue. GST revenue is projected to grow more slowly over the four years of the Budget than in recent years, however recent experience highlights difficulties in accurately estimating it.
- Steady increases in conveyance duty estimated over the four years of the Budget contrasts with recent historical experience of downward revisions for this revenue. The State may have difficulty achieving the conveyance duty estimates in the 2019-20 Budget.
- Significant increases in other user charges (\$307 million) and regulatory fees (\$55 million) are expected between 2018-19 and 2019-20 owing to budget presentation changes and projected increases in fees under the *Real Property Act 1886* and solid waste levy revenue.
- Dividend and ITE income is expected to drop sharply in 2018-19 and 2019-20 as proceeds from the Motor Accident Commission (MAC) privatisation wind down.
- SA Water will provide 76% of dividend and ITE income by 2022-23, which increases the State's exposure to SA Water operations in achieving budgeted outcomes.

### 5.1 Composition of total revenue

#### 5.1.1 Grant and taxation revenues expected to represent 81% of total revenue in 2019-20

Figure 5.1 shows that total budgeted revenue in 2019-20 primarily comprises grants of \$11.6 billion (58%) and taxation revenue of \$4.6 billion (23%).

**Figure 5.1: 2019-20 general government revenue by class**

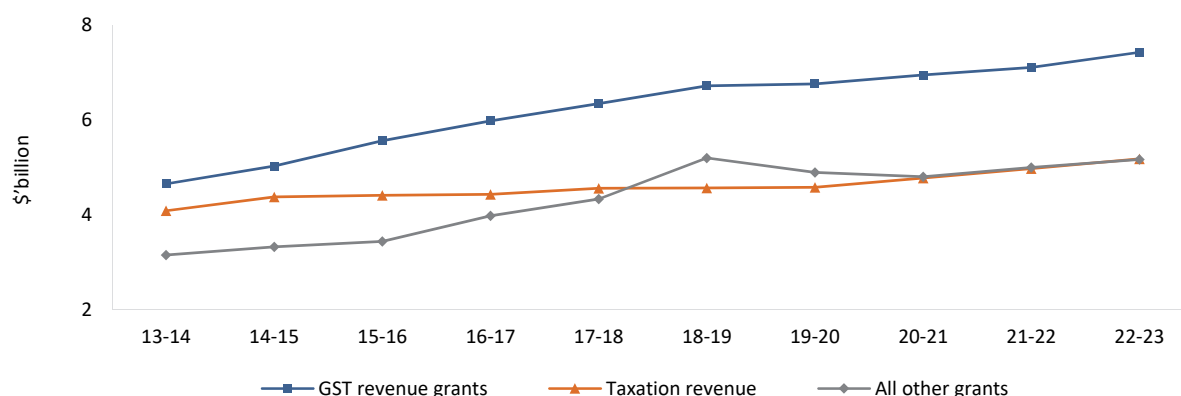


GST revenue is the largest component of grants (58%). Payroll tax, property taxes and conveyance duties make up 65% of taxation revenue.

Taxation revenue and fees and charges within sales of goods and services are the SA Government's primary discretionary revenue instruments, whereas grant revenue is almost entirely sourced from the Commonwealth Government.

Figure 5.2 shows expected trends for the major revenue items in the 2019-20 Budget against the experience of the five years to 2017-18.

**Figure 5.2: General government sector Commonwealth grants and taxation revenue**



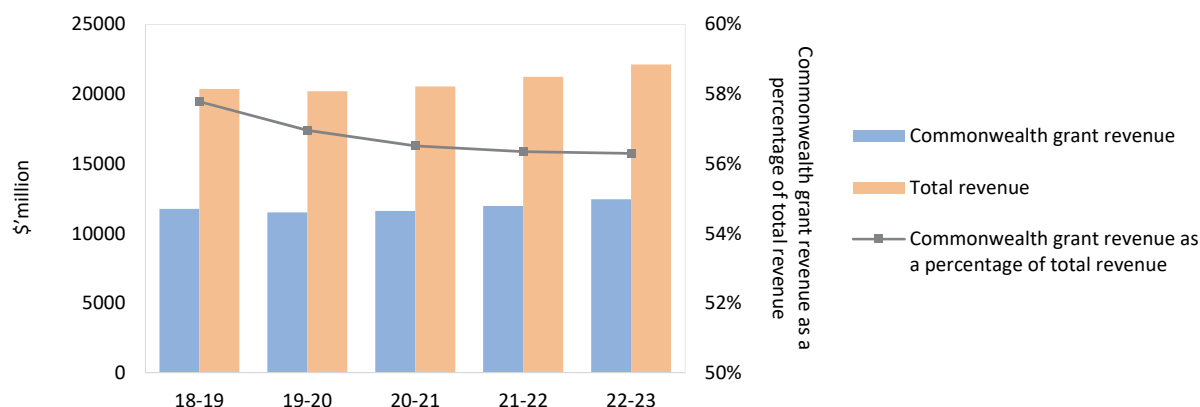
GST revenue is expected to continue growing over the four years of the Budget, however at a lower rate than experienced in the previous six years. Taxation revenue is expected to grow moderately, while other grants will increase again from 2021-22 after dipping in 2019-20 and 2020-21.

Further details on trends in GST and taxation revenue are provided in sections 5.2 and 5.3. The peak in all other grants revenue in 2018-19 is mainly due to significant Commonwealth capital grant funding being brought forward, as discussed in section 3.1.2.

### 5.1.2 The State's reliance on Commonwealth grant revenue is expected to decrease marginally over the forward estimates

Figure 5.3 shows Commonwealth grants revenue as a percentage of total revenue between 2018-19 and 2022-23.

**Figure 5.3: General government sector Commonwealth grants revenue as percentage of total revenue**



The State's reliance on Commonwealth grant revenue is expected to decrease marginally by the end of the forward estimates, from 57.8% in 2018-19 to 56.3% in 2022-23. This is due mainly to write-downs in GST revenue over the forward estimates and the introduction of new revenue measures to cover the shortfall. Section 4.2 provides further details.

## 5.2 GST revenue

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### 5.2.1 The State has a significant risk exposure to GST revenue reductions

GST revenue is a significant component of the State's revenue base and has the potential to significantly impact the State's budget position. The State has significant risk exposure to reductions in GST caused by downturns in national economic activity driving lower than expected growth in the GST pool and changes in the GST distribution methodology. Risk analysis in the Budget Papers highlights the importance of GST revenue to the Budget projections:

- A 1% change in GST pool growth has a revenue impact for South Australia of about \$68 million p.a.
- A 0.01 change in South Australia's relativity would result in a change in GST revenue grants of about \$42 million.

GST relativities are particularly sensitive to fluctuations in the value of mining output, variations in Commonwealth Government payments between States and differential growth rates in conveyance duty receipts.

### 5.2.2 GST revenue is expected to grow more slowly in 2019-20 and over the forward estimates than in recent years

Figure 5.2 shows that GST revenue grants are expected to be flat between 2018-19 and 2019-20 before growing modestly between 2% and 4% each year over the forward estimates. The growth in GST revenue over the four years of Budget is significantly lower than that experienced between 2014-15 and 2018-19, when growth each year ranged between 6% and 11%.

As noted in section 4.2.2, parameter variations revised GST revenue significantly downwards from 2018-19 to 2021-22. The total decrease in GST over this period is \$2.1 billion.

This is mainly due to the impact of significant downward revisions of around \$11 billion to the national GST pool from 2018-19 to 2021-22 in the Commonwealth's 2019-20 Budget, compared to projections in its 2018-19 Budget. In addition, grant estimates were revised down to reflect a deterioration in South Australia's share of GST grants. This is due to the combined impact of the Commonwealth Grants Commission's 2019 update<sup>13</sup> as well as a forecast higher share of specific purpose and national partnership payments.

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<sup>13</sup> *Report on GST Revenue Sharing Relativities: 2019 update*, Commonwealth Grant Commission, Australian Government, February 2019.

South Australia's per capita relativities for the distribution of GST revenue grants decreased from 1.47727 in 2018-19 to 1.46552 in 2019-20, which when combined with forecast changes in State populations, will result in South Australia receiving 10.1% of the GST pool in 2019-20, compared to 10.2% in 2018-19.

The portion of the \$2.1 billion write-down attributable to changes in the national GST pool is \$1.3 billion, with changes in the State's share of the pool representing \$800 million.

Beyond 2019-20, South Australia's GST relativity is expected to be impacted by further moderation in eastern States' property markets, changes in the State's share of Commonwealth grant payments and below average population growth.

### 5.2.3 Significant variability in estimates over the past four budgets highlights difficulties in accurately estimating GST revenue

Figure 5.4 shows estimated GST revenue for 2019-20, 2020-21 and 2021-22 over the last four Budgets.

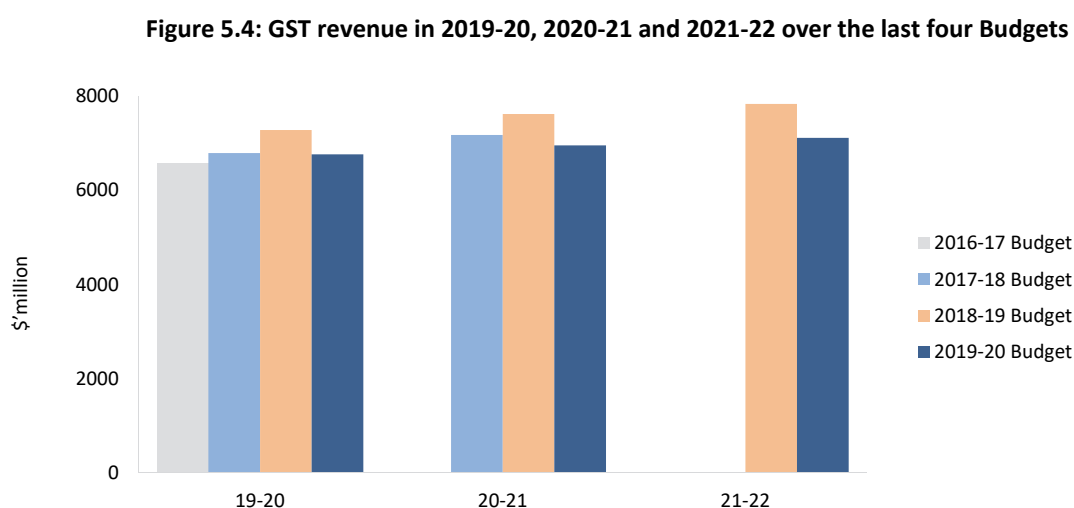


Figure 5.4 indicates that GST revenue estimates were revised significantly upwards in the 2018-19 Budget, before being revised downwards to an even greater extent in the 2019-20 Budget.

This highlights the inherent difficulties and uncertainties associated with accurately estimating GST revenue from year to year, given the number and complexity of factors that drive GST revenue, including national economic conditions, taxation revenues, Commonwealth funding levels and population factors specific to each state.

The Governor of the Reserve Bank of Australia in his monetary policy decision of 3 September 2019<sup>14</sup> indicated 'the main domestic uncertainty continues to be the outlook for consumption'. Domestic consumption expenditure is a key driver of the size of the national GST pool.

<sup>14</sup> Lowe, Philip (Governor) 2019, *Monetary Policy Decision*, media release number 2019-23, Reserve Bank of Australia, Sydney, 3 September, viewed September 2019.

In view of these difficulties and uncertainties, it is important to maintain a robust GST revenue estimation approach to limit variability in estimates between years and ensure budget decisions are made on the most reliable information available.

Section 4.2.2 provides further detail on the GST revenue parameter variations reflected in the 2019-20 Budget.

## 5.2.4 New revenue measures expected to reduce the State's reliance on GST revenue

The significance of GST and taxation revenue is demonstrated in figure 5.5, which shows the actual ratio of GST and taxation revenue to total general government sector revenue up to 2017-18 and the estimated ratio from 2018-19 to 2022-23.

**Figure 5.5: GST revenue and taxation revenue as a percentage of total revenue**

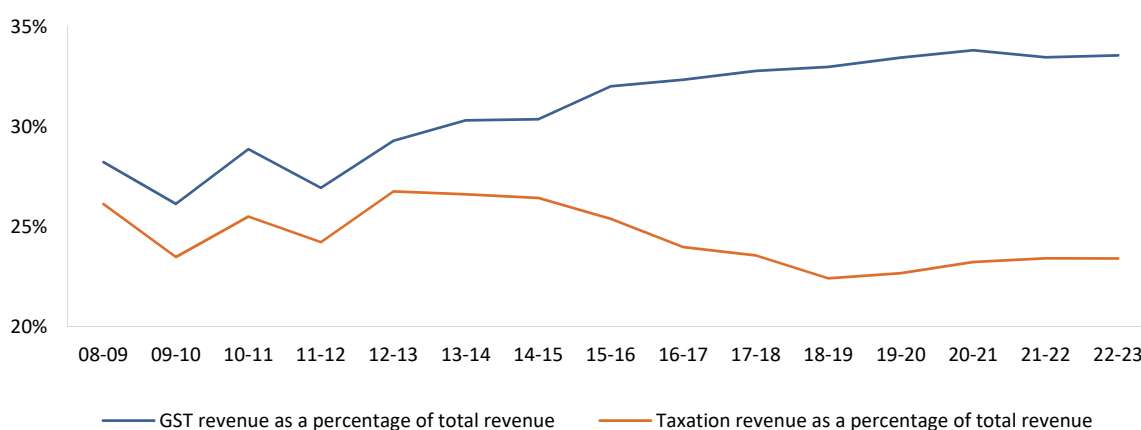


Figure 5.5 shows the gap between the GST and taxation revenue ratios widened between 2013-14 and 2019-20 as a greater proportion of total revenue came from GST revenue grants and a diminishing proportion from taxation revenue. This trend has changed from 2020-21 onwards, with the GST revenue ratio and taxation revenue ratio expected to remain relatively constant over the forward estimates.

The GST revenue ratio has also decreased compared to the 2018-19 Budget. The GST revenue ratios over the four years of the 2019-20 Budget range between 33% and 34%, whereas the GST revenue ratio was as high as 37% in the four years of the 2018-19 Budget.

