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

Report

of the

Auditor-General

for the

Year ended 30 June 2005

Tabled in the House of Assembly and ordered to be published, 17 October 2005

Fourth Session, Fiftieth Parliament

PART A

Audit Overview

By Authority: G. K. Parker, Acting Government Printer, South Australia

2005

Government
of South Australia

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30 September 2005

The Hon R R Roberts, MLC
President
Legislative Council
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The Hon R Such, MP
Speaker
House of Assembly
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Gentlemen,

AUDITOR-GENERAL'S REPORT 2004-05

Pursuant to the provisions of the *Public Finance and Audit Act 1987*, I herewith provide to each of you a copy of my 2005 Annual Report. This Report includes the Honourable the Treasurer's Statements for the financial year ended 30 June 2005.

Content of the Report

This Report is in two parts – Part A and Part B.

Part A –The Audit Overview is a general review of, and report on, the public finances of the State. It also contains some commentary of Audit findings and comment concerning specific issues of importance and interest in the public sector that are brought to the attention of the Government and the Parliament pursuant to the provisions of subsections 36(1)(a)(iii) and 36(1)(b) of the *Public Finance and Audit Act 1987*.

Part B – Volumes I, II, III, IV and V contain comment on the operations of individual public authorities, the financial statements of those public authorities, and the Treasurer's Statements. A number of matters that, in my opinion, are of administrative significance or importance to the Government and the Parliament that are contained in Part B of this Report are listed separately under the heading 'References to Matters of Significance'. This list can be found immediately after the Table of Contents in the front of Volumes I, II, III, IV and V of Part B.

Auditor-General's Annual Report

In accordance with subsection 36(1)(a) of the *Public Finance and Audit Act 1987*, and subject to comments made within this Report, I state, that in my opinion:

(i) the Treasurer's Statements reflect the financial transactions of the Treasurer as shown in the accounts and records of the Treasurer for the financial year ended 30 June 2005;

(ii) the financial statements of each public authority reflect the financial transactions of the authority as shown in the accounts and records of the authority;

(iii) the controls exercised by the Treasurer and public authorities in relation to the receipt, expenditure and investment of money; the acquisition and disposal of property; and the incurring of liabilities, are sufficient to provide reasonable assurance that the financial transactions of the Treasurer and public authorities have been conducted properly and in accordance with law.

Whilst I have not seen fit to express a qualified opinion with respect to matters referred to in subsection 36(1)(a)(iii) above, there have been cases where in some agencies, systems of internal controls have not, in my opinion, been of an acceptable standard. Where this has occurred, I have, in accordance with the provisions of subsection 36(1) of the *Public Finance and Audit Act 1987*, drawn attention to this fact and included comment on my reason(s) in the report on the agency concerned in Part B of this Report.

Report and Opinion on Controls

As required by subsection 36(1)(a)(iii) of the *Public Finance and Audit Act 1987*, the audit included an assessment of the controls exercised by the Treasurer and public authorities in relation to the receipt, expenditure and investment of money, the acquisition and disposal of property and the incurring of liabilities and also, where applicable, whether the controls in operation were consistent with the prescribed principles of the Financial Management Framework as required by Treasurer's Instruction 2 'Financial Management Framework'. The overall aim of that assessment was to establish whether those controls were sufficient to provide reasonable assurance that the financial transactions have been conducted properly and in accordance with the law.

It is not practical in any such assessment to review each and every control in respect of each and every transaction. Whilst every effort is made to test the sufficiency of controls across a representative range of transactions, it must be remembered that no system of control is 'fail-safe'.

The Parliament has recognised this in stating that the controls need only be sufficient to provide, at the time of audit, 'reasonable assurance' of the matters set out in subsection 36(1)(a)(iii).

The Audit assessment has been made by reviewing the adequacy of procedures and testing a number of control components against a range of financial transactions conducted at various levels of the organisation.

In assessing the sufficiency of these controls, particular regard has been had to the organisation's structure, risk and the inter-relation of policies, procedures, people, management's philosophy and operating style, demonstrated competence, and overall organisational ethics and culture. All of these matters serve as inter-related elements of control.

The standard by which Audit has judged the sufficiency of controls is whether and how well those controls provide reasonable assurance that financial transactions of the Treasurer and public authorities have been 'conducted properly and in accordance with law'. This concept requires the organisation to meet the standards of financial probity and propriety expected of a public authority and, at all times, discharge its responsibilities within the letter and spirit of the law, both in terms of its own charter and as an instrumentality of government discharging public functions.

Except for the matters detailed for each agency in Part B of my Report under the section 'Audit Findings and Comments', Audit formed the opinion that the controls exercised in relation to the receipt, expenditure and investment of money; the acquisition and disposal of property; and the incurring of liabilities were sufficient to provide reasonable assurance that the financial transactions were conducted properly and in accordance with the law. In respect of those matters where the controls exercised were not sufficient to provide that level of assurance, Audit has made recommendations as to where improvements are required.

Qualified Audit Opinions

It was found necessary to issue a qualified audit opinion in the Independent Audit Report in seven instances. The agencies concerned are:

- Administrative and Information Services — Department for
- Education and Children's Services — Department of
- Environment and Heritage — Department for
- South Australian Forestry Corporation
- South Australian Motor Sport Board
- University of South Australia

The reason for, and the extent of, the qualification in the Independent Audit Report is described in the commentary on each of those agencies to be found in Volumes I, II, III, IV and V of Part B of this Report.

Acknowledgments

I would like to place on record my gratitude for the dedicated efforts of my staff throughout the financial year. Their professionalism and dedication have been of the highest order. Their efforts are reflected in the contents of this Report.

I extend my thanks to the Under Treasurer, Government Publishing SA, and their staff, and the report printing coordinator, Mr D O'Keefe, for their efforts which have assisted materially in the production of this Report. The cooperation of all public authorities with my staff during the financial year is also acknowledged.

Yours sincerely,

K I MacPherson
AUDITOR-GENERAL

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MEMORANDUM TO PARLIAMENT

INTRODUCTION

The legislative audit of the State necessitates that the Auditor-General examine and reflect upon aspects of governmental activity that give rise to financial consequences either actual or contingent, and where appropriate, draw matters of importance to the attention of the Government and the Parliament.

In this Report, in addition to the extensive commentary on the State's finances, I provide comment on matters of relevance to the discharge of the audit mandate that have arisen in 2004-05. Some matters are associated with public administrative responsibilities and the implementation of public policy initiatives that, in my opinion, have the potential to give rise to future liabilities. This is particularly the case in circumstances where the risks involved may, at present, either not be appropriately recognised and/or managed.[1]

The Public Finances

The 2005-06 Budget Papers show the Government financial operations for 2004-05 to be on target for a third consecutive annual surplus. Strong revenues have again assisted in the achievement of established budget targets. The marked improvement in the State's finances over a number of years culminated in September 2004 with South Australia being upgraded to a triple-A credit rating for the first time in nearly 14 years. This recognised the State's strong balance sheet, good financial performance, and commitment to fiscal discipline.

These achievements have allowed the Government to modify is budget strategy. The Government's revised fiscal targets and the reported progress in the achievement of these targets is as stated in the 2005-06 Budget Papers.[2]

The revised strategies relax some of the stringent targets allowing for the pursuit of other policy initiatives including further infrastructure development. As stated in the commentary on State Public Finances in Part A of this Audit Report, should the Government's projections with respect to lower revenue growth come to pass, then the need to manage expenses will be keener than in past years. The move to lower some of the previous targets in turn reduces some of the inbuilt buffer to the annual budget outcomes. This, in turn, emphasises the importance of soundly based data input to underpin the integrity of the budget process, commencing with the setting of estimates to the monitoring of outcomes.

Public Policy and the Audit Mandate

Public policy has its outworking in the operational decisions and the conduct of those public officers[3] who have the responsibility for the implementation of that policy.[4] All

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[1] See *Public Finance and Audit Act 1987*; section 36 (1)(a)(iii) and section 36 (1)(b).

[2] See Budget Paper 3, page 1.7.

public policy initiatives either directly or indirectly have a financial consequence and accordingly invoke the legislative audit of the State under the *Public Finance and Audit Act 1987*.[5]

Subject to any constitutional and/or statutory provisions to the contrary, it is a matter for the Executive Government of the day to determine its policy objectives. The implementation of those objectives, ie public administrative policy, is undertaken in accordance with the Executive's prerogative powers and/or the authority of the Parliament as provided in legislation.

Audit Risk and the Matter of Internal Controls

As stated in an earlier Audit Report, audit planning and procedures must necessarily adjust to developments that have implications for the assessment of the 'audit risk'.[6] Audit risk can and does arise across a broad range of administrative activities and may involve matters that are not necessarily directly concerned with the financial attest opinion for a particular year. In this context, there are certain matters that, in my opinion, if not adequately managed and proper controls implemented, should be noted as having a high potential to give rise to contingent liabilities for this State.

The audit mandate, simply stated, requires that the Auditor-General must express an opinion and report to the Government and the Parliament regarding those matters stipulated in the *Public Finance and Audit Act 1987*. It is, in my opinion, not possible to express such an audit opinion, ie discharge the audit responsibilities mandated by law, without a proper analysis of the factual circumstances that underlie the financial transactions upon which such an opinion is based.

Assurance that the exercise of public powers by public authorities are in accordance with the requirements of propriety and lawfulness necessitates that the operation of the internal controls within public authorities provide reasonable assurance that such is the case. It is the responsibility of the Auditor-General to provide the Government and the Parliament with his/her opinion regarding such matters.[7]

The continued development of the law with respect to the liability of public authorities necessitates a constant focus on risk management within government.[8] The need for adequate public/corporate governance and risk management processes are now firmly established as matters of significance in the audit and accountability of government.

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3 'Public officers' in this context includes not only those persons employed under the *Public Sector Management Act 1995*, but also those persons who may more broadly be regarded as part of the public sector. Public officers include Ministers of the Crown.

4 In some matters, the responsible Minister has the authority to direct the manner and form of the implementation of certain policy objectives of the Government. In other matters, express statutory provisions either limit or provide for the manner and form in accordance with which the responsible Minister may exercise authority regarding the implementation of policy objectives.