The new trends in the GST revenue ratio reflect the combined impact of GST revenue write-downs from 2018-19 and new revenue measures introduced from 2019-20 to address the shortfall, including taxation revenue measures. Further detail on the GST write-downs and new revenue measures is provided in section 4.2.

## 5.2.5 Changes to the GST distribution model

In November 2018, the Federal Parliament passed the Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018, which produces a new



GST distribution system over a six-year transitional period commencing in 2021-22. Key provisions of the legislation include:

- a shift from full equalisation to partial equalisation, with States' fiscal capacities equalised to the stronger of New South Wales or Victoria rather than the fiscally strongest State
- introducing a minimum GST relativity of 0.7 in 2021-22, to be increased to 0.75 in 2024-25
- a permanent Commonwealth top-up to the GST pool, indexed to growth in the GST pool
- a guarantee that States will receive at least the same amount of GST grants as they would have received under the current system (in cumulative terms) over the transition period due to the change in the equalisation objective
- a review of the new system to be conducted by the Productivity Commission by December 2026.

The legislated 'no worse-off' guarantee only provides a level of certainty for the States over the six year transition period from 2021-22. There is a risk the State may receive lower GST revenue than it otherwise would have under the previous system when the transition period ceases.

DTF advised that the 2019-20 Budget estimates the legislative amendments will result in a \$26 million increase in South Australia's GST revenue grant in 2021-22 compared to the current system of full Horizontal Fiscal Equalisation. This is impacted by the additional Commonwealth contribution to the GST pool of \$600 million in 2021-22. At the time of the 2019-20 Budget, DTF estimated there was no net impact from the legislative amendments in 2022-23.

Separate to these new arrangements, the Commonwealth Grants Commission is also reviewing the methodology it uses to calculate the relativities used by the Commonwealth Government to distribute GST revenue grants to achieve Horizontal Fiscal Equalisation. Methodology reviews are done about every five years, with the last review completed in February 2015. The current review is scheduled for completion by February 2020. The outcomes from it will influence the distribution of GST revenue grants from 2020-21.

## 5.3 Taxation revenue

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### 5.3.1 Historical growth in payroll tax between years was relatively consistent while conveyance duty was more volatile

The two largest items of State taxation are payroll tax and conveyance duty. Historically, growth in payroll tax was relatively consistent between years while conveyance duty was more variable.

The difference in the volatility of these two taxation revenue sources is represented in figure 5.6, which shows actual annual nominal percentage changes from 2007-08 to 2017-18 and the estimated changes from 2018-19 to 2022-23.

**Figure 5.6: Annual percentage change in payroll tax and conveyance duty**

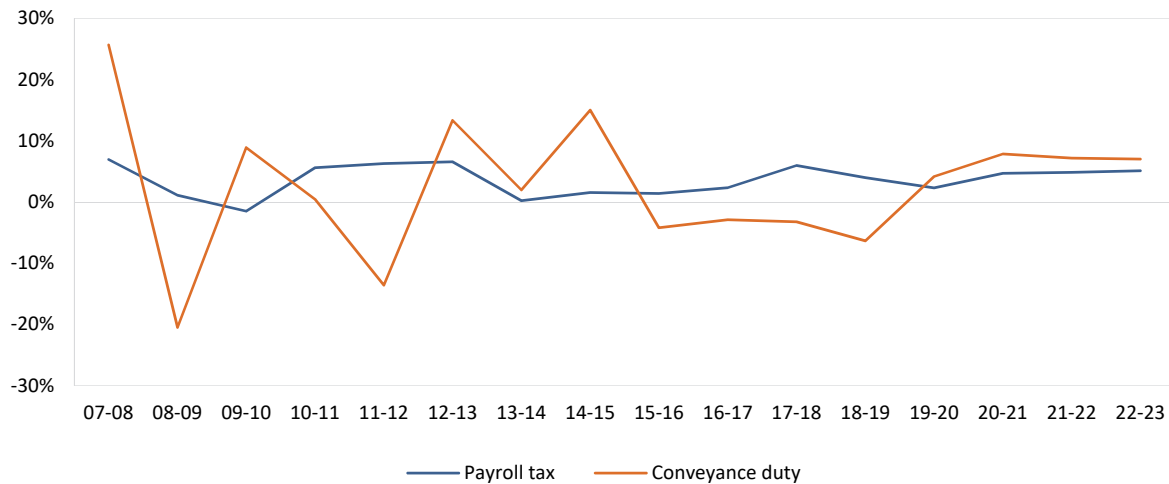


Figure 5.6 shows the relative stability of growth in payroll tax over the historical period in comparison to the significant fluctuations in conveyance duty. It also indicates that over the forward estimates, conveyance duty is estimated to grow at a faster rate than payroll tax, averaging 7.4% compared to 4.9%.

### 5.3.2 Steady increases in conveyance duty estimated over the four years of the Budget contrasts with recent historical experience

Figure 5.6 shows conveyance duty is expected to grow by 7% or more each year from 2020-21 to 2022-23. This contrasts with consistent reductions in conveyance duty experienced in each of the four years up to 2018-19, including an expected 6% reduction in the 2018-19 estimated result compared to the prior year.

The 2019-20 Budget also reflects downward conveyance duty parameter variations since the 2018-19 MYBR totalling \$184 million between 2018-19 and 2021-22, owing to softer than expected growth in residential property transfers in 2018-19 which flows through to future years.

These factors indicate the State may have difficulty achieving the conveyance duty estimates in the 2019-20 Budget if there is ongoing softness in the volume and value of property transfers.

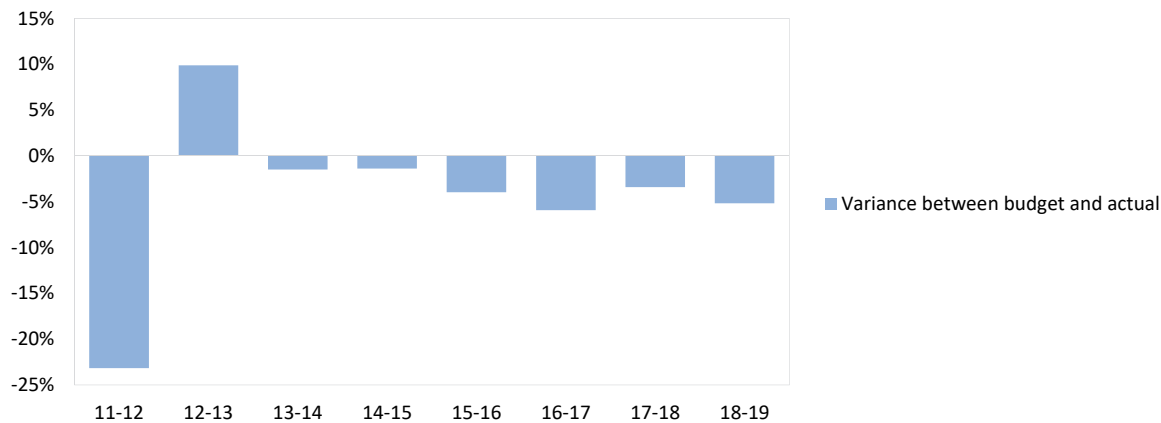
The Budget indicates collections from 2019-20 reflect growth in the price and volume of transfers in residential and primary production properties. Moderate price growth is expected to continue, with property values expected to grow by around 3% each year over

the forward estimates. Underlying property transfers are also expected to grow moderately over the forward estimates and return to long-term levels.

### 5.3.3 Conveyance duty historically revised downwards from estimates in the original Budget

Figure 5.7 compares budget to actual outcomes for conveyance duty for the period 2011-12 to 2017-18 and estimated results compared to budget for 2018-19. It illustrates that conveyance duty estimates were generally optimistic and consistently revised downwards, except for 2012-13 when actuals were higher than budgeted mainly due to large one-off transactions.

Figure 5.7: Variations between budget and actual results for conveyance duty



The estimated write-down for conveyance duty in 2018-19 is \$42 million (5%).

This highlights the difficulty of predicting trends in property market values and transaction levels that drive conveyance duty taxation revenue.

It is important to maintain a robust and conservative conveyance duty estimation approach to limit the number of significant write-downs between years.

## 5.4 Sales of goods and services

### 5.4.1 Sales of goods and services expected to grow moderately over the four years of the Budget as increases in fees and charges are offset by change in budget classification of Commonwealth contributions

Figure 5.8 shows the expected trend for sales of goods and services in the 2019-20 Budget against the experience of the five years to 2017-18.

**Figure 5.8: Percentage change in sales of goods and services  
between 2013-14 and 2022-23**

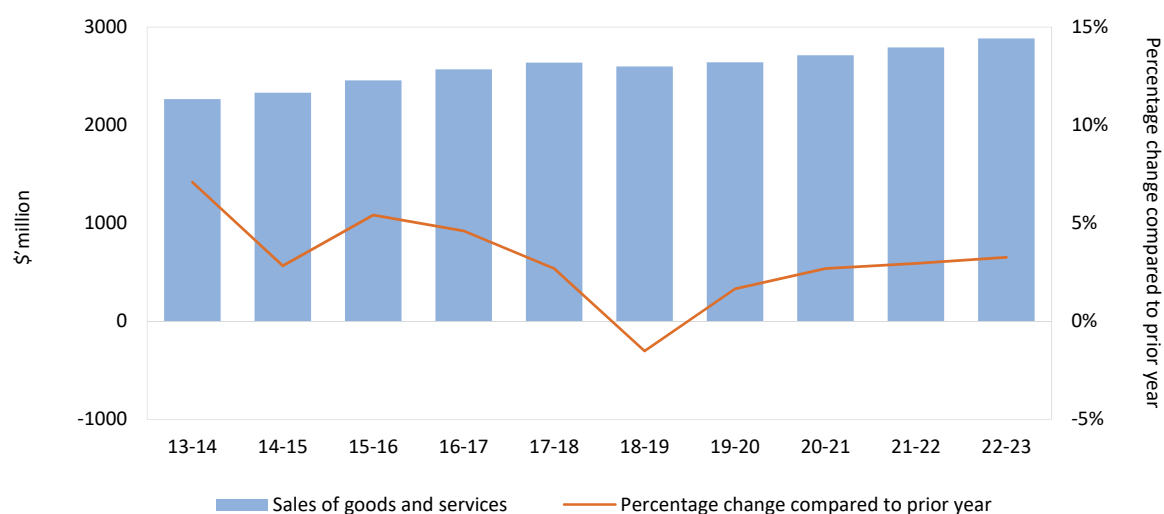


Figure 5.8 shows that after a dip in 2018-19, sales of goods and services are expected to rise at an increasing rate over the four years of the Budget.

The dip in 2018-19 is mainly due to a decline in revenue from other user charges owing to the cessation of payments from the SAHT to the Department of Human Services (DHS) for social housing functions.

The increase in sales of goods and services between 2018-19 and 2019-20 is mainly due to the following budget presentation changes taking effect from 2019-20:

- lottery gambling revenues no longer netted off against lottery prize expenses and agents commission expenses, resulting in higher revenues from sales of goods and services (other user charges) and higher other operating expenses (\$390 million impact in 2019-20 ranging up to \$409 million impact in 2022-23)
- guarantee fees charged by the Treasurer to government authorities being classified under sales of goods and services rather than taxation revenue (\$163 million impact in 2019-20 ranging up to \$166 million impact in 2022-23).

Further details on the budget presentation changes are provided in section 3.3.3.

The increase between 2018-19 and 2019-20 is also due to a 7.8% increase in regulatory fees from \$707 million to \$762 million and a 7.6% increase in health unit fees from \$424 million to \$456 million.

The \$55 million increase in revenue from regulatory fees is mainly due to:

- a projected increase in fees collected under the *Real Property Act 1886*, reflecting expected growth in transactions, property prices and the impact of the once-off 5% indexation of fees and charges
- increases in the solid waste levy in the 2019-20 Budget.

The \$32 million increase in health unit fees mainly reflects:

- the estimated impact of the proposed additional facility fee in the 2018-19 Budget to recover the public system costs of providing clinicians rights of private practice
- the revision of public hospital parking fee structures for staff and the general public in the 2019-20 Budget
- the impact of private patient activity levels in public hospitals.

These increases are offset by the reclassification of Commonwealth contributions from sales of goods and services to Commonwealth grant revenue from 2019-20 onwards due to budget presentation changes. These contributions are \$514 million in the 2018-19 estimated result and \$493 million in 2019-20.

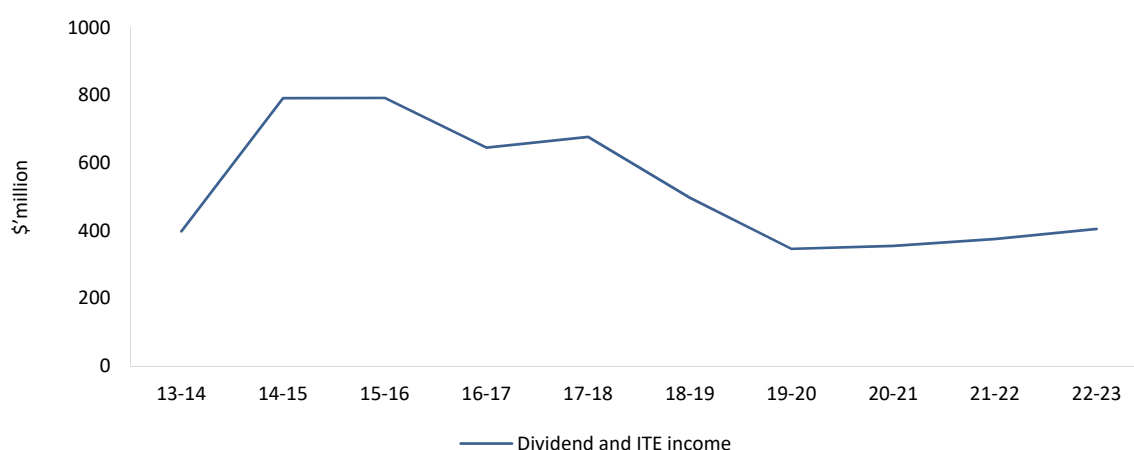
The percentage change between 2018-19 and 2019-20 is significantly impacted by the structural break between the two years owing to the budget presentation changes. The increases over the forward estimates range from 2.7% to 3.3% and are more in line with Adelaide CPI forecasts in the Budget.

## 5.5 Dividend and income tax equivalent income

### 5.5.1 Dividend and ITE income is expected to drop sharply in 2018-19 and 2019-20 as proceeds from MAC privatisation wind down

Figure 5.9 shows the expected trend for dividend and ITE income in the 2019-20 Budget against the experience of the five years to 2017-18.

**Figure 5.9: Trend in dividend and ITE income between 2013-14 and 2022-23**



The downward trend in dividend and ITE income between 2014-15 and 2017-18 was driven by the wind down of privatisation proceeds from the MAC. Our last report on the State finances provides further detail on the proceeds from the MAC privatisation and reforms to the compulsory third party (CTP) insurance market in South Australia during this period.<sup>15</sup>

<sup>15</sup> Auditor-General's Report 1 of 2019 *State finances and related matters*, section 5.5.

The Budget indicates the SA Government received a further dividend from MAC of \$143 million in 2018-19 as a result of the CTP insurance market reforms. Dividends from MAC are expected to be much lower over the four years of the Budget, ranging from \$4 million to \$11 million. This reflects the start of new reinsurance arrangements for CTP insurance effective from 1 January 2019.

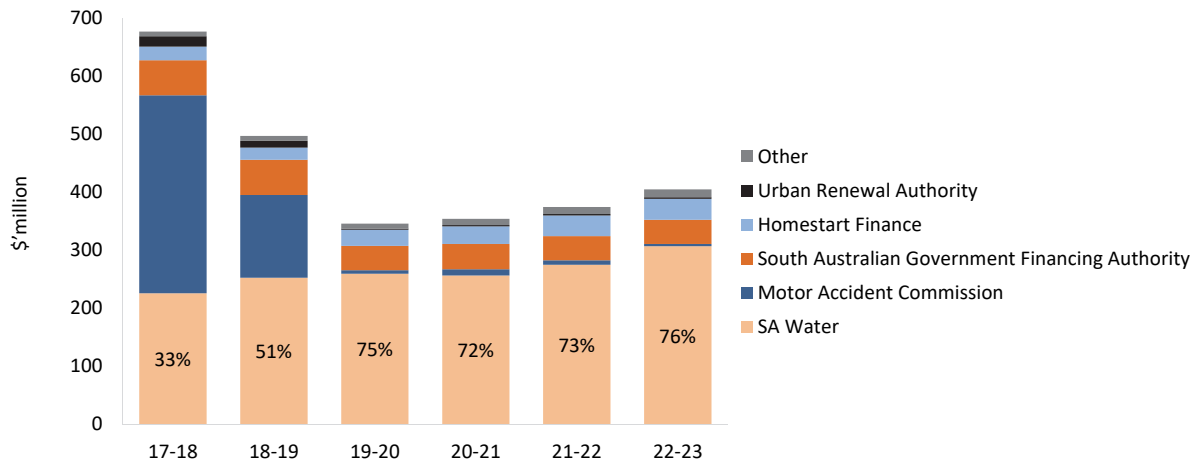
The slight increasing trend in dividend and ITE income from 2019-20 onwards reflects the new SA Government policy revenue measure to increase the dividend payout ratio for all government businesses to 100% of profit after tax. This will apply to all government businesses that currently pay a dividend including SA Water, HomeStart Finance, SAFA and MAC.

The additional revenue from this measure is expected to range between \$24 million and \$29 million each year over the four years of the Budget.

### 5.5.2 SA Water is the main source of dividend and ITE income over the four years of the Budget

Figure 5.10 shows the SA Government's dividend and ITE income is expected to be less diversified from 2019-20, as the distributions from the MAC privatisation cease and new reinsurance arrangements for CTP insurance commence in 2018-19.

**Figure 5.10: Sources of dividend and ITE income**



SA Water is projected to become the main source of dividend and ITE income, with its share of the total increasing from 33% in 2017-18 to 76% in 2022-23. As a result, the SA Government will have increased exposure to SA Water operations in meeting its budgeted outcomes.

## 6 Expenses

### Key points

- The health and education sectors incur 57% of the State's total expenses and salaries and wages comprise almost half of the State's budgeted expenditure. Controlling expenditure in these areas is therefore crucial to the State achieving budgeted outcomes.
- Future wage negotiations and FTE reductions are critical to achieving very limited budgeted growth in employee expenses between 2018-19 and 2021-22.
- Other operating expenses increase significantly over the four years of the Budget mainly due to indexation and growth in activity in health, education and human services.
- Interest expenses are expected to increase substantially over the four years of the Budget owing to budget classification changes and significantly higher borrowings.
- Health and Wellbeing faces ongoing challenges in meeting its \$1.173 billion cumulative savings task over the four years of the Budget given the significant budget overrun in the portfolio in 2018-19.
- The whole-of-government savings task in the Budget is substantial, involving annual savings of \$979 million by 2022-23. New savings measures totalling \$362 million were introduced over the four years of the 2019-20 Budget to partially offset significant GST reductions.

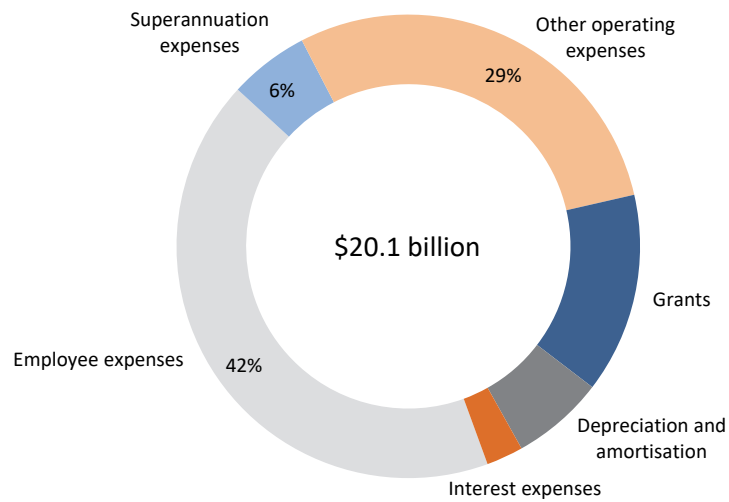
### 6.1 Composition of total expenses

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#### 6.1.1 Employee and superannuation expenses account for almost half of total expenses

Figure 6.1 shows that in 2019-20, employee and superannuation expenses combined represent almost half of total general government expenses (48%). Other operating expenses represent 29% of general government operating expenditure and include items such as supplies and services, consultancies, contractors and repairs and maintenance expenses.

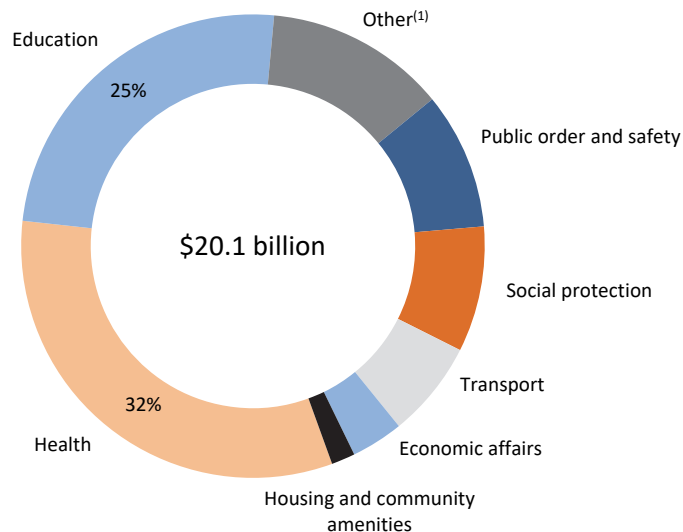
**Figure 6.1: 2019-20 general government expenses by class**



### 6.1.2 Health and education sectors represent 57% of total expenses

Figure 6.2 shows the split of 2019-20 Budget year expenses by sector and demonstrates the extent to which the health and education sectors dominate overall expenditure by the SA Government.

**Figure 6.2: 2019-20 general government expenses by function<sup>16</sup>**



<sup>(1)</sup> Includes recreation, culture and religion, environmental protection, and general public services.

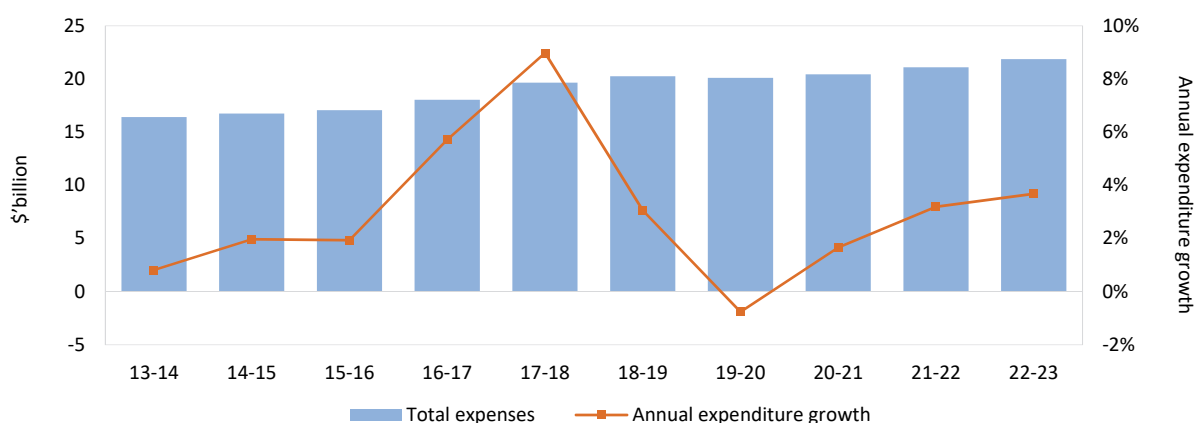
### 6.1.3 Other operating expenses expected to increase across the four years of the Budget while employee expenses and grants remain relatively steady

Figure 6.3 shows trends in total expenses and annual expenditure growth in the 2019-20 Budget against the experience of the previous five years.

<sup>16</sup> Sourced from 2019-20 Budget Paper 3 *Budget Statement*, table A.13.



**Figure 6.3: General government sector total expenses**



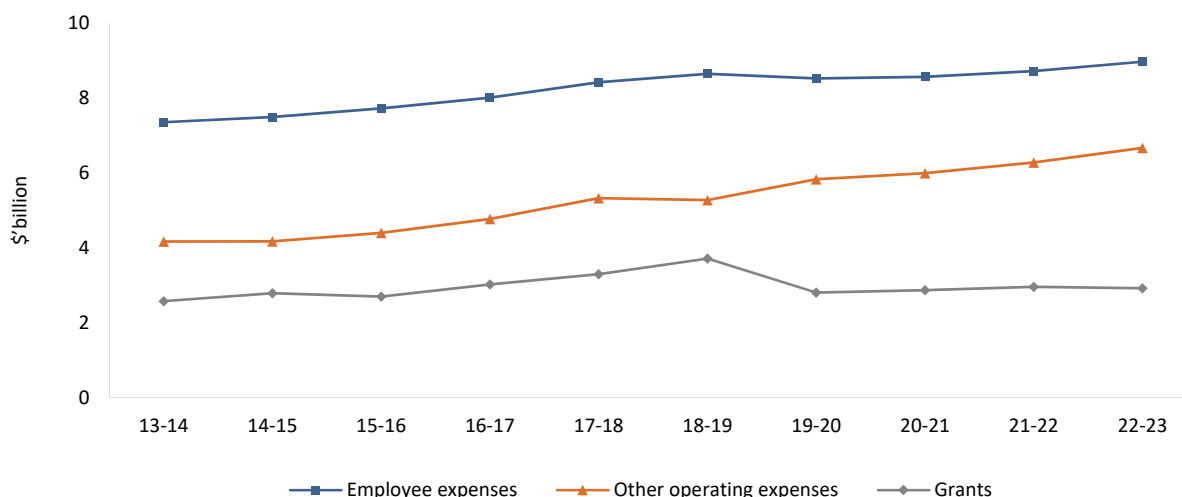
Higher levels of expenditure growth occurred in 2016-17 and 2017-18 mainly due to:

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

Growth in total expenses is expected to be significantly lower in 2018-19 and to be negative in 2019-20 after peaking in 2017-18. Growth in expenses is estimated to increase moderately year on year across the forward estimates towards 4% in 2022-23.

Figure 6.4 shows that the increase in total expenses is mainly driven by other operating expenses.

**Figure 6.4: General government sector key expense types**



Employee expenses are expected to be flat between 2018-19 and 2021-22 before increasing modestly in 2022-23. Other operating expenses are estimated to grow consistently across all four years of the Budget, with more significant increases expected in 2019-20 and 2022-23. Grant expenses are relatively flat across the four years of the Budget after a peak in 2018-19.

Further details on trends in employee expenses and other operating expenses are provided in sections 6.2 and 6.3. As outlined in further detail in section 3.1.1, the peak in grant expenses in 2018-19 is mainly due to a once-off grant payment to the SAHT of \$602 million.

## 6.2 Employee expenses

### 6.2.1 The SA Government is expected to achieve the 2018-19 budget for employee expenses

The 2018-19 estimated result for employee expenses (\$8.645 billion) is consistent with the original 2018-19 Budget (\$8.623 billion) and represents a 2.7% increase on 2017-18 actual employee expenses. The estimated total FTE employees in 2018-19 (85 142) are 1.2% higher than the original 2018-19 Budget (84 118).

### 6.2.2 Very limited expected growth in employee expenses between 2018-19 and 2021-22 mainly due to FTE decreases in DHW and constraint in public sector wages growth

Employee expenses are estimated to grow by less than 1% between 2018-19 and 2021-22. The Budget indicates this reflects estimated reductions in general government sector employment levels and constraint in public sector wages growth over the forward estimates.