5 See A J V Durell; 'The Principles and Practice of the System of Control Over Parliamentary Grants', Gieves Publishing, page 1: *'All State action costs money, directly or indirectly, and questions of finance must sooner or later affect all public policy and business as weighty, if not determining factors'*.

6 Report of the Auditor-General for the year ended 30 June 2004; Part A, page 2.

7 *Public Finance and Audit Act 1987*; section 36 (1)(a)(iii).

8 See *Brodie v Singleton Shire Council* (2001) 206 CLR 512.

THE AUDIT MANDATE IN MATTERS ASSOCIATED WITH THE 'LAW AND ORDER POLICIES' OF GOVERNMENT

Introduction

Responsibilities associated with the implementation of the law and order policies of government involve a number of public sector entities, ie, inter alia, Departments of State, a statutory authority, an independent office-holder, and private contractors.[9] All transactions associated with those policies, as noted above, involve the expenditure of public monies, and, accordingly, are subject to legislative audit assurance, and importantly, must comply with all applicable common law and statutory requirements.

In this Memorandum, having regard to issues of audit relevance that have arisen during the past financial year, the comments in this Report consider certain matters associated with the South Australian Police Department (SAPOL)[10] and the Department of Correctional Services.

Both of these departments are 'public authorities' as defined in the *Public Finance and Audit Act 1987*.[11] Certain matters have arisen in recent times that give rise to the requirement that the legislative audit of the State make appropriate inquiry with respect to the adequacy of controls associated with the administration and management of operational and financial matters within this State as they relate to these two public authorities.

Certain Principles Associated with Police Management and Operations

As a matter of principle and sound policy, subject to the provisions of the *Police Act 1998* and any other relevant statutory provisions, 'Police operational independence' does not, in my opinion, override express statutory provisions that provide for accountability for public monies, eg the *Public Finance and Audit Act 1987.* Further, where such statutory arrangements specifically require that the controls associated with the receipt, expenditure, etc, of public monies require that the internal administrative controls within the public authority provide for reasonable assurance as to the propriety and lawfulness concerning the transactions of the public authority, the audit procedures must necessarily examine the processes undertaken that relate to the matter that is the subject of audit review.[12]

It is important to be aware of the nature of the relationship between the Executive Government and the Police in matters associated with law enforcement. This involves an

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9 eg South Australian Police Department (SAPOL), Department of Correctional Services, Courts Administration Authority, Director of Public Prosecutions and private prison contractors.

10 The *Police Act 1998* in section 4 refers to the 'South Australia Police'. The Police Department includes not only the South Australian Police as defined in the *Police Act 1998*, but also includes public servants under the *Public Sector Management Act 1995* and other employees attached to the Police Department. For ease of reference the term 'SAPOL' has been used in this commentary. Where it has been necessary to differentiate between Police officers and other employees this has been made clear in the text.

11 Section 4; *Public Finance and Audit Act 1987*.

12 Section 36 (1)(a)(iii) of the *Public Finance and Audit Act 1987*. It is to be emphasised that there has been no suggestion by SAPOL that this is not the case. See also in this Memorandum under the heading 'Audit Mandate and Audit Procedures: Advice to the Parliament on Matters that have been Raised in 2004-05'.

understanding of the legislative and common law principles that apply in this context.[13] Decisions regarding the control and management of SAPOL are, under the *Police Act 1998,* vested in the Commissioner for Police.[14] Section 6 of the *Police Act 1998* provides that, subject to that Act, the Commissioner may be directed by the responsible Minister. Where a direction is given by the Minister it must be Gazetted for public notification and laid before Parliament.[15]

The implementation of the law and order policies of government, having as they do a direct consequence for matters involving Police administrative and operational processes, fall within the State audit legislative mandate. In order that there should be no misunderstanding, there is no suggestion in this context that the audit mandate allows for any involvement by State Audit in the matter of Police management and/or operational decisions.

Nonetheless, all administrative and operational decisions within government must take place within a proper framework of controls that provide reasonable assurance as to the propriety and lawfulness of the transactions involved. Where necessary, the legislative audit of this State must, where circumstances so require, examine processes and the associated controls of public authorities and report on matters that, in the opinion of the Auditor-General, are important to bring to the attention of the Government and the Parliament.[16]

Inadequacies in the control environment within government agencies can result in actual costs to the community that could have been avoided had proper/adequate controls been in place and properly managed. The Kapunda Road Royal Commission is an example of this situation in this State.[17]

Kapunda Road Royal Commission

The Kapunda Road Royal Commission has raised a number of concerns regarding the adequacy of the internal controls associated with the operational procedures in the Major

13 See *Police Act 1998*. The functions of the SA Police are set out in section 5 of the *Police Act 1998*. See also the 'Royal Commission Report on the September Moratorium Demonstration' (1970) and the 'Royal Commission Report on the Dismissal of Harold Hubert Salisbury' (1978) regarding the relationship between the Executive Government and the Commissioner of Police.

14 The Commissioner for Police, as a Chief Executive Officer of a public authority, with respect to matters associated with the administration of the Police Department, is subject to legislative provisions regarding the responsibilities of a Chief Executive of an administrative unit under the *Public Sector Management Act 1995* and the *Public Finance and Audit Act 1987*. This also includes compliance with the Treasurer's Instructions issued under the *Public Finance and Audit Act 1987*.

15 The *Police Act 1998;* section 8. In accordance with his/her responsibilities under the *Public Sector Management Act 1995*, the Commissioner for Police is subject to the direction of the Premier (in his capacity as the Minister responsible for the *Public Sector Management Act 1995)* and/or by the Minister responsible under the administrative arrangements for the administration of the *Police Act 1998*. The Commissioner is not, however, subject to direction with respect to the control and management of SAPOL otherwise than as is provided for in the *Police Act 1998*. No Ministerial direction can be given regarding the exercise of the prosecutorial discretion of the Police (see Salisbury Royal Commission Report – 1978; paragraph 53).

16 An advice from the Crown Solicitor confirming the Auditor-General's mandate in these matters has been issued.

17 By way of a further example of issues that can arise in the context of Police operations, in August 2005, the Victorian Government announced that millions of dollars would be incurred to implement new administrative arrangements and a new computer system to resolve deficiencies in the security of sensitive information held on that State's current criminal database, namely the 'LEAP' system.

Crash Investigation Unit (MCIU) of SAPOL. The MCIU is only one of several operational areas within SAPOL. The Royal Commissioner did not accept the submissions of SAPOL that the Police investigation regarding Mr Eugene McGee was undertaken appropriately, efficiently and expeditiously.

The public interest demand that gave rise to the need for the calling of the Royal Commission was, in part, a direct result of the concern as to the adequacy of the Police procedures associated with the investigation of the actions of Mr Eugene McGee. The Royal Commission Report was critical of the SAPOL procedures associated with the MCIU.[18]

The financial costs associated with the conduct of the Royal Commission were significant.

There are corrective measures that must now be taken by SAPOL, and other agencies involved in this Royal Commission, to address the various inadequacies concerning internal controls that have been identified.

The Administration of the DNA Database: *Criminal Law (Forensic Procedures) Act 1998*

SAPOL perform a central role in the administration of the justice system within the State. As with most large government agencies, SAPOL spends considerable public monies on the implementation and operation of systems and associated controls to facilitate the administration and management of operational and financial matters.

The systems and associated controls under the administration of SAPOL in relation to the criminal justice system are required to meet a high standard. This is necessary to minimise the risk of error and sub-optimal operation of critical systems, and avoid if possible incurring unnecessary expense, or indeed, incurring potential liabilities. The public confidence in the administration of justice is dependent upon SAPOL ensuring that high operational and ethical standards are maintained at all times.

During the year, Audit undertook a review of one of the key systems under the responsibility of SAPOL that is critical in the matter of the administration of justice within the State.

This system is the 'DNA database' system. Its configuration and use is, in a large part, governed by specific legislation.[19] Under the legislation, the Commissioner of Police is responsible for the DNA database. Key aspects of its operations have been delegated under a Memorandum of Understanding to the Director, Forensic Science, Department for Administrative and Information Services.

The DNA database system provides for the searching and matching of certain personal DNA profiles, as determined by the legislation. The information contained in the DNA

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[18] Report of the Kapunda Road Royal Commission (July 2005). Term of Reference 1A of the Royal Commission required the Royal Commissioner to report as to whether the Police investigation of the relevant conduct associated with the investigation was undertaken appropriately, efficiently, and expeditiously in all respects. The 'Findings' of the Royal Commission as set out on page 90 of its report states, inter alia, that the SAPOL investigation 'is open to criticism that it was inappropriately conducted' and that the investigation 'was not undertaken appropriately, efficiently and expeditiously in all respects'.

[19] *Criminal Law (Forensic Procedures) Act 1998.*

database is used by SAPOL for the investigation of criminal offences and in subsequent legal proceedings.

The audit of the system and associated controls revealed some important matters of administration, process, and security and control, that did not meet the quality standards required for such a critical system.

These matters of concern[20] relate to:

- certain issues associated with the operation of the DNA database that, in my opinion, were not in strict compliance with the relevant statutory requirements. In particular, this relates to the important matter of the destruction and removal of DNA profile information as stipulated in the *Criminal Law (Forensic Procedures) Act 1998* from all electronic and hard copy records, including temporary files and backup media;

- the security and control arrangements applying to the system did not, in some important respects, meet the Government's required security standards;[21]

- notwithstanding the system having been in operation for many years, the administrative arrangements for annual internal audit reviews of the DNA database system operation have only recently been initiated.

The review of the DNA database system was one of three systems relating to sensitive personal information of a forensic and medical nature that was the subject of audit examination during 2004-05. The results of this audit will be the subject of further commentary in a separate report to be tabled in the Parliament.

Audit Comment

SAPOL's legislative and administrative activities are wide ranging and as such in the discharge of their law enforcement activities wide discretionary powers are vested in Police officers. In these circumstances, it is important that there be adequate controls associated with the exercise of these powers. In short, to comply with relevant legislative and common law requirements, each operational activity within SAPOL must be adequately managed and controlled.[22]

All SAPOL operational decisions, directly or indirectly, involve the expenditure of public monies. There is always the potential for these decisions to give rise to actual and/or contingent liabilities. The propriety and lawfulness of transactions associated with Police operational procedures has, on the basis of recent experience, raised public interest concerns. Apart from the statutory provisions concerning State Audit, there is no

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[20] These matters have been raised with the relevant authorities, ie SAPOL and the Department for Administrative and Information Services and corrective action is now being implemented.