Figure 6.5 shows FTE and employee expense trends expected in the 2019-20 Budget against the experience of recent years.

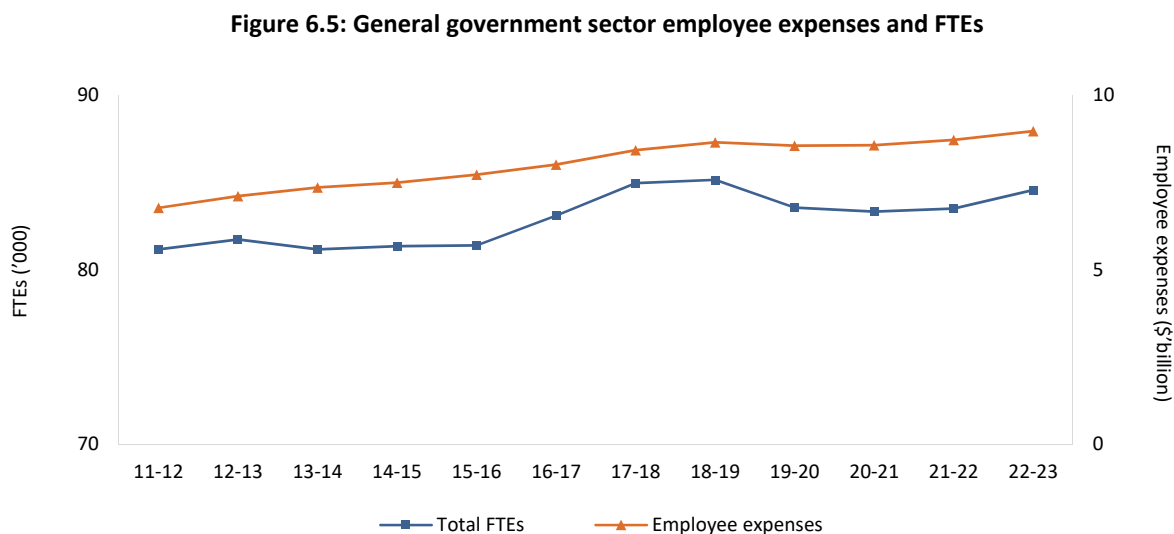


Figure 6.5 highlights that total FTEs are expected to trend downwards in 2019-20 and 2020-21 before flattening out in 2021-22 and increasing again in 2022-23. Estimated total FTEs are expected to decrease by 577 FTEs (0.7%) between 2018-19 and 2022-23 from 85 142 to 84 565.

In the 2018-19 Budget, FTE estimates reflected the full phased transfer of SA Government disability services to the non-government sector as part of the State's transition to the National Disability Insurance Scheme (NDIS).

The Budget indicates the SA Government approved DHS continuing to provide accommodation services under the NDIS until at least June 2023, with the service to be reformed to bring costs more into line with revenue expected to be received through the NDIS for these services. These changes result in the retention of 1403 FTEs by June 2023 when compared to previous budget forecasts.

Figure 6.5 also highlights that total FTEs are expected to decrease by 1588 (1.9%) between 2018-19 (85 142) and 2019-20 (83 554). This is mainly due to FTE decreases in SA Health (1140 FTEs) which primarily relate to CALHN (776 FTEs) and DHW (294 FTEs).

The Budget notes FTE estimates for general government sector agencies are based on FTE caps. These caps are established to be consistent with the salaries and wages budget for each agency and are adjusted in line with changes to agency budgets. FTE reductions associated with savings measures, such as those for CALHN and DHW, are notional, and chief executives have flexibility to deliver savings in the way that best suits the needs of the business, including reducing expenditure in areas other than employee expenses. As a result the actual level of FTEs over the forward estimates may vary to those in the Budget.

### 6.2.3 Future wage negotiations critical to expenditure control

Salaries and wages are a major public sector operating cost and wage negotiations will occur for major employee groups in 2019-20.

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

The 2019-20 Budget provides for anticipated public sector wage increases from enterprise agreement outcomes over the forward estimates, both in individual agency budgets and in the total of the contingency items in the administered items for DTF.

Figure 6.6 summarises the approximate expenditure impact of a 1% p.a. variation by year as advised by DTF. The value increases across the forward estimates as active enterprise agreements expire.

**Figure 6.6: Expenditure risk – wage outcomes for new enterprise agreements**

	2019-20 \$'million	2020-21 \$'million	2021-22 \$'million	2022-23 \$'million
Expenditure impact if wage outcomes vary by 1% p.a. from allowances in the forward estimates	72	154	257	368

The Budget indicates that if public sector-wide wage outcomes for new enterprise agreements vary by 1% p.a. from allowances in the forward estimates, the impact will be to increase employee expenses by around \$368 million in 2022-23. The impact of public sector wage outcomes has increased significantly from the 2018-19 Budget, which indicated an impact of \$210 million by 2021-22 if new enterprise agreements varied by 1% from budget allowances. The more significant budget impact in the 2019-20 Budget is mainly due to the inclusion of an additional year's wage increments and the expiration of some enterprise agreements.

The 2019-20 Budget notes that enterprise agreement negotiations will occur for major employee groups including school and preschool staff, South Australia Police, South Australian Ambulance Service, and nursing and midwifery staff. The wage outcomes for these employee groups will be critical to expenditure control as DTF advised that they collectively represent almost half (49%) of total general government sector employees, with a total cost base in 2018-19 of \$4.5 billion.

The Budget does not specify a cap or limit on salary increases for enterprise agreement negotiations. It indicates there is no capacity to meet excessive wage and condition demands and that enterprise agreements must support efficiency and productivity in delivering government services.

#### **6.2.4 Lower than budgeted take-up of the TVSP scheme may impact the SA Government's ability to reduce FTEs and employee expenses**

The targeted voluntary separation package (TVSP) scheme introduced by the SA Government in November 2010 to help agencies achieve savings targets is still open.

The 2018-19 Budget included \$170 million in 2018-19 to help agencies meet TVSP and separation costs associated with workforce reductions. DTF advised that 1554 TVSPs and executive separations (1431 FTEs) were accepted in 2018-19 totalling \$131 million, \$39 million less than budgeted.<sup>17</sup>

Expenses totalling \$116 million for 1359 TVSP and executive separation acceptances were centrally reimbursed by DTF. Agencies met the costs for the remaining 195 TVSP and executive separation acceptances totalling \$15 million.

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

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<sup>17</sup> The total of \$131 million includes payroll tax and shared services fees of \$2.6 million. DTF centrally reimbursed \$2.4 million of these fees.

DHS (340 acceptances totalling \$27 million), the Department for Correctional Services (135 acceptances totalling \$9 million) and the Department for Environment and Water (119 acceptances totalling \$10 million).

The 2019-20 Budget includes \$60 million in 2019-20 to help agencies meet the cost of TVSPs and/or separation payments for the first six months of the year. From 1 January 2020 agencies will again become responsible for managing these costs.

The less than budgeted take-up of the TVSP scheme in 2018-19 and extension of the scheme into 2019-20 increases the risk that FTE and employee expense reductions may not be sufficient to achieve the budgeted reduction in employee expenses between 2018-19 and 2019-20.

DTF advised that TVSPs are available at the discretion of chief executives. Agencies can also achieve savings through other means, including not filling vacancies or natural attrition.

## 6.3 Other operating expenses

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### 6.3.1 Other operating expenses increase significantly over the four years of the Budget mainly due to indexation and growth in activity in health, education and human services

Other operating expenses include items such as supplies and services, consultancies and contractors, NDIS contributions, repairs and maintenance, computer and communication charges, concessions and operating leases.

Other operating expenses are expected to increase at rates above Adelaide CPI across the four years of the Budget. This includes a \$558 million (11%) increase between the 2018-19 estimated result and 2019-20 Budget and a \$390 million (6%) increase between the 2021-22 and 2022-23 forward estimates.

DTF advised that the increase between the 2018-19 estimated result and 2019-20 Budget is largely due to:

- general increases across a number of agencies as a result of indexation and growth in activity, particularly in DHW, DHS and the Department for Education
- slippage provisions resulting in operating expenditure being carried over from 2018-19 into 2019-20.

This is partially offset by a \$75 million reduction in the Department for Innovation and Skills for operating lease rentals on TAFE SA assets previously leased from the Urban Renewal Authority. As a result of the transfer of these assets to the general government sector, the operating lease payments will no longer be made to the NFPS from 2019-20 onwards.

DTF also advised that the increase from 2021-22 to 2022-23 is mainly due to:

- funding for year 7 in high school commencing in 2022

- growth in school enrolments
- growth in the number of children and young people in out of home care
- activity growth in DHW
- the increase in the State's NDIS annual contribution due to 4% indexation.

2019-20 Budget Paper 3 identifies growth in hospital expenditure, student enrolment numbers and children in care, and managing the NDIS transition costs, as major financial risks that could negatively affect the fiscal outlook in the 2019-20 Budget.

### 6.3.2 \$302 million in contingencies provides expenditure flexibility

Contingency amounts are incorporated into the Budget to provide flexibility if additional expenditure needs to be made by the SA Government. Figure 6.7 shows the composition of contingency provisions for 2018-19 and 2019-20 as advised by DTF.

**Figure 6.7: Contingency provisions**

	2018-19 Budget \$'million	2018-19 Estimated result \$'million	2019-20 Budget \$'million
Employee entitlements	220	13	93
Investing contingencies	18	42	94
Supplies and services	154	199	115
	392	254	302

The 2019-20 Budget includes contingency amounts totalling \$302 million, \$48 million more than the estimated outcome for 2018-19.

While sums are allocated to each of the categories for presentation purposes in the original Budget, revisions may be made to the allocation of contingencies across contingency lines during the budget year, resulting in variations between the original budget and the estimated result.

## 6.4 Interest expenses

### 6.4.1 Interest expenses are expected to increase substantially over the four years of the budget owing to budget classification changes and significantly higher borrowings

Interest expenses comprise interest paid by the Treasurer to SAFA on government borrowings and agency interest expenses for finance leases. Figure 6.8 shows the expected trend for interest expenses in the 2019-20 Budget against the experience of the five years to 2017-18.

**Figure 6.8: Trend in interest expenses between 2013-14 and 2022-23**

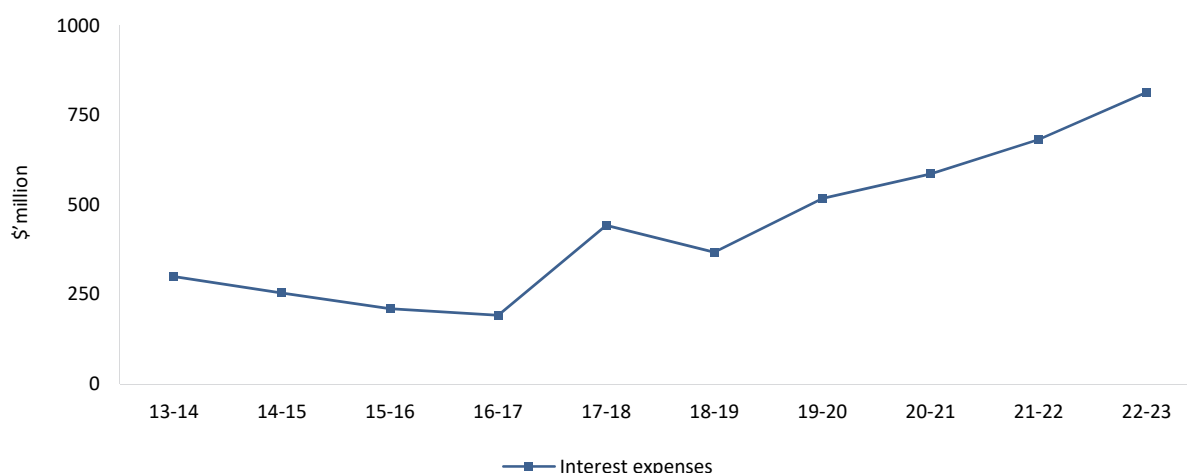


Figure 6.8 highlights that interest expenses are expected to trend significantly upwards from 2018-19 over the four years of the Budget after an earlier peak in 2017-18. Interest expenses are expected to more than double between 2018-19 and 2022-23, from \$368 million to \$814 million.

The increase in 2017-18 was mainly due to the recognition of a full year of interest expenses associated with the new Royal Adelaide Hospital finance lease agreement for the first time.

The increase in interest expenses over the four years of the Budget is mainly due to budget presentation changes from 2019-20, where interest received on the Treasurer's deposit accounts with SAFA is no longer offset against the Treasurer's interest paid on borrowings from SAFA. Based on estimates at the time of the 2018-19 MYBR, this budget presentation change was expected to increase interest expenses by \$162 million in 2019-20 and rise to \$317 million in 2022-23.

The accounting treatment of leases under the new accounting standard will also result in the recognition of additional interest expenses of around \$30 million p.a. from 2019-20.

Section 3.3 provides further information on major accounting standard and budget presentation changes taking effect from 2019-20.

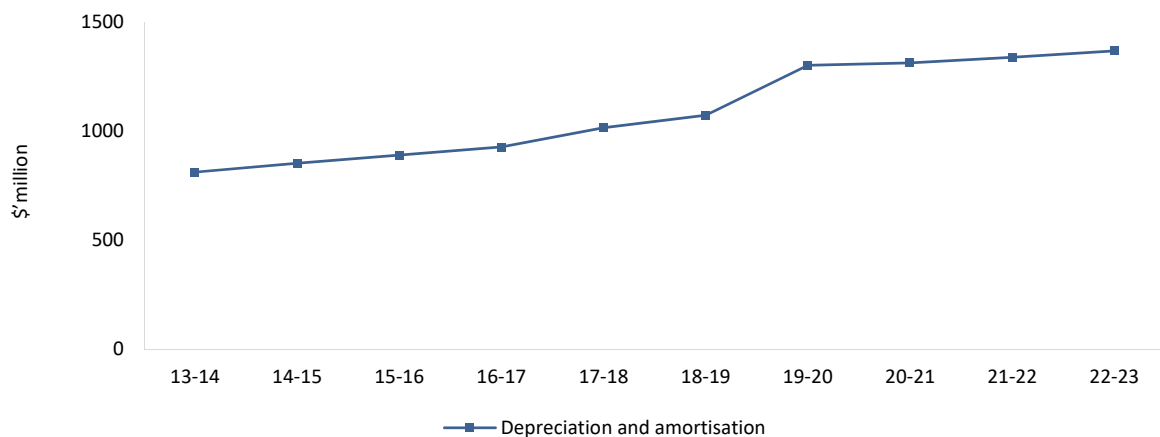
Interest expenses (excluding the budget presentation and accounting standard changes) are expected to increase by \$163 million from \$368 million in 2018-19 to \$531 million in 2022-23 as borrowings increase. Section 7.3 provides further details on the increases in borrowings and net debt.