[21] Government-mandated Information Security Management Framework, April 2003.

[22] The exercise of all public power is subject to the requirements of the Rule of Law. One aspect of particular relevance concerning compliance with the Rule of Law is the requirement that in the exercise of both prerogative and statutory powers public officers must act within the framework generally known as the Wednesbury rules, ie act reasonably. See also discussion of this matter in *Zaravinos v New South Wales* (2005) 214 ALR 234. This case involved the exercise of Police powers. Zaravinos' case discusses the importance of compliance with the law and government exposure to liability where there has been a failure in this regard.

provision in the constitutional framework whereby the Parliament can be independently informed on an ongoing basis regarding matters relating to Police accountability concerning financial administration and the adequacy of the controls associated with operational decisions within SAPOL.[23]

Whilst the Government has the right to be informed generally as to the operations of any particular section of the Police Force,[24] in my opinion, there is a need to review the current arrangements. Whilst the audit mandate is reasonably extensive and encompasses matters of propriety and lawfulness regarding the transactions of public authorities, in my opinion, there are nonetheless, gaps in the accountability framework that applies to Police operational matters at the present time.

MANAGEMENT OF INHERENT RISK ISSUES ASSOCIATED WITH THE ADMINISTRATION OF PRISONS

Introduction

Where government has a duty of care, there are certain matters that, in my opinion, give rise to the potential for a contingent liability in situations that have not, in the past, been readily recognised as such, or if recognised as such, were not the subject of adequate controls and/or proper risk management. Two such matters involve 'child protection' and 'persons in lawful custody'.

Whilst child protection has received considerable prominence in recent times and is now a focus for attention by relevant authorities, the second mentioned matter, ie a duty of care to persons in lawful custody, has only recently come into prominence. This recent prominence, in large part, is due to matters arising with respect to Commonwealth immigration detention, although there are a number of cases that have come before the courts in which the liability of the State to those in custody has been examined. In my opinion, this is a matter that should be accorded appropriate attention in State custodial institutions to mitigate and manage the risks that are involved.[25]

Departmental Processes

In response to Audit inquiry in 2005, the Department of Correctional Services outlined prison admission processes and provided proforma documentation that recorded relevant information for the initial assessment of prisoners. There was clear evidence that the Department of Correctional Services has processes and procedures and protocols in place that provide the opportunity to identify and manage risks associated with mental

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23 There is, of course, the jurisdiction of the Police Complaints Authority and the Ombudsman that is relevant in certain circumstances. There is also an external auditor, ie a former judicial officer who has been appointed External Auditor of the Anti-Corruption Branch of the South Australia Police. The External Auditor under the administrative arrangements reports to the Minister.

In a number of Australian and overseas jurisdictions it has been deemed necessary to provide a capacity to ensure that Policing activities are subject to independent oversight. In the absence of this capacity there can be no independent assurance that instances of Police failure to comply with the law will necessarily be brought to account, other than as a result of a Royal Commission, judicial proceeding, or other similar Inquiry. See also *Zaravinos v New South Wales* (2005) 214 ALR 234.

24 Royal Commission Report on the Dismissal of Commissioner Harold Salisbury (1978); paragraph 55.

25 See also the comment by the Hon AJ Redford, MLC on 21 July 2004, reported in the Parliamentary Hansard at pages 2108-2109.

illness and other risk issues. This includes involvement of the South Australian Prison Health Service. In summary, Procedural Manuals provided by the Department for review indicated that the substantive procedures that apply are comprehensive in seeking to identify issues associated with the health and other risks of prison inmates.

The Department of Correctional Services was also committed to being able to provide a primary mental health response knowledge to its staff. This is, of course, subject to relevant industrial implications. Notwithstanding its existing procedures and commitment to improvements, it also acknowledged that due to an increased prevalence of prisoners identified as requiring forensic mental health intervention, some of those in prison are being held awaiting assessment and transfer simply because there is no capacity to accommodate them in psychiatric institutions.

Some Fundamental Principles

It is also to be noted that persons in custody continue to have the common law right to bring an action against the Government for damages for injuries suffered by them whilst in custody where these injuries are the result of negligence on the part of the relevant government agency. In circumstances where there is a known risk and governmental authorities do not, having regard to that risk, take reasonable steps to address the risk where it would be appropriate to do so, as a matter of general principle, in my opinion, where damage and/or injury arises from that failure, there is a breach of the relevant duty of care.[26] In the absence of specific legislative provisions that protect the Government from liability, there is no forensic shield that would exempt the Government in these circumstances.

In my opinion, injury in this context and hence the potential for governmental liability, may include exposure to contact with communicable diseases whilst in custody, eg hepatitis and HIV Aids. The issues associated with mental illness give rise to particular concerns and impose specific responsibilities on government. Failure to adequately address these responsibilities has the potential to give rise to future liabilities.[27]

There is, in my opinion, in principle, no difference between the exposure to liability now being highlighted by the claims for damages against those institutions, both public and private, that in the past were responsible for a breach of their duty of care to children for whom they were responsible, and prisoners, etc who have been or presently are in State custodial institutions.

The High Court of Australia in K*ondis v State Transport Authority* (1984) 58 ALJR 531 and in *Burnie Port Authority v General Jones Pty Ltd* (1984) 179 CLR 520 has authoratively stated the duty of care of the State in circumstances where the State has a non-delegable duty of care.

In Burnie Port Authority (at 550-551) it was stated as follows:

> *Mason J [in Kondis] identified some of the principal categories of case in which the duty to take reasonable care under the ordinary law of negligence is non-delegable in that sense: adjoining owners of land in relation to work threatening support of common walls; master and servant*

26 *Behrooz v Secretary*, DIMIA (2004) 208 ALR 271. See also Finn J in *S and M v DIMIA* FCA (2005).

27 *S and M v DIMIA* (2005) FCA Finn J.

*in relation to a safe system of work; hospital and patient; school authority and pupil; and (arguably), occupier and invitee. In most, though conceivably not all, of such categories of case, the common 'element in the relationship between the parties which generates [the] special responsibility or duty to see that care is taken' is that 'the person on whom [the duty] is imposed has undertaken the care, supervision or control of the person or property of another or is so placed in relation to that person or his property as to assume a particular responsibility for his or its safety, in circumstances where the person affected might reasonably expect that due care will be exercised' [*Kondis v State Transport Authority *(1984) 154 CLR at 687; see also Stevens v Brodribb Sawmilling Co Pty Ltd (1986) 160 CLR at 31, 44-46]. It will be convenient to refer to that common element as 'the central element of control'. Viewed from the perspective of the person to whom the duty is owed, the relationship of proximity giving rise to the non-delegable duty of care in such cases is marked by special dependence or vulnerability on the part of that person. [*The Commonwealth v Introvigne *(1982) 150 CLR 258 at 271, per Mason J].*

Recent Parliamentary Visit to Pt Augusta and Comments made by Members of the Visiting Delegation

The Parliamentary delegation that visited Pt Augusta gaol on 14 July 2005 has acknowledged that there is a serious and known mental health care issue that exists for prisoners in South Australia's regional gaols. The Parliamentary delegation has also acknowledged that it is extremely difficult to provide proper mental health care to those prisoners who are known to be suffering a mental illness. This is, of course, a long standing problem that has existed for many years.

As already noted in this Memorandum, governments must conduct their activities consistently with the underlying principles of the Rule of Law. To fail to meet its duty of care to persons who are in no position to take care of themselves raises the potential for liability in tort.[28]

In regard to regions, the Department has advised Audit that the issue in regions has been the difficulty attracting qualified persons to positions in those areas. In view of this difficulty, the Department also advised of existing processes to manage its duty of care responsibilities, including transferring offenders to metropolitan prisons for supervision and assessment where this was considered necessary. The Department also advised of plans underway to improve the ability to provide mental health care in regions.

Audit Comment

Inquiries with the Department for Correctional Services have shown the Department is aware of its responsibilities regarding the management of the inherent risks associated with the administration of prisons and its duty of care and has controls and processes in place to mitigate the risk.

Notwithstanding, the Department has also identified specific areas requiring improvement and has indicated strategies to address those matters.

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28 *Behrooz v Secretary*, DIMIA (2004) 208 ALR 271.

The responsibility of governments to protect the vulnerable within the community, and particularly those who are in their care and under their control and for whom they have a direct responsibility under the law is fundamental. The Department has indicated that it will continue to address these matters and respond to the changing characteristics of prisoners over time. A failure to maintain effective controls for this responsibility, may, in my opinion, result in future financial consequences.

THE LEGISLATURE OF SOUTH AUSTRALIA: ACCOUNTABILITY FOR FINANCIAL ADMINISTRATION: THE ADEQUACY OF STANDARDS OF PUBLIC GOVERNANCE, INTERNAL CONTROLS, AND FINANCIAL REPORTING: AUDIT COMMENT

Introduction

The 'Legislature' for the purpose of this Memorandum comprises the House of Assembly, the Legislative Council, and the Joint Parliamentary Service.

Under current arrangements, the financial position and details of the operational performance of the Legislature are not available for Parliamentary and/or public scrutiny.[29] However, from what Audit can readily determine, the costs associated with the Legislature was at least $43 million for 2004-05.

For the reasons discussed hereunder, the governance processes, accountability, and the internal controls of the Legislature in South Australia do not meet the standards that are presently required of other South Australian State public sector agencies and the financial and governance standards that have been implemented in the Commonwealth and each of the other interstate Parliaments. In short, there is a significant accountability deficit with respect to the South Australian Legislature as compared to all other Australian Legislatures. This is a matter of public importance and for this reason, the commentary that follows hereunder has detailed some of the issues that give rise to audit concern.

With respect to a number of matters, there is inadequate information to permit independent audit assurance that transactions undertaken with respect to certain matters involving the expenditure of public monies are proper and lawful. In my opinion, the continuance of a situation where this is permitted is incompatible with current expectations of accountability where public monies are involved.

Audit of the Legislature

The scope of the audit of the Legislature in the 2004-05 financial year included a review of internal controls and sample testing of transactions associated with the following financial systems and activities:

- Budgetary control and management reporting;
- Risk management;
- Payroll for Members and employees of the Legislature;
- Accounts payable and credit cards;
- General ledger;
- Members allowances;
- Property and equipment.

[29] General Purpose Financial Statements are not produced for the Legislature.

In performing the audit, reference was made to the Treasurer's Instructions and the Financial Management Framework. These instructions and framework prescribe the key elements for public governance, accountability, and internal control in the State public sector. Reference was also made to the public governance and accountability processes established by the Commonwealth Parliament and each of the interstate Parliaments.

Limitation on Scope

Audit has not been provided with access to the minutes of the meetings of the Joint Parliamentary Service Committee and the Management Advisory Committee.[30] Audit has been advised that the Committees are prepared to consider specific requests for items of information contained within the minutes. This approach to this matter by the Committees is incompatible with the requirements for auditing independence as established by professional auditing standards and, on any objective basis of accountability and transparency by a publicly funded entity, in my opinion, cannot be regarded as acceptable.

These Committees are responsible for matters of financial management that involve the expenditure of public monies. The failure to provide Audit with full unrestricted access to the records of the two Committees means that Audit is not in a position to independently assess whether the financial decisions of the Committees are proper and lawful and whether those decisions have financial consequences and what the consequences may be. In the absence of the requirement for the preparation of general purpose financial statements for the Legislature, any financial consequences, adverse or otherwise, are not readily capable of identification and measurement.

Responsibility for Ensuring Adequacy of Control Processes

Under the law and practice of the Parliament, it is the Presiding Officers who have the obligation to ensure that the administrative arrangements within their respective spheres of responsibility are adequate in terms of the requirements associated with public financial administrative responsibilities. These responsibilities include the establishment and maintenance of effective public governance processes, accountability, and internal controls within the Legislature.

Audit noted that under the current arrangements no report is made to the Parliament with respect to progress in establishing and maintaining effective public governance and accountability processes. The financial and operational performance of the Legislature is not being effectively reported to Parliament and, as a consequence, the Legislature is not subjected to public scrutiny. Apart from an annual statistics report produced by the Legislative Council, the Parliament's website has no information about the financial and operational performance of the Legislature.

Public Governance and Accountability

In my opinion, the Presiding Officers could consider the following matters to enhance the accountability of the South Australian Legislature:

- Produce a general purpose financial report that enables the Parliament and the public to scrutinise the financial performance and financial position of the Legislature. Although Audit has raised this matter every year since 1996 there has been little progress towards the production of financial statements. The

[30] The Management Advisory Committee provides advice to the Joint Parliamentary Service Committee and the Presiding Officers in relation to the management and working conditions of the staff of the Parliament.

Commonwealth Parliament and all interstate Parliaments produce 'general purpose financial reports'. Under current arrangements there is no capacity for independent audit assurance regarding the detailed analysis of the revenue and expenditure associated with the Legislature nor the position regarding the assets and liabilities of the Legislature. In this situation, in my opinion, there can be no proper accountability.

- Produce Annual Reports for both Houses and the Joint Parliamentary Service that contain information that is consistent with the information included in the Annual Reports of State public sector agencies and interstate Parliaments and make the Annual Reports available for public scrutiny on Parliament's website.[31] The Commonwealth Parliament and most interstate Parliaments produce separate Annual Reports for each House and Joint Services.

- Report to Parliament and the public, possibly through the Annual Report, their progress in establishing effective public governance and accountability processes.

- Report to Parliament and the public, possibly through the general purpose financial report, the cost to taxpayers of providing all benefits to Members and Ex-Members including catering services, allowances, etc.

- Produce a corporate plan outlining the mission, goals and strategies to improve the delivery of Parliamentary services. The Commonwealth Parliament and all interstate Parliaments produce a corporate plan.

- Establish a risk management policy and plan. Although Audit has raised this matter every year since 2001 there has been limited progress towards the establishment of a risk management policy and plan. The Commonwealth Parliament and some interstate Parliaments have established a risk management policy and plan.

- Document policies and procedures for all major financial activities to ensure staff are aware of how to perform the tasks required to maintain an efficient and effective control environment.

Audit Findings

In summary, the audit findings indicated that the public governance processes, accountability, and internal controls of the Legislature require significant improvement to achieve the standard presently required of the State public sector, and applied in the Commonwealth Parliament, and each of the interstate Parliaments.

PARLIAMENTARY (JOINT SERVICES) ACT 1985: CATERING ARRANGEMENTS AT PARLIAMENT HOUSE: THE MATTER OF THE ACCOUNTABILITY BY A STATUTORY AUTHORITY FOR THE EXPENDITURE OF PUBLIC MONIES

Introduction

There have been comments in the media[32] that the cost of the food and drink provided at Parliament House in Adelaide is not subsidised by the South Australian taxpayer.

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[31] The Joint Parliament Service Committee does prepare and table an Annual Report in each of the two Houses of Parliament.

[32] See transcript of ABC Radio 891, Friday 15 October 2004, 8.30-9.00am, Current Affairs.

Whilst the actual 'purchase cost' of the food ingredients and the drink may not be subsidised by the taxpayer, there is not, for the reasons discussed hereunder, full cost recovery for the provision of this service.

The employment cost of the staff who are employed by the Joint Parliamentary Service Committee are paid with monies provided from the Consolidated Account, ie the taxpayer. The various Divisions of the Joint Parliamentary Service are set out in section 7 of the *Parliamentary (Joint Services) Act 1985*. 'Catering' is one of the four Divisions that is established under the Act. It is to be noted that the officers employed in each of the four Divisions are paid with monies made available from the Consolidated Account.

Were the claim of no subsidisation by the taxpayer regarding those officers employed in the 'Catering' Division to be correct, there would necessarily be a reimbursement back to the Consolidated Account of these employment costs and all other costs associated with the provision of this service. There is no record of any such reimbursement of the Consolidated Account. In fact, it is Audit's understanding that the cost of catering operations funded by the taxpayer was at least $890 000 in 2003-04.

Current Audit Arrangements

The audit of the 'Trading Account' of the Joint Parliamentary Service Committee associated with catering is not undertaken by the Auditor-General, but is undertaken by a private sector audit firm.[33] The scope of this audit is not co-extensive with the audit that is required to be undertaken of other public sector bodies. In short, the audit does not include the requirement to express a 'control opinion' that is mandatory in the case of other public sector entities. Whilst such a situation may be acceptable in circumstances where public monies are completely quarantined from the activities involved, that is not the case with respect to the operation of the provision of food and drink at Parliament House. This situation, and the accountability arrangements for the Legislature as discussed in a separate item in this Memorandum, is incompatible with the requirements for accountability and transparency in other matters where public monies are involved.

Why Current Accountability Arrangements are Inadequate

Where public monies are payable for the salary, wages, allowances, superannuation costs, etc of the staff of the 'dining and bar' facilities of the Parliament, there is a public interest in ensuring that the administration of this matter accords with proper standards and controls associated with the expenditure of public monies and that the reporting of these matters is transparent and open to public scrutiny.

In the event that any of these costs are not factored into the price of the food and drinks charged to members of the Parliament and Parliamentary staff, it is clear that the taxpayer is subsidising the provision of food and drinks at Parliament House.

The Auditor-General has made a request to review the minutes of the Joint Parliamentary Service Committee. Whilst this request has been denied, a preparedness 'to consider' specific requests for particular information has been indicated. As already

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[33] It is to be emphasised that nothing in this commentary suggests that the private sector audit is not being discharged in accordance with the highest standards of professionalism and competence. It is also necessary to emphasise that private sector auditors do not have the legislative powers of an Auditor-General to require the disclosure of information that, in my opinion, is important to bring to the attention of the Government and the Parliament.

discussed in another part of this Memorandum, this imposes a scope limitation on the audit responsibilities.[34]

The reason that the Auditor-General does not have the authority to audit the records of the Joint Parliamentary Service Committee arises from the fact that the legislation establishing this Committee is so drafted that the Committee is not a public authority as defined in the *Public Finance and Audit Act 1987*.

Notwithstanding that it is not, by definition, a public authority, the financial operations of the Joint Parliamentary Service Committee, as an entity, are an integral element within the financial operations of the 'Legislature'. The decisions made by this Committee have potential financial consequences for the audit of the two other entities that comprise the Legislature, ie the House of Assembly and the Legislative Council.

Audit Conclusions and Recommendations

As a matter of principle, there is no reason why a statutory body that is an integral part of the governmental structure of the State, and that is funded in part by the taxpayer, should be exempted from the audit scrutiny that is applicable to other governmental entities. In my opinion, it is in the public interest that the *Parliamentary (Joint Services) Act 1985* be amended to address the accountability concerns that presently exist.

SOME ISSUES ASSOCIATED WITH FINANCIAL STATEMENT CERTIFICATION THAT HAVE ARISEN FROM AUDIT COMMENTS IN THE 2003-04 AUDIT REPORT CONCERNING THE MATTER OF THE CROWN SOLICITOR'S TRUST ACCOUNT

Introduction

The issues associated with the audit of the Attorney-General's Department in the 2004 Audit Report, with particular reference to matters arising from the operation of the Crown Solicitor's Trust Account, has raised some matters of importance that, in my opinion, should be brought to the attention of the Government and the Parliament. The operation of this account has been the subject of evidence to two Parliamentary Committees. Neither of these Committees has, at the date of preparation of this Memorandum, presented a report to the Parliament.[35]

In summary terms, the issues that have arisen emphasise the importance for all governmental procedures to be undertaken in compliance with relevant statutory and common law requirements. The commentary hereunder concerning legislative compliance is limited to matters that are associated with the preparation and presentation of financial statements.

A further issue that has arisen in the context of the Crown Solicitor's Trust Account is that members of the public service have a duty of loyalty to the Government of the day to comply with lawful government policy directions. I will briefly discuss this last mentioned matter before providing comments on matters relating to the preparation and presentation of the financial statements of public authorities.