## 6.5 Depreciation and amortisation

### 6.5.1 Depreciation and amortisation expenses expected to increase significantly in 2019-20 due to implementation of new leases accounting standard

Figure 6.9 shows the expected trend for depreciation and amortisation in the 2019-20 Budget against the experience of the five years to 2017-18.

**Figure 6.9: Trend in depreciation and amortisation between 2013-14 and 2022-23**



Depreciation and amortisation expenses are expected to increase significantly in 2019-20 before flattening out over the rest of the forward estimates. The peak in 2019-20 is mainly due to the impact of recognising additional depreciation on implementing the new leases accounting standard. Under the new standard, leases are recognised as right-of-use assets that are depreciated over time. As it applies from 1 July 2019, depreciation expense for these assets is recognised from 2019-20 resulting in the increase from 2018-19. The Budget indicates this change increases depreciation expenses by around \$200 million p.a. from 2019-20. Section 3.3.3 provides further information on the impact of the new leases accounting standard.

TAFE SA's purchase of sites currently held by the Urban Renewal Authority also contributes to the increase in depreciation expenditure in 2019-20.

Moderate growth in depreciation expense across the forward estimates is projected as projects are completed in line with the State's infrastructure program. These include additional prison beds, Adelaide Botanic High School, science technology engineering and mathematics facilities in schools as well as other education infrastructure upgrades, the North-South Corridor Regency Road to Pym Street upgrade, and the Gawler Line electrification.

## 6.6 Health savings

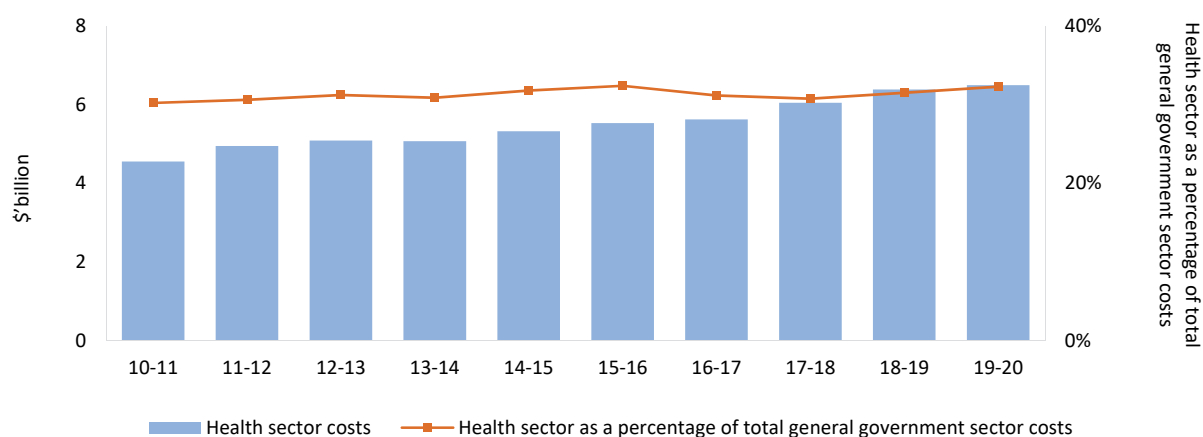
### 6.6.1 Health sector expenditure growth

Health sector costs are a significant component of the general government sector budget and hospital expenditure growth remains a highlighted risk in the 2019-20 Budget, as it has for many years.

Figure 6.10 shows the actual health sector costs over the past eight years, the 2018-19 estimated cost and the 2019-20 budgeted cost, compared to total general government sector costs.



**Figure 6.10: Health sector costs**



Health sector costs have remained relatively consistent as a percentage of total general government sector costs during this period, ranging between 30% and 32%.

The Budget notes that a 1% increase in hospital expenditure above the level in the 2019-20 Budget would increase expenditure by around \$58 million p.a.

#### 6.6.2 2018-19 estimated result for the Health and Wellbeing portfolio is a \$238 million budget overrun

The Budget indicates the 2018-19 estimated result for the net cost of providing services for DHW<sup>18</sup> is \$4.053 billion, compared to the 2018-19 Budget of \$3.815 billion, resulting in a \$238 million budget overrun. This is mainly due to:

- additional funding to meet the increased costs of providing hospital services (\$154 million)
- increased expenditure associated with the Electronic Medical Records Project (\$19 million)
- engagement costs associated with appointing KordaMentha in its role as implementation partner for CALHN's organisational and financial recovery plan (\$11 million).

Part A of my 2018-19 Annual Report to Parliament provides further commentary on DHW's 2018-19 budget performance, including analysis of variations between 2018-19 Budget and 2018-19 actual results.

#### 6.6.3 The SA Government has taken steps to address budget overruns in Health and Wellbeing but faces ongoing challenges in meeting savings targets

The Budget indicates the SA Government remains committed to all the reforms outlined in the 2018-19 Budget, including delivering hospital services at national average efficiency

<sup>18</sup> The reference to DHW in this section reflects the whole Health and Wellbeing portfolio, including local health networks.

levels by 2021-22. Figure 6.11 summarises the changes in DHW's savings task in the 2019-20 Budget.

**Figure 6.11: Summary of Health and Wellbeing's revised savings measures and initiatives**

	2018-19 \$'million	2019-20 \$'million	2020-21 \$'million	2021-22 \$'million	2022-23 \$'million
2017-18 Budget savings measures	(212)	(324)	(425)	(516)	(516)
2018-19 Budget new savings measures	(45)	(46)	(46)	(46)	(46)
2018-19 Budget reduction in savings measures	175	183	191	181	181
<b>2018-19 Budget revised savings measures</b>	<b>(82)</b>	<b>(187)</b>	<b>(280)</b>	<b>(381)</b>	<b>(381)</b>
2018-19 MYBR reduction in savings measures	23	-	-	-	-
2018-19 MYBR additional inefficiency identified	36	24	-	-	-
<b>2018-19 MYBR revised savings measures</b>	<b>59</b>	<b>24</b>	<b>-</b>	<b>-</b>	<b>-</b>
2019-20 Budget reduction in savings measures	95	89	89	89	89
2019-20 Budget increase in savings measures to recover from additional inefficiency identified in 2018-19	(81)	(81)	(81)	(81)	(81)
<b>2019-20 Budget revised savings measures</b>	<b>14</b>	<b>8</b>	<b>8</b>	<b>8</b>	<b>8</b>
<b>Total 2019-20 Budget savings measures</b>	<b>(9)</b>	<b>(155)</b>	<b>(272)</b>	<b>(373)</b>	<b>(373)</b>
Annual growth in savings task	-	(146)	(117)	(101)	-

	2018-19 \$'million	2019-20 \$'million	2020-21 \$'million	2021-22 \$'million	2022-23 \$'million
<b>Department for Health and Wellbeing savings initiatives</b>					
Efficiencies in DHW (central office)	5.6	14.5	14.6	14.7	14.7
SA Health grant and service contracting arrangements	2.5	2.5	2.5	2.5	2.5
Recover the public system costs of providing clinicians right of private practice	-	13.0	13.0	13.0	13.0
An efficient public pathology service	-	7.3	18.3	34.8	34.8
Reform of hotel services at SA hospital sites	-	1.1	4.5	4.5	4.5
An efficient public imaging and diagnostic service	1.1	4.9	6.2	6.2	6.2
Achieving national efficiency benchmarks by 2021-22	-	111.7	212.9	297.3	297.3
	9.2	155.0	272.0	373.0	373.0

Note: Totals may not add due to rounding.

Figure 6.11 shows an \$89 million reduction in savings measures in each of the four years of the Budget. DTF advised that this relates to analysis performed by DHW indicating the acuity of activity delivered was historically understated owing to coding errors. DHW estimates, based on more accurate coding, that it is \$89 million closer to national average efficiency levels than estimated in the 2018-19 Budget. The ongoing funding provided in the 2019-20 Budget reflects this estimate and that lower savings need to be achieved to meet national average levels for hospital services by 2021-22.

This reduction in savings is almost entirely offset by new savings of \$81 million p.a. in each of the four years of the Budget to address additional inefficiency identified in the health system in 2018-19. DTF advised that as the 2018-19 Budget target to achieve national average efficiency in delivering health services by 2021-22 was reaffirmed in the 2019-20 Budget, this reduction in DHW's savings targets has been classified as a parameter adjustment. DTF also indicated that DHW's overall savings targets are incorporated under the existing savings line in table 2.4 in Budget Paper 3.

The net impact of these revisions is that DHW's overall savings targets have only modestly reduced from the 2018-19 Budget by \$8 million p.a. The revised savings task for DHW is \$155 million in 2019-20, growing to \$373 million in 2021-22 and 2022-23.

The Budget outlines the steps the SA Government has taken in 2018-19 to achieve health savings and improve health budget performance:

- established boards of management for each local health network commencing 1 July 2019 that have full responsibility for overseeing clinical and financial outcomes for their respective networks
- implemented an organisational and financial recovery plan for CALHN with support from KordaMentha
- engaged PricewaterhouseCoopers to independently review SA Pathology to identify opportunities to improve its efficiency and effectiveness
- implemented changes to improve the timeliness and accuracy of activity coding performed by local health networks.

Despite these steps, DHW did not achieve its savings target in 2018-19 and has an estimated budget overrun in 2018-19 of \$238 million. It was the only portfolio to receive funding in 2018-19 due to not achieving its savings targets.

A significant savings task also remains, totalling \$1.173 billion over the four years of the Budget. We expect the savings task to remain a challenge until there is a demonstrated history of achieving savings goals. DHW and the local health networks will need to continue driving efficiencies across the sector to achieve budgeted outcomes.

## 6.7 Other savings

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### 6.7.1 The savings task in the Budget is substantial involving annual savings of \$979 million by 2022-23

The 2019-20 Budget introduces a range of new savings on top of existing saving measures included in previous budgets to partially offset significant reductions in GST revenue. The new operating savings total \$361.6 million over the four years of the 2019-20 Budget.

The Budget indicates the savings do not fully offset the loss of GST revenue, recognising the impact that could have on the services delivered to South Australians and the economy more generally. The Budget states savings were targeted at improving the efficiency of services provided to the community to maintain the standard of them.

As shown in figure 6.12, the Budget plans to deliver annual operating savings of \$979 million by 2022-23, comprising \$883 million from prior budgets and \$96 million in new savings measures.

**Figure 6.12: Savings initiatives**

	2019-20 \$'million	2020-21 \$'million	2021-22 \$'million	2022-23 \$'million
Existing savings targets	573.9	709.5	861.5	883.0
2019-20 Budget savings	79.7	91.9	94.1	95.9
<b>2019-20 Budget total savings</b>	<b>653.6</b>	<b>801.4</b>	<b>955.6</b>	<b>978.9</b>

Note: Totals may not add due to rounding.

The 2019-20 Budget savings measures primarily relate to departmental efficiency measures. This includes efficiency measures for Department for Child Protection (\$21 million), Education (\$50 million), Innovation and Skills (\$31 million), Premier and Cabinet (\$39 million) and DTF (\$31 million).

Other savings initiatives include housing reform efficiencies for the SAHT (\$28 million) and the purchase of the Sir Samuel Way Building by the Courts Administration Authority from the Superannuation Funds Management Corporation of South Australia, which is expected to result in savings of \$6 million p.a. in lease costs from 2019-20.

In addition to the new savings measures introduced in the 2019-20 Budget, agency budgets include a continuation of the existing efficiency dividend policy.<sup>19</sup> Efficiency dividends total \$461 million over the four years of the Budget.

DTF advised that the following agency 2018-19 savings targets were not achieved:

- TAFE SA operating efficiencies (\$1.9 million shortfall)
- DPTI across government savings reform (\$500 000 shortfall) and Service SA efficiencies (\$2.15 million shortfall)
- South Australia Police court enforcement fee increase (\$97 000 shortfall).

With the exception of DHW, no agency received funding for not achieving its savings targets in 2018-19. DHW's overall savings targets are incorporated under the existing savings targets line in figure 6.12.

The SA Government may face challenges in continuing to achieve savings targets given their size. The savings total is almost \$1 billion in 2022-23 and represents 4.5% of total expenditure in that year.

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<sup>19</sup> 1% of the agency employee expenses budget per year and a 1% reduction in agency net cost of services per year. The policy applies to most general government agencies.

## 7 Balance sheet

### Key points

- The State's most significant asset is land and other fixed assets and the State's liabilities primarily comprise borrowings and the unfunded superannuation liability.
- Capital expenditure is projected to increase compared to the prior year Budget, with purchases of non-financial assets expected to total \$9.7 billion over the four years of the 2019-20 Budget. Proper planning and management of major capital projects will be needed to mitigate risks to the Budget from increased capital outlays.
- NFPS net debt is expected to increase by \$7.7 billion between 2018-19 and 2022-23 to \$21.3 billion primarily to fund the general government sector investing program.
- South Australia's non-financial public sector net debt to revenue ratio is expected to be higher than all other States by 2022-23. There is a risk the SA Government will have less capacity and flexibility for expenditure on services after meeting additional borrowing costs on the higher net debt.
- Credit rating agencies have maintained a stable outlook for the State.
- The Budget reports the SA Government is on target to fully fund the unfunded superannuation liability by 2034.