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[34] See herein under the heading 'The Legislature of South Australia: Accountability for Financial Administration: The Adequacy of Standards of Public Governance, Internal Controls, and Financial Reporting: Audit Comment'.

[35] The two Committees concerned are the Economic and Finance Committee of the House of Assembly and a Select Committee of the Legislative Council.

Public Sector Employees Responsibility Regarding Government Policy Directions

The following is an extract from my 16 February 2005 Submission to the Economic and Finance Committee and, in my opinion, is adequate to communicate the issues that are relevant with respect to this topic.

> *The matter of the obligations of public sector employees has been considered in an Auditor-General's Report on an earlier occasion.*[36]
>
> *Good and proper administration necessitates adherence by public sector employees to those principles and values that are essential to protect the community from the arbitrary exercise of governmental power and the misapplication of public monies. These principles and values include compliance with relevant statutory requirements and the obligation of public employees to act with impartiality and objectivity, and with loyalty and fidelity to the Government of the day.*
>
> *Public sector employees are required to serve governments of any political persuasion and must not knowingly and intentionally frustrate the implementation of the legitimate policy goals of the Government of the day. (see section 14 (d) and section 37 (d) of the* Public Sector Management Act 1995*).*[37]
>
> *This is an issue that transcends the party political process and goes to the values that underpin the system of government in this State. It is not for public sector employees to arrogate unto themselves the right to override a legitimate policy directive by a proper authority and seek to circumvent a specific policy requirement. Notwithstanding the fact that it may be considered that a particular policy requirement creates difficulties, where there is no physical and practical impossibility of compliance, it is, in my opinion, the duty of public sector employees to act in accordance with the policy directives.*
>
> *In matters where it is sought, for whatever reason*[38] *to persuade the Government to change a policy decision, it is essential that this be done transparently, through proper processes, and in conjunction and with the concurrence of the proper authority or authorities. In circumstances*

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36 Auditor-General's Supplementary Report on the 'Processes of Procurement of a Magnetic Resonance Imaging Machine by the North Western Adelaide Health Service'; 15 July 2003. The comment on the operations of the applicable principles that, in my opinion, are relevant in this context are taken from that report and restated in the above text with such modifications as are deemed appropriate in the circumstances of the Crown Solicitor's Trust Account.

37 **14. Chief Executive's general responsibilities**

The Chief Executive of an administrative unit is responsible to the Minister responsible for the unit for—

(a) the effective management of the unit and the general conduct of its employees; and

(b) the attainment of the performance standards set from time to time under the contract relating to the Chief Executive's appointment; and

(c) ensuring the observance within the unit of the aims and standards contained in Part 2; and

(d) ensuring that the unit contributes to the attainment of the Government's overall objectives consistently with legislative requirements.

Section 37 is in similar terms with respect to Executives who are not Chief Executives.

38 ie because it is believed that the policy decision is impracticable/unworkable, etc.

where public sector employees take unto themselves the authority to override lawful policy directions of the Government of the day the tendency inherent in such a course of conduct has the potential to undermine public confidence in the governmental administrative processes.

Preparation of Financial Statements

The *Public Finance and Audit Act 1987* is the primary legislative instrument that prescribes the matters to be dealt with by public authorities in discharging their annual financial reporting obligations.

The Chief Executive of each public authority is responsible for the preparation of the authority's annual financial statements. Those statements are to comply with generally accepted accounting principles,[39] Treasurer's Instructions issued pursuant to the *Public Finance and Audit Act 1987,* and Accounting Policy Statements issued by the Treasurer pursuant to the Treasurer's Instructions.

The financial statements, together with a certificate that certifies as to the underlying integrity of the information in the financial statements, are required to be submitted to the Auditor-General for the purpose of the financial statement statutory audit.

Certification of Financial Statements

The authority for the certificate and the requirements to be incorporated in the certificate are stated in section 23 (2) of the *Public Finance and Audit Act 1987*. Section 23 (2) has remained unamended since 1987. In certain respects the requirements of section 23 (2) do not reflect recent changes to financial reporting practices and related requirements. The unchanged position of section 23 (2) has been recognised in an Accounting Policy Statement[40] issued pursuant to the Treasurer's Instructions. That policy statement prescribes the content of the certificate, reflecting both the provisions of section 23 (2) and the present day financial reporting requirements that are informed by prevailing accounting standards and financial accounting and reporting conditions of the Treasurer.

The following extract from the Accounting Policy Statement of the Treasurer outlines the stated requirements of the certificate to cover the financial statements prepared by public authorities.

> *Certification of the Financial Report*
>
> *17. The general purpose financial report of an* **entity** *shall be certified by the Chief Executive and the officer responsible for the financial administration:*
>
> *a. that the financial statements are in accordance with the accounts and records of the authority and give an accurate indication of the financial transactions of the authority for the year then ended;*

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[39] Generally Accepted Accounting Principles includes Accounting Standards, Accounting Interpretations, Urgent Issues Group Consensus Views, Statements of Accounting Concepts, Accounting Guidance Releases, and Accounting Bulletins.

[40] Accounting Policy Statement refers to Accounting Policy Statement No 13 'Form and Content of General Purpose Financial Reports'.

b. *as presenting fairly, in accordance with the Treasurer's Instructions promulgated under the provisions of the* Public Finance and Audit Act 1987*, applicable Accounting Standards and other mandatory professional reporting requirements in Australia, the financial position of the entity as at the reporting date and the result of its operations and its cash flows for the year then ended; and*

c. *that internal controls over financial reporting have been effective throughout the reporting period.*

Diligence to be Applied in the Provision of the Certificate

The certification under the Treasurer's Accounting Policy Statement relates to the integrity of financial statement preparation and the effectiveness of internal controls over financial reporting.

The *Public Finance and Audit Act 1987* and the Accounting Policy Statement do not simply impose an obligation upon a Chief Executive to provide a certificate in a particular form. If that were the extent of the obligation, public authorities would not be obliged to prepare accurate financial statements. Such a situation would be inimical to the accountability principles that underpin the legislative intent of the *Public Finance and Audit Act 1987*.

The certification obligations of a Chief Executive and the officer responsible for financial administration, in my opinion, include a responsibility to be satisfied that the certificate is honestly and responsibly given. In short, both the Chief Executive and the officer responsible for financial administration must take reasonable steps to ensure that the certificate signed by them is not false or misleading. The Chief Executive and the officer responsible for financial administration would not have a reasonable basis for execution of the certificate if either of them was aware that there was information that a particular account balance was knowingly misstated and likely to mislead any interested user of the financial statements.

It is, therefore, important that the Chief Executive has established and maintained satisfactory internal control processes and procedures over financial reporting to ensure the efficient and effective preparation and audit of financial statements, and to enable the certification to be given. Adequate controls would incorporate reconciliation processes in respect of the financial accounting systems, and financial account balances, and quality assurance procedures with regard to documentation supporting the representations in the financial statements.

Audit Comment

In my opinion, a high standard of due diligence is required in the preparation of financial statements of public authorities and the provision of the certificate under section 23 (2) that relates to those financial statements. The certification obligation is a critical underpinning of the accountability processes applied in respect of the preparation of those financial statements. As such, in my opinion, the requirements of the certificate as currently specified in the Accounting Policy Statement should, as is now proposed by the Treasurer in his foreshadowed amendments, be reflected in section 23 (2) of the *Public Finance and Audit Act 1987.*[41]

IMPLEMENTATION OF THE AUSTRALIA UNITED STATES FREE TRADE AGREEMENT IN SOUTH AUSTRALIA

Introduction

Negotiations on the Australia United States Free Trade Agreement (the Agreement) were finalised in February 2004 after 11 months of negotiations.[42] The final text of the Agreement was signed in Washington DC on 18 May 2004.

Both Australia and the United States have passed enabling legislation giving effect to their respective commitments under the Agreement.[43] On 17 November 2004 both governments exchanged 'notes' in Washington DC. These notes provided for the acceptance by each Government of the implementation processes of the other with respect to the Agreement.

The Agreement commenced operation on 1 January 2005.[44]

Contractual arrangements are undertaken by the South Australian Government that fall within the scope of these new arrangements. Set out hereunder are some relevant considerations that, in my opinion, are important to draw to the attention of the Government and the Parliament.

Application of the Agreement in South Australia

Unlike the Commonwealth Parliament, the Parliament of South Australia is not required to pass enabling legislation in order for the Agreement to be effective in South Australia.[45] In short, this is because the external affairs power, contained in section 51(xxix) of the Commonwealth Constitution, vests in the Commonwealth Parliament the legislative power to implement the Agreement.[46]

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41 Similar obligations are required in the private sector under the Corporations Law.

42 The South Australian Government has sought and obtained expert advice regarding the implications for industries in this State that may arise as a result of the implementation of the Australia-United States Free Trade Agreement.

43 In Australia, the legislation is the *US Free Trade Agreement Implementation Act 2004* (Act No 120 of 2004) and the *US Free Trade Agreement Implementation (Customs Tariff) Act 2004* (Act No 121 of 2004). Both Acts were assented to on 16 August 2004.

44 Subsection 2(1) of the *US Free Trade Agreement Implementation Act 2004*.

45 An international agreement to which Australia is a party does not form part of Australian domestic law unless the agreement has been validly incorporated into domestic law by statute: *Minister for Immigration and Ethnic Affairs v Teoh* (1995) 183 CLR 273.

46 *Commonwealth v Tasmania (Tasmanian Dams case)* (1983) 158 CLR 1 at 228 per Brennan J; *Victoria v Commonwealth* (1996) 187 CLR 416 at 485 per Brennan CJ, Toohey, Gaudron, McHugh and Gummow JJ. The *Administrative Decisions (Effect of International Instruments) Act 1995* (SA) is also relevant to the way in which the Agreement applies to South Australian Government agencies. Subsection 3(1) of the Act provides that an international instrument (even though binding in international law on Australia) affects administrative decisions and procedures under the law of South Australia only to the extent the instrument has the force of domestic law under an Act of Parliament of the Commonwealth or South Australia.

What Government Procurement is Covered by the Agreement?