### 7.1 Composition of balance sheet

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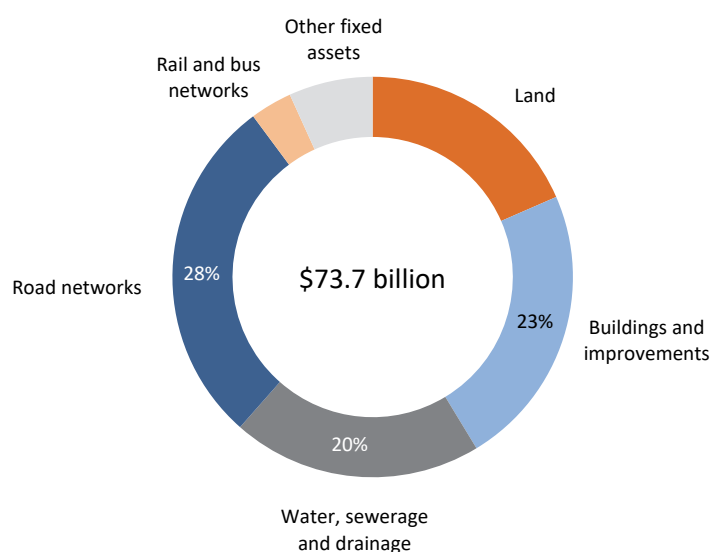
#### 7.1.1 Land and other fixed assets represent the vast majority of total assets

The vast majority of estimated total assets at 30 June 2019 is land and other fixed assets (94%).<sup>20</sup> Figure 7.1 shows the composition of land and other fixed assets estimated at 30 June 2019.

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<sup>20</sup> Balance sheet data is for the NFPS as detailed in 2019-20 Budget Paper 3 *Budget Statement*, table B.10, unless otherwise stated. The NFPS consolidates the general government and PNFC sectors.

**Figure 7.1: Composition of land and other fixed assets estimated at 30 June 2019**

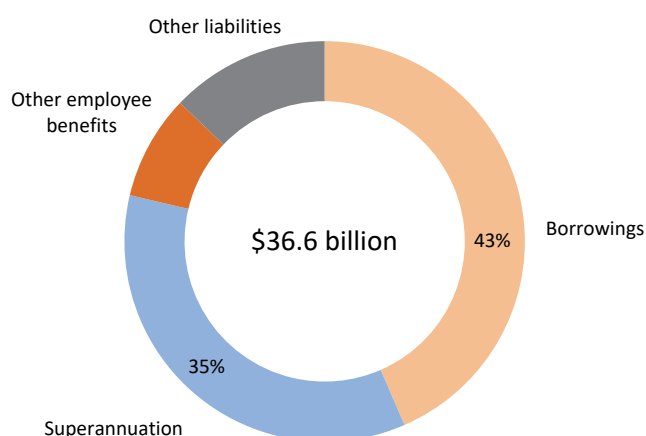


Road networks represent the largest component (28%), with the other major components including buildings and improvements (23%), water, sewerage and drainage assets (20%) and land (18%).

### 7.1.2 Liabilities primarily comprise borrowings and the unfunded superannuation liability

Figure 7.2 shows the composition of total liabilities estimated at 30 June 2019.

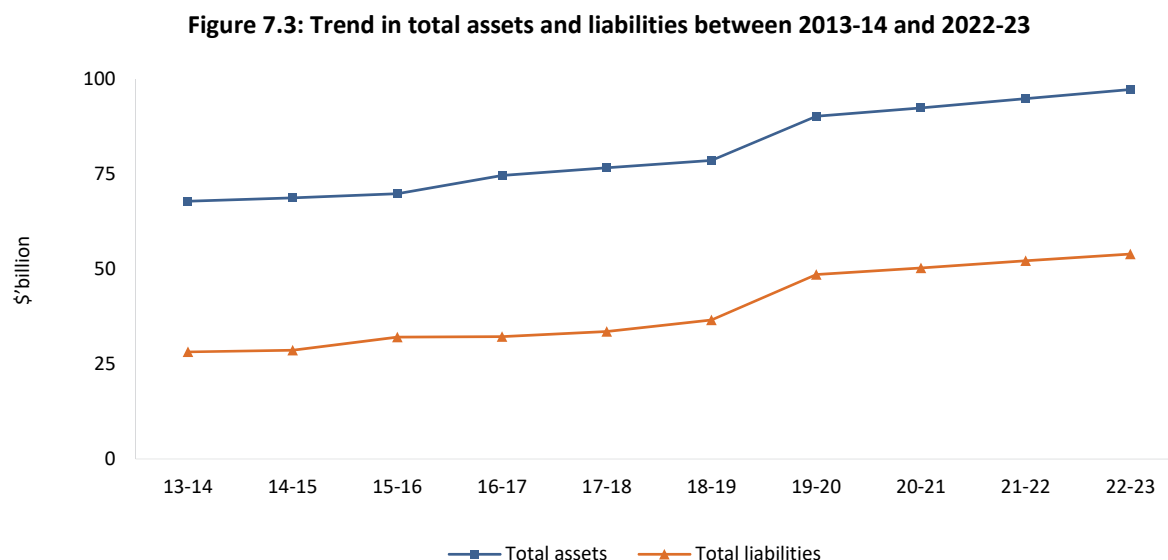
**Figure 7.2: Composition of total liabilities estimated at 30 June 2019**



The major components of total liabilities are borrowings (43%) and the unfunded superannuation liability (35%).

### 7.1.3 Total assets expected to increase by \$18.6 billion over the four years of the Budget largely due to budget presentation changes and increases in land and other fixed assets

Figure 7.3 shows the trend in total assets and liabilities in the 2019-20 Budget against the experience of the previous five years.



Total assets and liabilities both increase at a consistent rate over the 10 years, resulting in a moderate change in net worth from \$39.7 billion in 2013-14 to \$43.3 billion in 2022-23.

Total assets are expected to increase by \$18.7 billion over the forward estimates from \$78.6 billion at 30 June 2019 to \$97.3 billion at 30 June 2023, due mainly to increases in financial assets and land and other fixed assets.

Cash and deposits are estimated to increase by \$8.6 billion from \$2.2 billion in 2018-19 to \$10.8 billion in 2019-20. This is largely attributable to a budget presentation change from 2019-20 where deposits the Treasurer makes with SAFA and borrowings the Treasurer has with SAFA are no longer netted off. This results in higher reported assets and liabilities in 2019-20 and across the forward estimates, ranging from \$8.8 billion higher in 2019-20 up to \$11.9 billion higher in 2022-23. Further details on budget presentation changes taking effect from 2019-20 are provided in section 3.3.3.

The increase in total assets over the forward estimates is also due to increases in land and other fixed assets, which are projected to rise by \$7.1 billion from \$73.7 billion to \$80.8 billion. This primarily reflects investment and revaluations in buildings and improvements, water, sewerage and drainage assets and road networks.

### 7.1.4 Total liabilities expected to increase by \$17.4 billion over the four years of the Budget mainly due to budget presentation changes and higher borrowings

Figure 7.3 shows total liabilities are expected to increase by \$17.4 billion over the forward estimates from \$36.6 billion at 30 June 2019 to \$54 billion at 30 June 2023. This is mainly

due to an expected \$19.4 billion increase in borrowings from \$15.9 billion to \$35.3 billion, offset partly by an estimated \$2.4 billion reduction in the unfunded superannuation liability from \$12.9 billion to \$10.5 billion.

As outlined in section 7.1.3, borrowings have primarily increased due to a budget presentation change from 2019-20.

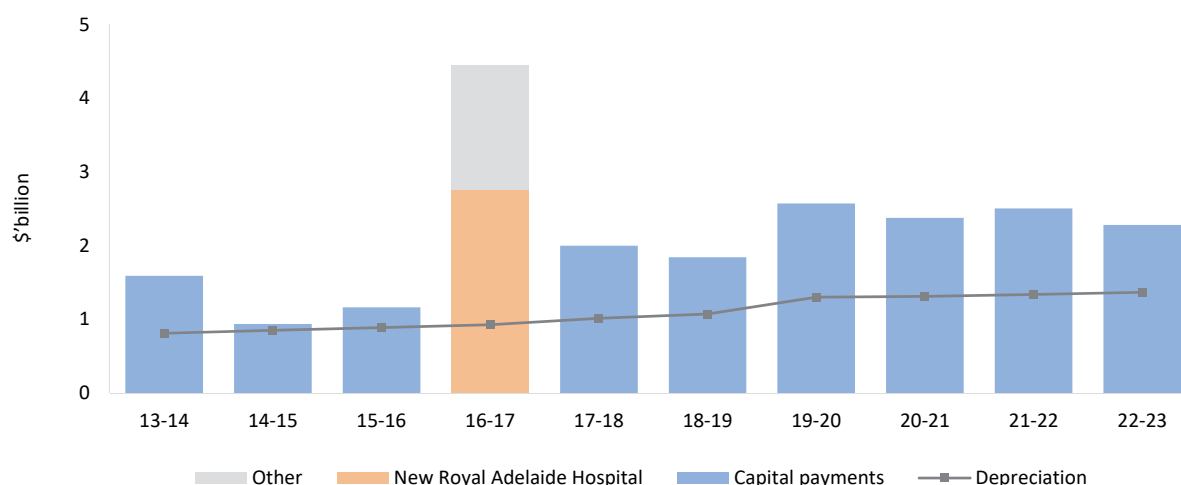
Borrowings have also increased to fund a significant proportion of the SA Government's capital program. Further information is provided in section 7.3.

## 7.2 Purchases of non-financial assets

### 7.2.1 Capital expenditure projected to increase compared to prior year Budget

Figure 7.4 shows the purchase of non-financial assets for the general government sector over the 10 years to 2022-23.

**Figure 7.4: General government sector purchases of non-financial assets**



General government capital investment across the period has remained above the level of depreciation. This indicates the SA Government has spent or expects to spend more on replacing and renewing assets each year than the consumption of assets through depreciation.

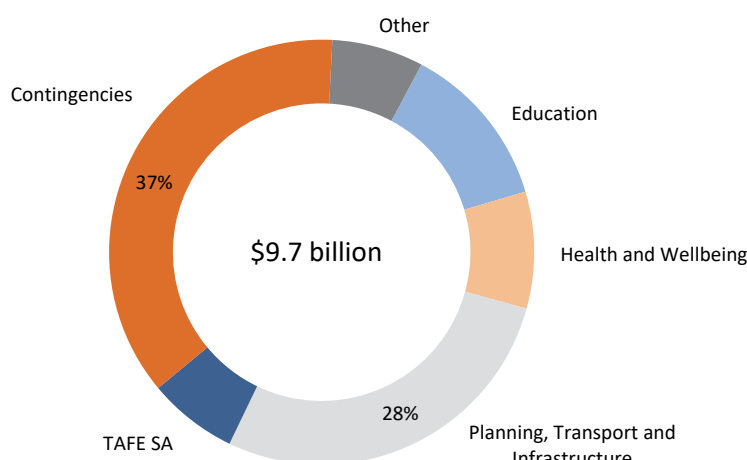
Capital payments peaked in 2016-17 mainly due to the recognition of the new Royal Adelaide Hospital finance lease asset (\$2.8 billion), which represented 62% of total capital payments in that year.

Estimated capital expenditure from 2019-20 onwards is high compared to historical levels, being in excess of \$2 billion each year. Purchases of non-financial assets are projected to total \$9.7 billion over the four years of the 2019-20 Budget, compared to \$8.6 billion over the four years of the 2018-19 Budget.



Figure 7.5 provides a breakdown of the capital program by agency and the portion of the program allocated to contingencies over the four years of the Budget.

**Figure 7.5: Breakdown of general government capital program by agency**



A large proportion of the capital program over the four Budget years is attributable to:

- DPTI – total capital investment of \$2.7 billion including Gawler Line Electrification (\$435 million), Main South Road duplication from Seaford to Aldinga (\$303 million), North-South Corridor Regency Road to Pym Street (\$298 million) and Duplication of Joy Baluch AM Bridge (\$198 million).
- Department for Education – total capital investment of \$1.2 billion including Sustainable Enrolment Growth capital works program (\$806 million), Northern and Southern Adelaide Schools public private partnership (\$261 million) and Whyalla Secondary School (\$99 million).
- DHW – total capital investment of \$865 million including Queen Elizabeth Hospital Redevelopment Stage 3 (\$242 million), Modbury Hospital Upgrades (\$89 million) and Repatriation Health Precinct Reactivation (\$69 million).
- TAFE SA – total capital investment of \$663 million including purchase of TAFE SA sites from the Urban Renewal Authority (\$619 million).

## 7.2.2 Contingency provisions for capital investing program

The general government sector budget holds a contingency provision over the forward estimates to maintain the overall size of the SA Government's investing budget. While agency budgets typically decline over the forward estimates as projects are scheduled to finish, the contingency provision rises as the unallocated component of the overall general government sector budget increases. Figure 7.5 highlights that \$3.6 billion (37%) of the total capital program over the four years of the Budget is allocated to contingencies.<sup>21</sup>

<sup>21</sup> Table 2.17 in 2019-20 Budget Paper 3 *Budget Statement* of the 2019-20 Budget notes contingencies include a capital slippage provision to reflect the tendency, on a whole-of-government basis, for underspending due to some projects slipping from their current budgeted expenditure profile. Contingencies also include consolidation adjustments to eliminate inter-agency transactions and recognise contributed assets, as well as the creation of right-of-use assets under the new accounting standard for leases.

Contingencies include amounts allocated to a new Adelaide Women's and Children's Hospital (\$552 million), a new Aboriginal Art and Culture Gallery (\$150 million) and land transport infrastructure upgrades for intersection/level crossings and regional roads (\$501 million).

### **7.2.3 The SA Government's objective in expanding the capital investing program is stimulating jobs and economic growth in response to softening economic conditions**

The Budget indicates that in response to the weaker than expected revenue outlook, the SA Government is prioritising spending to continue to deliver key services and invest in important economic infrastructure to support the State's economic growth.

DTF advised the expanded capital program also responds to comments made by the Governor of the Reserve Bank of Australia recommending that States increase infrastructure spending on 'shovel ready' projects to stimulate economic growth and take advantage of low market interest rates when borrowing to fund the projects.