Chapter 15 of the Agreement sets out specific rules, procedures and standards to be applied by government agencies when conducting procurement processes, including the overarching requirement that agencies afford the goods, services, and suppliers of the United States the same treatment that applies to domestic goods, services, and suppliers (which is referred to as 'non-discrimination').[47]

The Chapter applies only to procurements by government agencies listed in Annex 15-A with a value equal to or above certain thresholds. These agencies are referred to as 'procuring entities' in Chapter 15.[48]

South Australian Government Agencies Required to Comply with the Agreement

Australian State and Territory Governments were given the opportunity to nominate which of their government agencies would be subject to the requirements of Chapter 15. South Australian Government agencies — along with other 'regional government' agencies — to which Chapter 15 applies, are listed in Section 2 of Annex 15-A.[49]

Threshold Procurement Values

The threshold procurement values for Australian regional government agencies are set out at the beginning of Section 2 of Annex 15-A as follows:

- for procurement of goods and services (other than construction services) - A$666 000;
- for procurement of construction services - A$9 396 000.[50]

These monetary thresholds are inclusive of the value of any options, premiums, fees commissions and interest.[51] The Agreement requires the thresholds to be adjusted every two years (commencing on 1 January 2006) in accordance with specified adjustment formulas.[52]

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47 See Article 15.5(2).

48 See Article 15.1(2)(c).

49 The South Australian Government agencies listed in Section 2 are Department of the Premier and Cabinet, Arts SA, Department of Treasury and Finance, Independent Gambling Authority, Department of Trade and Economic Development, Department of Primary Industries and Resources SA, Department of Justice, Attorney-General's Department, Department for Correctional Services, Country Fire Services, Courts Administration Authority, Emergency Services Administration Unit, South Australian Metropolitan Fire Services, South Australian Police Department, State Electoral Office, Auditor-General's Department, Department of Health, Department of Families and Communities, Department of Aboriginal Affairs and Reconciliation, Department of Further Education, Employment, Science and Technology, SA Tourism Commission, Department of Environment and Heritage, Environment Protection Authority, Department of Water, Land and Biodiversity Conservation, Department of Transport and Urban Planning, Transport Services, Transport Planning, Office of the Public Transport Board, Planning SA, Office for Sustainable Social, Environmental and Economic Development, Office of Local Government, Department for Administrative and Information Services and State Supply Board.

50 See Article 15.1(2)(b).

51 See Article 15.1(6)(b).

52 The formulas for calculating the amount of the adjustment are contained in Section 8 of Annex 15-A.

Exemptions

Article 15.1(3) excludes certain procurement processes from the application of Chapter 15 generally.[53]

In addition, in respect to South Australian Government agencies, Chapter 15 does not apply to the procurement of health and welfare services, education services, advertising services, or motor vehicles.[54]

Phasing Out Offsets

Any measure providing for inclusion of offsets[55] in procurements by South Australian Government agencies to which Chapter 15 of the Agreement applies, are required to be phased out within three years of the date of commencement of the Agreement.[56]

Summary of Action Taken to Date to Implement Agreement in South Australia

On 13 March 2005, the State Supply Board released State Supply Board Policy Number 17, 'Implementation of the Australia United States Free Trade Agreement'.[57] The policy's purpose is to provide:

> *… a simple introductory overview of the provisions of [Chapter 15] of the AUSFTA and is not intended to be a complete or definitive description of the compliance requirements.*

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53 Examples of excluded procurement processes include:

- non-contractual agreements or any form of assistance that a government agency provides, including grants, loans, equity infusions, fiscal incentives, subsidies, guarantees, cooperative agreements, and sponsorship arrangements;
- procurement of goods and services by a government from its own agencies and provision of goods or services by or between a procuring agency of a government and a regional or local government;
- purchases funded by international grants, loans, or other assistance, where the provision of such assistance is subject to conditions inconsistent with Chapter 15;
- purchases funded by grants and sponsorship payments from persons not listed in Annex 15-A;
- procurement for the direct purpose of providing foreign assistance;
- procurement of research and development services;
- procurement of goods and services (including construction) outside the territory of the procuring government, for consumption outside the territory of the procuring government; and
- acquisition of fiscal agency or depository services, liquidation and management services for regulated financial institutions, and sale and distribution services for government debt.

54 Note 1 to the South Australian Schedule to Section 2 of Annex 15-A.

55 An offset is an offer by a bidder/supplier to provide local content, eg that the overseas bidder/supplier would place a percentage of work with a local firm.

56 See Article 15.2(5) and Note 2 to the South Australian Schedule to Section 2 of Annex 15-A.

57 The *State Supply Act 1985* (SA) establishes the State Supply Board and gives the Board responsibility for achieving these objectives, with a primary focus on ongoing efficiency and effectiveness in South Australian public sector procurement. The functions of the Board as set out in section 13 of the Act are to undertake, make arrangements for or control the supply operations of public authorities, develop and issue policies, principles and guidelines, and give directions, relating to the supply operations of public authorities, investigate and keep under review the supply operations of public authorities and provide advice relating to the supply operations of public authorities, including the training and development of persons engaged in supply operations.

Appendix 1 of the Policy discusses the requirements of Chapter 15 which differ from 'current procurement policies and practices'. Apart from this discussion, and the list of South Australian Government agencies to which Chapter 15 applies, no comprehensive guidance or elicitation of the Board's views is otherwise contained in the Policy.

Audit Comment

Specific risks to the South Australian Government and government agencies covered by Chapter 15 in conducting procurements include the following:

- The limited circumstances in which selective or sole/direct source tendering options can be undertaken.

- The requirement that any supplier whose tender is received after the time specified for receiving tenders should not be excluded from the tender process if the delay is due solely to mishandling on the part of the agency has been interpreted by other jurisdictions as prohibiting an agency from accepting late tenders in any circumstances other than agency mishandling.

- Unless a procuring entity determines that it is not in the public interest to award a contract, it shall award a contract to the supplier that the entity has determined satisfies the conditions for participation and is fully capable of undertaking the contract and whose tender is determined to be the lowest price, the best value, or the most advantageous, in accordance with the essential requirements and evaluation criteria specified in the notices and tender documentation.

- The limitations which have been imposed on the nature of the technical specifications which can be included in a request for tender.

- The limitations which have been imposed on permissible conditions of participation.

- The timing requirements for allowing for the provision of tender responses.

- The requirement for conformance with essential requirements being 'at the time of opening' tenders, which means that an agency may be unable to seek clarification of tenders or provision of information that may have been inadvertently omitted from a tender, unless the agency considers that the non-compliance is an 'unintentional error of form'.

Government agencies should also be aware that Chapter 15 preserves the range of possible remedies available to an unsuccessful tenderer who alleges that an agency has not acted fairly in the conduct of a tender process include an action for breach of process contract,[58] or lack of procedural fairness, or under the law of estoppel or misrepresentation.

Having regard to its importance, this matter is brought to the attention of the Government and the Parliament. In my opinion, there will need to be more detailed policy and procedural guidance provided to agencies to ensure strict controls are implemented in relation to tender processes that fall within the scope of the Agreement.

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[58] *Hughes Aircraft Systems International v Airservices Australia* (1997) 76 FCR 611.

CONTINGENT LIABILITIES OF GOVERNMENT ARISING UNDER THE IMPLIED GOVERNMENT GUARANTEE

Introduction

WorkCover Corporation commenced operations in 1987 and is currently constituted as a Statutory Authority under the *WorkCover Corporation Act 1994* (the Act).

Pursuant to the Act, Workcover holds its property on behalf of the Crown, is subject to the general control and direction of the Minister, and the Board consists of nine members appointed by the Governor. The Act does not provide that the liabilities of WorkCover are guaranteed.

A new Board was appointed in August 2003 following the expiry of the terms of the previous Board on 31 July 2003.

The current Minister has issued directions to WorkCover in May 2002 and April 2003.

In June 2002, the Minister commissioned a report on financial reporting, corporate governance and other practices critical to the financial management of WorkCover. A report was subsequently provided by the South Australian Government Financing Authority in March 2003.

In May 2003, the Minister tabled the Statutes Amendment (WorkCover Governance Reform) Bill. Included in that Bill was a provision that would have resulted in the Auditor-General having an ongoing role in reviewing WorkCover as opposed to the existing audit arrangements that provide that the Corporation must, within the first three months of each financial year, appoint two or more auditors of the Corporation for the financial year.[59]

As the Parliament will record, this arrangement is similar to that that applied with respect to the former State Bank of South Australia. As Auditor-General, I advised the then Public Accounts Committee of my concern that the State Bank was not subject to audit by the Auditor-General. I hold a similar view with respect to WorkCover. In my opinion, the legislation that removed the audit responsibility of WorkCover from the legislative audit mandate created an audit risk that, in the light of the former State Bank of South Australia experience should not continue.

A Matter for Emphasis

It is important to emphasise that the commentary in this part of the Memorandum is not a reflection on either the private sector audit professionalism and/or competence regarding the audit of WorkCover at the present time nor WorkCover management. This commentary has as its focus the scope and the powers that are essential to enable that level of assurance that is necessary in the public interest that is not available to a private sector auditor.[60]

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59 This Bill lapsed and has not been reintroduced.

60 Public interest requirements necessitate that an Auditor-General have formal powers to obtain information. See section 34 of the *Public Finance and Audit Act 1987*.

Some Relevant Matters to be Taken into Account in the Consideration of the Issues Raised in this Commentary

To ensure balance and fairness in the consideration of this matter as regards the measurement of the liabilities of WorkCover, the following advice, dated 5 August 2005, to the Auditor-General from the Under Treasurer, Department of Treasury and Finance should be noted.

> *It is important to note that the increase in the reported liabilities in recent years is in part due to the application of more appropriate measurement methodologies rather than a change in the substance of the liabilities. The new Board moved to value the liabilities using the risk free discount rate and using a prudential margin. Both measures caused a significant increase in reported liabilities but in reality simply reflected the measurement of existing liabilities according to currently accepted accounting principles and practices for such liabilities … The new Board has recognised that a major issue for WorkCover is claims management and is implementing, a range of measures designed to improve the corporation's performance in this area.*

WorkCover Corporation: Whole-of-Government Accounts

Following audit comments, the 2003-04 Budget papers noted the inclusion of WorkCover in the whole-of-government accounts for the first time noting: 'This effect is one of presentation rather than substance as the State was always ultimately responsible for the liabilities of WorkCover'.

Unfunded Liability of WorkCover

WorkCover has carried an unfunded liability for a number of years. The total of that liability has increased annually in all but one of the past four years as shown in the following table.

Reporting Date	Unfunded Liability $'million	Increase $'million
30 June 2000	22	
30 June 2001	56	34
30 June 2002	192	136
30 June 2003	591	399
30 June 2004	572	(19)
31 December 2004 (estimate)	631	59

With reference to the abovementioned table, in 2003 it was expected that the trend for the unfunded liability of WorkCover would be arrested and there was an expectation, published in the WorkCover 2002-03 Annual Report, that the unfunded liability would decrease. While there was a small decrease in 2003-04, to December 2004 the trend has continued in a way that shows the expectation has not been able to be met, at least to this point, which notwithstanding the advice from the Under Treasurer, raises issues regarding the underlying factors that give rise to this situation that should, in my opinion, be the subject of independent legislative Audit assurance to the Parliament and the Government.

Observations Regarding Audit Scope for WorkCover Under Current Arrangements

WorkCover is a statutory authority. Further, notwithstanding the fact there is no formal Government guarantee, on the basis of governmental involvement in the operations of WorkCover, as illustrated in the Under Treasurer's letter, and on the basis of views expressed by former Solicitor-General, Brad Selway QC, there is an 'implied guarantee' that would necessitate governmental action to maintain the viability of WorkCover should the circumstances arise. This could be achieved by way of premium increases, benefit reductions, or injection of funds from the Consolidated Account. The inclusion of the WorkCover liabilities in the whole-of-government accounts clearly indicates that the Government accepts this position.

Having regard to the experience of the State Bank, it is, in my opinion, imperative, notwithstanding the different nature and immediacy of the liabilities of WorkCover and the State Bank, that WorkCover be subject to the same standard of audit assurance as are public authorities. Clearly, at this point of time, the audit responsibilities do not require assurance to the Parliament on the adequacy of controls consistent with the requirement of section 36 (1)(a)(iii) of the *Public Finance and Audit Act 1987*:

> *(iii) the controls exercised by the Treasurer and public authorities in relation to the receipt, expenditure and investment of money, the acquisition and disposal of property and the incurring of liabilities is sufficient to provide reasonable assurance that the financial transactions of the Treasurer and public authorities have been conducted properly and in accordance with law;*

Audit Commentary

By way of a general comment, consistent with the policy intent in the lapsed Bill referred to above, consideration should be given to a substantive role for the Auditor-General so that Parliament can have the same standard of audit assurance that applies to public authorities. Implicit in this recommendation is the fact that the Government itself recognises the liabilities of WorkCover in the whole-of-government financial statements. This is not to say that private sector auditors would not continue to be involved. It would, however, mean that the Auditor-General was ultimately responsible for the determination of the scope of the audit and would have recourse, as may be necessary to the general powers provided for in the *Public Finance and Audit Act 1987*.

The experience of the State Bank has indicated the necessity, in public interest terms, that there be adequate audit powers to ensure the integrity of all information associated with the liability position of WorkCover. This would, in my opinion, suggest that the powers available to the Auditor-General under the *Public Finance and Audit Act 1987* to ensure the integrity and accountability of the processes of a statutory authority for which there is an 'implied guarantee' by the Government, are incorporated and/or applied to any WorkCover legislation.

FRAUD AWARENESS IN GOVERNMENT: RECENT EXPERIENCE INVOLVING THE AUDITOR-GENERAL'S DEPARTMENT

Introduction

In the course of conducting the audit of government during 2004-05, instances of bank account fraud within public sector agencies have come to my attention. Two cases of bank account fraud have also involved the Auditor-General's Department.[61] For the information of the Government and the Parliament I have set out hereunder some comments relevant to this matter.

The two most common methods of fraudulent practice were:

- a facsimile is sent to a bank requesting that funds be transferred into a foreign bank account. The facsimile requests that funds be drawn from a bank account of a public sector agency and the appropriate authorised signatories appear on the facsimile. The public sector agency had not authorised any such transaction but the perpetrator had obtained bank account and signature details in order to fraudulently obtain funds;

- cheques drawn by public sector agencies have been obtained by the perpetrator and amount details altered so that funds are banked into an account (usually overseas) to which they have access.

These incidences reinforce the need to have tight internal controls over the production and distribution of cheques and over the access to information such as bank account numbers and lists of authorised signatories. Additional monitoring mechanisms may also, in the light of recent experience, require consideration.

Auditor-General's Department Experience

During the year there was an attempt by an unknown external party to fraudulently transfer $25 500 from the Auditor-General's Department bank account. The Department's banker, Westpac, received a faxed telegraphic wire payment request dated 6 June 2005 purporting to authorise the transfer of money from the Department's Operating account to a bank account held at Mito Branch of the Kansai Urban Bank in Japan.[62] The Department was contacted by Westpac seeking confirmation that the request was legitimate and the Department immediately advised both Westpac and the Department of Treasury and Finance that the transaction was an attempted fraud.

The Department conducted an investigation and it was identified that the perpetrator had used information obtained from a cheque sent to a creditor which had gone missing. That cheque had been cancelled on 18 March 2005 and a new cheque was subsequently reissued to the creditor.

The information obtained from the Department's investigation was communicated in writing to both Westpac and the South Australian Police Department to facilitate their investigation of the attempted fraud.

Audit Comment

In the light of experience of deliberate fraud, public sector agencies will need to review existing arrangements. Examples of modified processes established by agencies affected by bank account fraud include:

- Requiring banks to refer **all** requests for transfer of funds to a designated officer within the public sector agency so that the transfer can be verified for validity prior to processing.[63]

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61 The Auditor-General does not audit the Auditor-General's Department.

62 A copy of the fraudulent authority is attached as Appendix A to this Memorandum.

63 There may be a threshold amount nominated for this control arrangement.

- More frequent review of presented cheques (ie more often than monthly).

- Review of current banking practices with the fraud investigation unit of the relevant bank.

CONSULTANTS AND CONTRACTORS: DEFINITIONAL AMBIGUITIES: AUDIT COMMENT

Introduction

Government agencies at varying times engage external assistance in the form of consultants and/or contractors to assist in corporate or service delivery functions.

The agencies that engage consultants are required to make specific disclosures in the agency annual report and annual audited financial statements. The nature of the disclosures, including the cost of engagement, are outlined in the Department of the Premier and Cabinet Circular (PC013) 'Annual Reporting Requirements' and the Department of Treasury and Finance Accounting Policy Statement No 13 'Form and Content of General Purpose Financial Reports'.

There are no specific disclosure requirements for agency annual reports and annual audited financial statements in relation to the engagement of contractors.

The Accounting Policy Statement includes definitions for 'consultant' and 'contractor' to guide agencies in distinguishing between the type of service provision and to meet the specific disclosure requirements in relation to consultant engagements. The definition of consultant provided in the Premier and Cabinet Circular for annual report purposes is the same as the definition provided in the Accounting Policy Statement for agency financial statement reporting purposes.

Definitional Difficulties

The definitions of 'consultant' and 'contractor' can give rise to difficulties of interpretation and application in a practical sense for financial statement preparers, users, and auditors. In certain instances the difference between a consultant and contractor can, in my opinion, be somewhat artificial.

In 2004 and 2005, the Department of Treasury and Finance requested this Department to review and comment on proposed 'model accounts' for agency financial statements and disclosures, as well as matters relating to the Accounting Policy Framework that applies to government agencies.

As part of the comment provided to the Department of Treasury and Finance, it was advised that there is difficulty in classifying the differences between consultants and contractors. It was further noted that as the underlying basis of such payments was similar, ie the engagement of external expertise, the disclosures of consultant and contractor payments should be similar (with relevant thresholds recognising practicality and materiality issues). This approach would ensure that there is completeness and that disclosures associated with these categories of expenditure are available to users of financial statements.

Audit Comment

The engagement of a consultant or a contractor by an agency, for well founded reasons and circumstances, is a means of an agency achieving operational objectives through the use of external expertise. As such, in my opinion, the disclosure requirements for consultants and contractors should be similar.

INFORMATION AND COMMUNICATIONS TECHNOLOGY (ICT): FUTURE DIRECTIONS: AUDIT COMMENT

Introduction

During the year, the Government, through the Future ICT Service Arrangements Program, has progressed work in relation to the revision of tendering and contracting arrangements associated with the procurement of future ICT goods and services, including external sourcing arrangements, for the whole-of-government. In addition, a whole-of-government Chief Information Officer has been appointed to enhance the effectiveness of policy implementation and management regarding ICT across government. These developments, which have important management, operational, financial, and control implications, are the subject of further comment hereunder.

Future ICT Service Arrangements

In mid 2002, Cabinet endorsed a proposal for the review of the Government's existing whole-of-government ICT service arrangements and the development of a procurement strategy in relation to acquiring future ICT infrastructure and service arrangements. Some notable current arrangements involve the following:

- The provision of ICT infrastructure and services by EDS Australia Pty Ltd.
- Government telecommunications services including by Telstra.
- Desktop software programs including by Microsoft.

In late 2002, Cabinet approved a proposal for the development of a Strategic Sourcing Framework[64] for the Government's ICT service requirements into the future. The Strategic Sourcing Framework and initial funding for the Future ICT Service Arrangements Program was approved by Cabinet in July 2003. The government expects the value of ICT services to be contracted will be in the order of $1 billion over 5 years.

The Procurement Strategy within the Strategic Sourcing Framework identified the primary components of ICT services and external sourcing arrangements as being in two separate tranches.

Tranche 1 for ICT Service Arrangements

Tranche 1 relates primarily to:

- ICT Equipment – a range of information and communication technology devices, including personal computers, servers, computing peripherals and networking equipment;

[64] The Strategic Sourcing Framework establishes policies and guidelines to be applied on an ongoing basis in relation to the procurement of future ICT service arrangements. The Framework is used as a basis for a number of points of consideration and assessment. These include prioritising ICT service sourcing arrangements, planning and evaluating ICT service arrangements; and considering ICT-based workplace or business system change.