DTF indicated that no specific modelling was undertaken to determine the size of the State's infrastructure program. Instead, each Minister/agency submitted bids through the 2019-20 Budget process and each bid was assessed on its merits. The capacity of the budget to support the SA Government's infrastructure priorities was assessed having regard to maintaining operating surpluses and sustainable debt levels.

The South Australian Centre for Economic Studies prepared a report for DTF in May 2018 outlining the employment impacts of infrastructure investment in South Australia. It provided details on employment multipliers by infrastructure type and indicated urban road construction and building works such as school upgrades support employment opportunities and the State's economic growth.

InfrastructureSA was also established to provide the SA Government with advice on future infrastructure priorities.

### **7.2.4 Proper planning and management of major capital projects is needed to mitigate risks to the Budget from increased capital outlays**

As the capital program expands, proper planning, management and control of major capital projects becomes more critical to achieving budgeted outcomes.

Major capital projects carry high inherent risks associated with estimating costs, complex contract arrangements, cost escalations and timeliness of completion. Appropriate procurement, contract and project management expertise, as well as sound information systems and financial controls, are required to effectively manage these risks and meet budget targets.

Capital projects that develop from long-term plans and have robust business cases are likely to be the most successful. It is also important that project performance is measured to

ensure planned benefits are realised and the SA Government captures and actions learnings from previous infrastructure projects.<sup>22</sup>

My previous Reports have highlighted significant scope to improve the planning, procurement, project management and contract management of major capital projects.<sup>23</sup> It is important that due consideration be given to the findings and recommendations in these Reports when planning and managing the State's capital program.

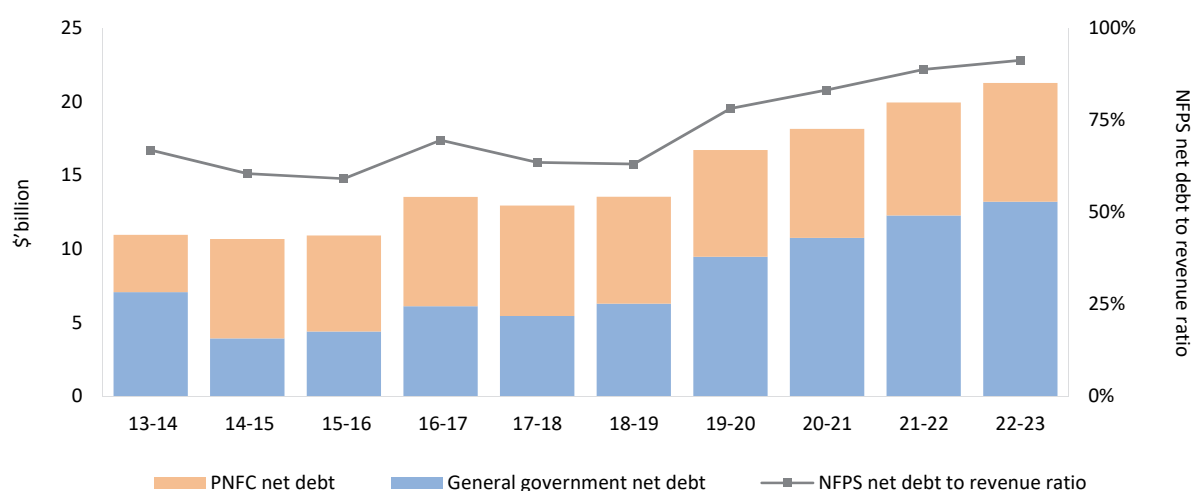
## 7.3 Borrowings and net debt

### 7.3.1 Non-financial public sector net debt expected to increase by \$7.7 billion between 2018-19 and 2022-23 to \$21.3 billion primarily to fund general government sector investing program

NFPS net debt reflects the combined debt of the general government and PNFC sectors. Net debt is the sum of deposits held, advances received and borrowings, minus the sum of cash and deposits, advances paid, and investments, loans and placements.

Figure 7.6 shows that NFPS net debt is projected to trend upwards from \$13.6 billion in 2018-19, rising \$7.7 billion to \$21.3 billion by 30 June 2023.

**Figure 7.6: South Australian NFPS net indebtedness 2013-14 to 2022-23**



General government sector debt is expected to more than double from \$6.3 billion in 2018-19 to \$13.2 billion in 2022-23. This reflects 90% of the total increase in NFPS net debt.

<sup>22</sup> Refer to Terrill, M 2016, *Cost overruns in transport infrastructure*, Grattan Institute, 23 October, viewed September 2019, <<https://grattan.edu.au/report/cost-overruns-in-transport-infrastructure>>.

<sup>23</sup> Refer to Auditor-General's Report 11 of 2018 *New Royal Adelaide Hospital operating term arrangements*, Auditor-General's Report 13 of 2017 *Adelaide Riverbank (Festival Plaza) Development* and Auditor-General's Report 5 of 2017 *The Torrens Road to River Torrens South Road Upgrade Project* for examples where significant scope for improvement in planning, procurement, project management and contract management of major capital projects was identified.

Figure 7.7 explains the expected movements in net debt for the general government sector at the time of the 2019-20 Budget.

**Figure 7.7: Reconciliation of movements in general government net debt as at the 2019-20 Budget**

	2018-19 Estimated result \$'million	2019-20 Budget \$'million	2020-21 Budget \$'million	2021-22 Budget \$'million	2022-23 Budget \$'million
<b>Opening general government net debt</b>	5 447	6 289	9 468	10 752	12 278
General government cash surplus (deficit)	(652)	(1 438)	(893)	(1 000)	(729)
Add: Net cash flows from equity transactions	(180)	(330)	(268)	(210)	(149)
Less: Finance leases granted	-	114	8	-	-
Finance/Operating lease arrangements (includes impact of new AASB 16)	(2)	(1 538)	(144)	(336)	(66)
Other movements	(6)	14	14	20	15
<b>Improvements (Deterioration) in general government net debt</b>	<b>(841)</b>	<b>(3 179)</b>	<b>(1 284)</b>	<b>(1 526)</b>	<b>(930)</b>
<b>Closing general government net debt</b>	<b>6 289</b>	<b>9 468</b>	<b>10 752</b>	<b>12 278</b>	<b>13 208</b>

Note: Totals may not add due to rounding.

The increase in general government sector net debt over the forward estimates is primarily attributable to the SA Government's larger investing program in the 2019-20 Budget compared to the previous year's Budget and resulting net lending deficits. The net lending deficits and capital program in the 2019-20 Budget are discussed further in section 3.2.3.

The increase is also due to the impact of the new leases accounting standard, particularly in 2019-20. Section 3.3.3 provides further details on the impact of new accounting standards from 2019-20.

The significant movements in PNFC and general government net debt prior to 2019-20 were:

- a reduction in general government net debt and converse rise in PNFC net debt in 2014-15 due to the SA Government's decision to vary SA Water's debt to asset gearing ratio
- an increase in general government net debt in 2016-17 mainly reflecting the recognition of the financial obligations for the new Royal Adelaide Hospital, offset partly by contributions from the MAC privatisation
- an increase in PNFC net debt in 2016-17 mainly due to borrowings incurred by the Urban Renewal Authority to purchase TAFE SA properties.

### 7.3.2 Increased risk the SA Government will have less capacity and flexibility for expenditure on services after meeting additional borrowing costs on the higher net debt

Figure 7.6 shows the estimated ratio of net debt to revenue for the NFPS is expected to increase from 63% as at 30 June 2019 to 91% at 30 June 2023, largely due to the increase in net debt in the general government sector.

As the ratio of net debt to revenue increases over the forward estimates, there is a corresponding increasing risk the SA Government will have less capacity and flexibility for expenditure on services after meeting additional borrowing costs on its debt.

The significant increase in net debt and borrowing costs also increases the State's interest rate risk exposure and the State may have difficulties achieving net operating surpluses if interest rates rise in the future.

Interest expenses (excluding the budget presentation and accounting standard changes outlined in section 6.4.1) are expected to increase by \$163 million from \$368 million in 2018-19 to \$531 million in 2022-23 as borrowings increase.

### 7.3.3 Increases in net debt over the four years of the Budget are well in excess of estimated growth in the State's gross state product and revenue base

Figure 7.8 shows the expected growth in general government and NFPS net debt over the four years of the Budget compared to estimated growth in the State's economy (GSP) and total general government and NFPS revenue.

**Figure 7.8: Comparison of expected changes in net debt, GSP and total revenue over four years of the Budget**

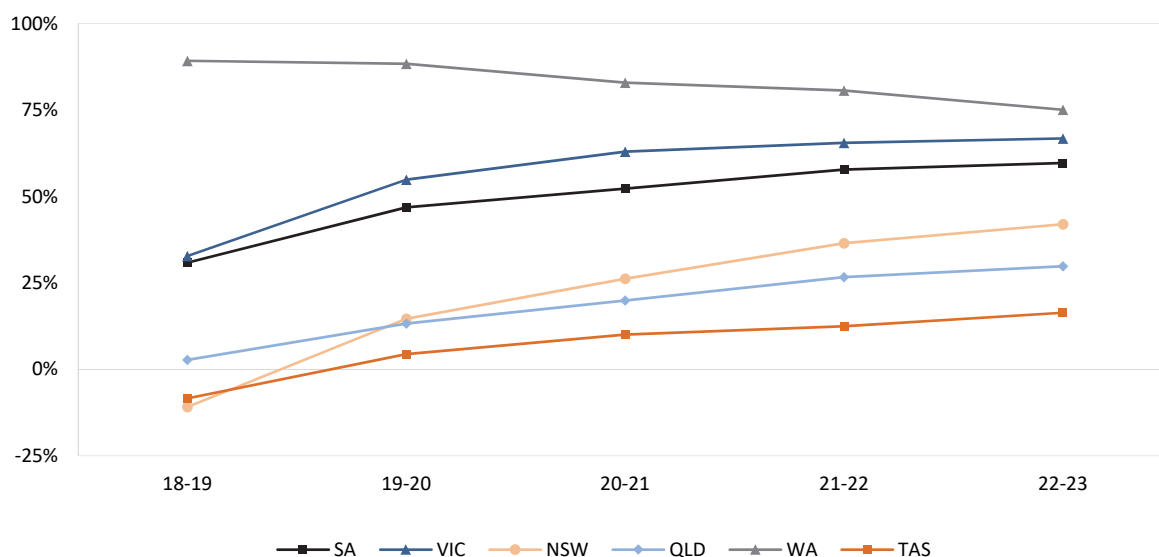
	2019-20 %	2020-21 %	2021-22 %	2022-23 %
General government net debt increase from prior year	51	14	14	8
NFPS net debt increase from prior year	23	9	10	7
Estimated growth in nominal GSP	4.6	4.5	4.7	4.7
Estimated growth in general government total revenue	-1	2	3	4
Estimated growth in NFPS total revenue	0	2	3	4

Increases in net debt over the four years of the Budget are well in excess of estimated growth in the State's GSP and revenue base. The SA Government will need to monitor net debt levels in comparison to growth in the State's economy and revenue base to ensure the sustainability of the Budget.

### 7.3.4 South Australia's non-financial public sector net debt to revenue ratio is higher than all other States in 2022-23

Figure 7.9 shows the general government sector net debt to revenue ratio for South Australia compared to all other States between 2018-19 and 2022-23.

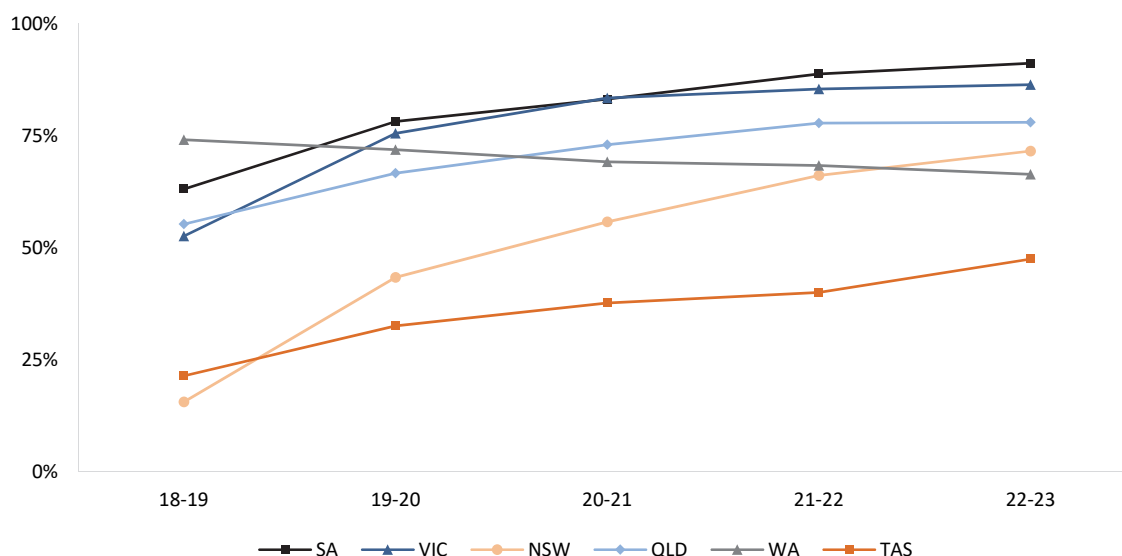
**Figure 7.9: Comparison of general government sector net debt to revenue ratio to all other States between 2018-19 and 2022-23**



South Australia's general government sector net debt to revenue ratio increases from 31% in 2018-19 to 60% in 2022-23. This increasing trend is consistent with all other States except Western Australia, which is trending down during the period. South Australia's net debt to revenue ratio for the general government sector is below that of Western Australia and Victoria, but above Tasmania, Queensland and New South Wales.

Figure 7.10 shows the NFPS net debt to revenue ratio for South Australia compared to all other States between 2018-19 and 2022-23.

**Figure 7.10: Comparison of NFPS net debt to revenue ratio to all other States between 2018-19 and 2022-23**



South Australia's NFPS net debt to revenue ratio increases from 63% in 2018-19 to 91% in 2022-23. This increasing trend is consistent with that in all other States except Western Australia, which is trending down during the period.

South Australia's NFPS net debt to revenue ratio is higher than all other States in 2022-23. Its ratio is five percentage points higher than the second highest State (Victoria, 86%) and 44 percentage points higher than the lowest State (Tasmania, 47%).

### 7.3.5 Increased likelihood that net debt levels will rise further as a result of large infrastructure projects planned beyond the forward estimates and other budget risk factors

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

- North-South Corridor Torrens River to Darlington project – \$5.4 billion total project cost, of which \$5.17 billion is beyond the forward estimates
- Regional Roads package – \$330 million total project cost of which \$225 million is beyond the forward estimates
- Princes Highway upgrade – \$250 million total project cost of which \$225 million is beyond the forward estimates
- Roads of Strategic Importance package – \$275 million total project cost of which \$224.5 million is beyond the forward estimates
- Brighton Road/Hove Level Crossing Upgrade – \$171 million total project cost of which \$80 million is outside the forward estimates.

In addition, there are three other projects (Adelaide Women's and Children's Hospital, the Aboriginal Art and Cultures Gallery and the International Centre for Food, Hospitality and Tourism Studies) where some costs were provisioned in the forward estimates but the balance will be incurred outside the forward estimates. These projects are still subject to final business cases and detailed planning to finalise cost estimates. This work will be progressed in 2019-20.

These large infrastructure initiatives may result in further net debt increases. Debt levels may also increase if significant savings targets, particularly in Health and Wellbeing, are not achieved, enterprise agreement increases for health, education and emergency services workers are above those provided for in the Budget and/or there are budget overruns in existing investing program projects.

These factors highlight the importance of ongoing monitoring of the net debt fiscal target and budget risk exposures.

### 7.3.6 Credit rating agencies maintained a stable outlook for the State

Moody's commented in August 2019 that the stable outlook for the State's credit rating reflects:

- the stable institutional framework that underpins the ratings for Australian States and Territories
- its expectation that there will be no material increase in the State's debt burden beyond its expectations.

Moody's stated that the increase in the State's debt burden to \$21.3 billion by 2022-23 comes from a low base of \$13.6 billion in 2018-19 and is manageable within the current Aa1 rating. It also noted that additional debt funding could be required if the State does not meet its low expenditure targets or there are slippages in its capital program.

Moody's highlighted some challenges for the State's savings program:

- With employee expenses representing 42% of the State's cost base, the targeted savings for 2020 could be difficult to achieve as key wage negotiations are concluded across health, education and emergency services.
- The State has lowered health savings targets to provide additional flexibility for the new Royal Adelaide Hospital to be restructured to deliver services at the national efficient price. Such restructuring may be challenging to achieve in the near term given the hospital's complexity and track record.

In late September 2019 Standard & Poor's confirmed a AA+ credit rating with a stable outlook for the State. It also commented that:

- it expects the State's disciplined approach to its expenditure measures will likely sustain its operating surpluses
- higher capital expenditure than expected has slightly weakened the State's budgetary performance
- the State's debt levels compare well with other similarly rated domestic and international peers.

### 7.3.7 SAFA manages most of the State's debt

SAFA is the State's central borrowing authority and is also responsible for managing most of the State's debt. It lends funds raised from financial markets to various South Australian public sector clients, including the Treasurer (who borrows on behalf of public sector agencies to support their operational requirements) and SA Water. SAFA aims to conduct its treasury functions with a low risk appetite and to protect the interests of the SA Government and clients.

At 30 June 2019, SAFA's liabilities were \$32.8 billion. It had loans to the Treasurer totalling \$13.7 billion. The Treasurer also had funds on deposit with SAFA totalling \$8.7 billion at 30 June 2019.

SAFA manages its treasury function through a portfolio structure. This structure and associated procedures contribute to treasury risk identification and management. This includes the daily management of liquidity, interest rate, currency and credit risk.

DTF advised that the increase in debt will not have a significant impact on SAFA's fundraising and liquidity requirements. The current forecast annual funding task ranges from \$5-6 billion each year, which is similar to SAFA's funding task in 2018-19. SAFA intends to increase the



term of its borrowings in 2019-20, with plans to issue bonds with maturities between 2028 and 2032. It is also reviewing the duration<sup>24</sup> of the Treasurer's borrowing from SAFA (currently around 3.4 years) and reviewing options to manage interest rate risk for the additional borrowings over the forward estimates.

Further details on SAFA's functions are included in the section of my 2018-19 Annual Report titled 'South Australian Government Financing Authority'.

## 7.4 Unfunded superannuation

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

The unfunded superannuation liability is a long-term liability to current and past members of closed defined benefit superannuation schemes. It is forecast to decrease by \$2.4 billion between 2018-19 and 2022-23, from \$12.9 billion to \$10.5 billion.

Unfunded superannuation liabilities are valued at points in time by discounting future superannuation benefit payments by a discount rate that reflects the prevailing risk-free interest rate, consistent with the requirement of Australian Accounting Standards.

The unfunded superannuation liability is calculated in line with Australian Accounting Standards as the net difference between the estimated value of accrued defined benefit superannuation obligations and the value of assets set aside to meet these obligations. Superannuation liabilities are determined on long-term estimates of total liabilities. They are not liabilities that will be called on in total in the immediate future, meaning they can be funded over many years. The State has a long-term funding strategy in place.

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

The Budget reports the SA Government is on target to fully fund the State's defined benefit superannuation liability by 2034. By then, superannuation assets are projected to reach \$11.5 billion, fully offsetting projected superannuation liabilities. Figure 4.1 in Budget Paper 3 provides further detail on trends in the unfunded superannuation liability and superannuation assets.

The Superannuation Funds Management Corporation of South Australia is responsible for investing and managing the funds of South Australia's public sector superannuation schemes. Further details on its functions are included in the section of my 2018-19 Annual Report titled 'Superannuation Funds Management Corporation of South Australia'.

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<sup>24</sup> Duration measures how long it takes, in years, for an investor to be repaid the bond's price by the bond's total cash flows.

#### 7.4.2 Unfunded superannuation liability significantly impacted by movements in risk-free interest rate used as discount rate

The estimated 2018-19 unfunded superannuation liability in the 2019-20 Budget is \$12.9 billion, a \$2.1 billion increase from the 2018-19 Budget estimate of \$10.8 billion. This is mainly due to the impact of a lower discount rate used for the 2019-20 Budget (2.1%) compared to the 2018-19 Budget (2.9%).

As required by Australian Accounting Standards, the unfunded superannuation liability is estimated at a point in time by discounting projected future superannuation benefit payments by a discount rate that reflects the risk-free interest rate. The reference rate used is the Commonwealth Government nominal bond rate that reflects the average maturity on the liability. Due to the high value of the expected payments to beneficiaries and the long-term nature of the liabilities, the valuation of the superannuation liability is sensitive to movements in the discount rate.

The Budget notes the unfunded superannuation liability is a long-term liability with significant volatility evident over time, reflecting the short-term variability resulting from some key valuation assumptions, in particular the discount rate and actual investment earnings. While volatility in the past has resulted in multi-billion dollar revisions to the value of the liability recorded on the balance sheet, there was no material change in the expected payments to beneficiaries underlying the liability.

# Appendix 1 – Reporting framework

## Uniform Presentation Framework

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

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

### Revisions to the UPF

The UPF was revised in 2008, following the introduction of AASB 1049 *Whole of Government and General Government Sector Financial Reporting*. AASB 1049 aims to harmonise Government Finance Statistics (GFS) and Generally Accepted Accounting Principles (GAAP), with the objective of improving clarity and transparency of government financial statements.

An updated UPF was released in February 2019 to incorporate revisions to the framework as a result of the 2015 update to the Australian GFS framework. The update of the Australian GFS framework aims to better align it with the International Monetary Fund's GFS 2014 framework and the System of National Accounts 2008.

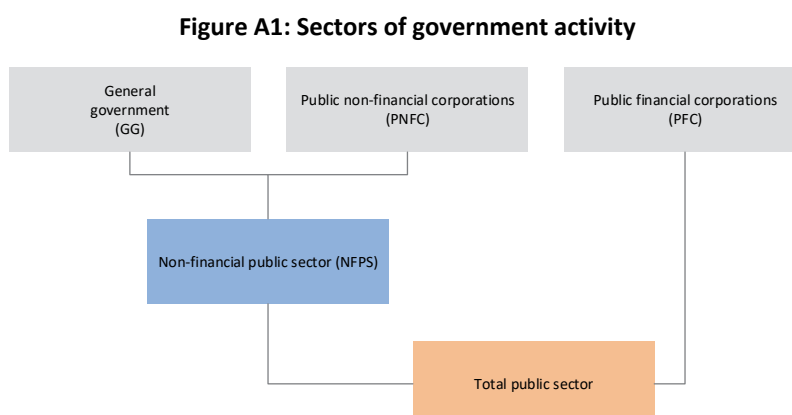
Presentation changes were made in the 2019-20 Budget from 2019-20 to achieve full compliance with the UPF. The impact of these changes on key account balances and fiscal measures is detailed in Appendix F of 2019-20 Budget Paper 3.

### Institutional sectors

Budget reporting is prepared for the following institutional sectors, recognising that SA Government responsibilities cover a wide range of activities:

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

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



## Budget reporting

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

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

PFC sector data is not published in the Budget Papers.

## Fiscal measures

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

Figure A2 sets out some of the key fiscal measures in the UPF.

**Figure A2: UPF – key fiscal measures**

Fiscal measure	Description
Net operating balance	<p>The excess of revenue over expenses from transactions. The net operating balance excludes expenditure on the acquisition of capital assets, but includes non-cash costs such as accruing superannuation entitlements and the consumption of capital (depreciation).</p> <p>Also referred to as operating result.</p> <p>Provides a measure of the sustainability of the government's fiscal position over time and provides an indication of the sustainability of the existing level of government services.</p>

Net lending/borrowing (fiscal balance)	<p>Net operating balance less the net acquisition of non-financial assets.</p> <p>Measures a government's investment-saving balance. A fiscal surplus indicates that a government is saving more than is required to finance all of its investment spending and is therefore not contributing directly to the current account deficit.</p>
Net worth	<p>Total assets (both financial and non-financial) less total liabilities, shares and other contributed capital.</p> <p>Net worth incorporates a government's non-financial assets, such as land and other fixed assets, which may be sold and used to repay debt, as well as certain financial assets and liabilities not captured by the net debt measure, most notably accrued employee superannuation liabilities, debtors and creditors.</p>
Net debt	<p>Sum of deposits held, advances received and borrowings, less the sum of cash and deposits, advances paid, investments, loans and placements.</p>
Net financial worth	<p>Calculated from the balance sheet as financial assets less liabilities. It differs from net financial liabilities in that equity in non-financial public corporations and PFCs is included as assets.</p> <p>Measures a government's net holdings of financial assets.</p>
Net financial liabilities	<p>Total liabilities less financial assets (net financial worth), but excluding equity investments (net worth) in the other sectors of the jurisdiction.</p> <p>Net financial liabilities include substantial non-debt liabilities such as accrued superannuation and long service leave entitlements.</p>

## Australian Accounting Standards

### New accounting standards

The following new accounting standards issued by the Australian Accounting Standards Board were applied for the first time in the 2019-20 Budget from 2019-20:

- AASB 15 *Revenue from Contracts with Customers*
- AASB 1058 *Income of Not-for-Profit Entities*
- AASB 16 *Leases*.

Appendix F of 2019-20 Budget Paper 3 details the impact from the adoption of new accounting standards.

## Whole of government and general government sector financial reporting

The whole of government/general government consolidated financial report is prepared under accounting standard AASB 1049. It sets out the requirements for whole of government and general government sector financial reporting. The standard requires compliance with other applicable Australian Accounting Standards (except as specified in the standard) and disclosure of additional information such as reconciliations to key fiscal aggregates determined in line with the Australian Bureau of Statistics' *Australian System of Government Financial Statistics: Concepts, Sources and Methods*.

The consolidated financial report provides the opportunity to observe the financial result of the SA Government using a full accrual accounting basis, and the consolidation of all sectors. The consolidation process means that all inter-sector transactions are eliminated, including significant transactions relating to SA Water dividends described in this Report.

## Budgetary reporting in general purpose financial statements

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

AASB 1055 *Budgetary Reporting* requires not-for-profit entities within the general government sector, whose budgeted financial statements are presented to Parliament, to disclose:

- original budgeted amounts, presented and classified on a basis that is consistent with the financial statements prepared in line with Australian Accounting Standards
- explanations of major variances between the original budget and actual amounts (which may include reference to revised budgets presented to Parliament).

These disclosure requirements have applied to both the controlled and administered items of an entity where such budget information is presented to Parliament.

AASB 1055 requirements also apply to the general government sector and the whole of government financial statements.

## Appendix 2 – Abbreviations used in this Report

Abbreviation	Description
AASB 15	<i>AASB 15 Revenue from Contracts with Customers</i>
AASB 16	<i>AASB 16 Leases</i>
AASB 1049	<i>AASB 1049 Whole of Government and General Government Sector Financial Reporting</i>
AASB 1055	<i>AASB 1055 Budgetary Reporting</i>
AASB 1058	<i>AASB 1058 Income of Not-for-Profit Entities</i>
CALHN	Central Adelaide Local Health Network
CPI	Consumer Price Index
CTP	Compulsory third party
DHW	Department for Health and Wellbeing
DHS	Department of Human Services
DTF	Department of Treasury and Finance
FTE	Full-time equivalent
GAAP	Generally Accepted Accounting Principles
GFS	Government Finance Statistics
GST	Goods and services tax
ITE	Income tax equivalent
MAC	Motor Accident Commission
MYBR	Mid-year budget review
NDIS	National Disability Insurance Scheme
NFPS	Non-financial public sector
PFC	Public financial corporation
PNFC	Public non-financial corporation
SAFA	South Australian Government Financing Authority
SAHT	South Australian Housing Trust
SA Water	South Australian Water Corporation
TVSP	Targeted voluntary separation package
UPF	Uniform Presentation Framework