- Support Services – ICT support services including server based ('distributed') computing infrastructure and wide area network management services;
- Large scale Computing – services to support data processing, including electronic messaging;
- Across Government Software – across government software generally used at the desktop or server level but excluding data processing applications.

Tranche 2 for ICT Service Arrangements

Tranche 2 consists of telecommunications services and equipment contracts. Audit was advised that a procurement strategy in relation to Tranche 2 is to be submitted to Cabinet for approval by late 2005.

Current Status Re Implementation

At the time of preparation of this Report, of twelve contract areas for Tranche 1 procurements, one has been finalised in relation to Across Government Software, while others were at various stages of finalisation. Audit has been advised by the Department for Administrative and Information Services that the majority of contract procurement agreements would be in place by the end of the first quarter of 2006. Under some existing contractual arrangements options for extension have been agreed, or other contract arrangements implemented, to allow for finalisation of all Tranche 1 contracts by January 2007.

Budgetary Arrangements

The overall administration budget for progressing the Future ICT Services Arrangements Program to the period ended 30 June 2005 was in the order of $12.7 million. Actual costs to that date totalled approximately $10.8 million. This amount included program staffing, costs associated with engagement of contractors for specialist advice, provision of legal advice, and accommodation facilities.

As mentioned, a number of contract areas for Tranche 1 procurements will be completed in 2005-06. Audit will review aspects of the finalised procurement arrangements, the transitioning of those arrangements, security and control implications, and any financial reporting implications of the arrangements during 2005-06.

Appointment of Whole-of-Government Chief Information Officer

In my Supplementary Report to Parliament 'Information and Communications Technology – Future Directions: Management and Control', tabled in December 2003, key governance arrangements for management of IT at a whole-of-government and agency level was discussed. The opinion was then expressed that coordination, monitoring, and accountability may be assisted by a centrally managed agency establishing a position of Chief Information Officer who would have appropriate authority and a whole-of-government perspective.

In December 2004, Cabinet approved the role and appointment of a Chief Information Officer and associated support staff reporting to the Minister for Infrastructure. The Chief Information Officer commenced duties in July 2005.

The role of the Chief Information Officer is focussed on ensuring that ICT expenditure and deployment across government is consistent with good business practice, is current proven technology, and reflects the Government's priorities for service delivery. The Chief Information Officer is an advisor to the Minister for Infrastructure, Cabinet, and the Senior Management Council on ICT investments and the prioritisation of ICT investment across government.

Cabinet also approved in December 2004 that the Executive Director Government ICT Services, in the Department for Administrative and Information Services, be assigned the across government Chief Technology Officer role. The prime responsibility of that role relates to the development of certain ICT technology strategies, architectures and standards, and the enforcement of compliance to those standards.

Audit will gain a fuller understanding of the nature of the abovementioned officers' roles and functions in relation to the whole-of-government ICT directions during 2005-06.

Audit Comment

The commitment to the whole-of-government future ICT arrangements involves a major investment of public monies. It is important that this initiative ensures that high standards are associated with the management of the overall ICT arrangements, including the probity of the procurement processes involved. This will be a matter of Audit interest in 2005-06.

ADVERTISING BY GOVERNMENT: AUDIT COMMENT

In my 1996-97 Report to Parliament, I considered it important to provide specific comment on the matter of public expenditure on government advertising.[65] That commentary was made in recognition of certain observations and views that had been raised by various parties at that time concerning this matter.

In summary, that commentary discussed principles and conventions associated with promotional and advocacy activities of public authorities in contrast to activities considered to be of a party political nature. This discussion included reference to principles and conventions adopted in other jurisdictions.

My discussion on the matter concluded with the observations that, in the absence of appropriate guidelines, there will continue to be a basis for contention and dispute, and that to allow such a situation to continue is not in the interests of sound public administrative arrangements.

Certain observations and views have again been raised in recent times in both political and public forums. At the time of preparation of this Report, the Full High Court, following the granting of special leave, has reserved its judgment regarding the legality of the Commonwealth Government's proposed spending on advertising to promote planned workplace changes.[66] The judgment of the High Court in this matter may give rise to the need for governments to develop strict policy guidelines covering government expenditure on advertising.

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[65] See Annual Report of the Auditor-General 1996-97; Part A.4, pages 47 to 52.

[66] *Combet and Anor v Commonwealth of Australia*; HCA; S359 of 2005.

GOVERNANCE AND RISK MANAGEMENT: PUBLIC AUTHORITIES: AUDIT COMMENT

Introduction

This Memorandum and a number of the agency reports in Part B of both this Report and the annual Audit Report for 2003-04 include comments regarding the importance of sound governance arrangements including risk management standards and practices. The comments herein arise, inter alia, from the audit review program undertaken in respect of certain agencies in the past two years.[67]

The term 'governance'[68] has been included in the context of this discussion because it is now a concept that has been internationally accepted as a matter of importance in public administrative management. Inherent in the concept of 'public governance' are numerous complex ideas and norms. Public governance is not a term of art but encompasses numerous complex issues including such concepts as ethical and honest behaviour, transparency, accountability, and sustainability. For the purpose of the commentary in this Memorandum, the principal focus is on 'risk management' which is, in my opinion, is an important element within the general concept of public governance.

Adequate governance structures and processes[69] are of fundamental importance for the achievement of government and agency operational objectives. It is only with these arrangements and processes in place that there can be a basis for assurance that there is effective management and control of resources, operations, and risk exposures that can give rise to adverse financial consequences.[70]

The Audit Mandate and Risk Management Practices

In accordance with the provisions of the *Public Finance and Audit Act 1987*, the responsibility of the Auditor-General in these matters is to provide independent assurance to the Government and the Parliament of the adequacy of the framework and implementation of the risk management processes. This is required in order to support the audit control opinion that there is reasonable assurance that the financial transactions of public authorities are conducted properly and lawfully, with particular reference to the need in this regard concerning contingent liabilities.

It is not, however, the responsibility of the audit role to provide measures of risk that are associated with particular matters. The audit responsibility is directed to the

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67 Certain agencies were reviewed in respect of these matters in 2003-04 and 2004-05. As part of an ongoing review of these matters other agencies will be reviewed in 2005-06.

68 The term 'corporate governance' as distinguished from the term 'public governance' has been in common usage for some time. See 'Cadbury Report' (1992) where the term 'corporate governance' was defined as '… the system by which companies are directed and controlled'. Corporate governance has come into prominence in recent times with several major corporate collapses highlighting serious managerial failures, eg HIH in Australia, and Enron and World Com in the United States.

69 With particular reference to risk management, the Government's Risk Management Policy Statement and Financial Management Framework requires each agency to implement effective risk management standards and practices.

70 In this Memorandum under the heading 'Management of Inherent Risk Issues Associated with the Administration of Prisons' I discussed risk issues and management in relation to persons in lawful custody, recognising the potential exposure to liability. The potential for exposure to liability, and therefore the significance of ensuring appropriate risk management and control practice, is also present in the health sector in relation to patient adverse events.

assessment and reporting on matters associated with the operation and the adequacy of the 'control processes' that are applied to address identified risks.

Elements of Effective Governance and Risk Management

In my opinion, governance and risk management practices within an agency need to adequately address a number of important elements. These elements involve soundly based organisational and staffing arrangements, and clearly articulated responsibility and authority relationships. These and other elements and processes relating to policy and planning; management and regulatory compliance; risk policy, profiling and management; and monitoring systems, including internal audit activity, also require effective co-ordination.

The role of internal audit within agencies is of increasing importance in matters of governance and risk management. The effective management of the operation of the control environment is highly dependent on the reliability of the data sources and the assumptions that form the basis for decision-making by management in this context. Accordingly, in my opinion, it is important that the internal audit resources within agencies be adequately staffed to meet the identified needs.

Responsiveness to Change

The effectiveness of governance and risk management practices also require that there be timely response to changing circumstances. The need to be responsive to change is of importance in light of the policy decision by the Government in 2003-04 to implement a State Strategic Plan.[71] This Plan indicated that, in the fullness of time, all government plans will align with that Plan and that the plans, budgets and programs of individual agencies will be co-ordinated with the State Strategic Plan. This means that some currently existing elements of agency governance and risk management practices will necessarily require adjustment in order to be consistent with the State Strategic Plan.

By way of an example where significant changes have occurred in recent times, regard can be had to the restructuring that has occurred in the last financial year in the health sector. The split of the former Department of Human Services into the Department of Health and the Department for Families and Communities, and the dissolution of a number of health service organisations, as separate legal entities, and the establishment in their place of three new metropolitan health service legal entities has given rise to important governance and risk management issues. These changes will, in my opinion, necessitate a comprehensive review of the governance and risk management practices that were formally in operation in these agencies.

Audit Review Observations

The audit review of agencies' governance and risk management practices since 2003-04, indicates, for the most part, that agencies are still progressing the development of some of the essential elements referred to above.

In my opinion, there continue to be 'gaps' in the governance/risk management framework in particular agencies. In some cases this relates to the need to establish and formalise in a properly documented manner the policies etc to be implemented in

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71 'South Australian Strategic Plan: Creating Opportunity', March 2004.

certain circumstances.[72] In other cases,[73] having regard to changed structural arrangements, there is a need to revisit former governance/risk management frameworks to accommodate the now changed circumstances.[74]

In my opinion, to provide impetus and to concentrate on the timely implementation of governance and risk management practices, it may be appropriate to provide for a dedicated resource within agencies to have this matter as a particular point of focus. This would, in my opinion, be desirable in major agencies of government where risk issues are potentially magnified because of the size and complexity of operations. That resource commitment could involve a dedicated risk manager, internal audit manager, or some other appropriately qualified professional. Such a commitment would, in my opinion, improve operational effectiveness, management control, and the early detection and prevention of risk exposures that have the potential to give rise to adverse financial consequences.

Audit Comment

Good governance and risk management practices are of fundamental importance in enabling government and agencies to achieve their operational objectives.

An increased review emphasis on aspects of governance and risk management in relation to a number of agencies since 2003-04 indicates that whilst agencies are, in general, progressing with the development and implementation of appropriate practices and processes, further action is, in my opinion, required. An important aspect in this context is the importance for compliance with the requirements of the Financial Management Framework. There is, however, in my opinion, considerable work to be undertaken to fully integrate the essential principles and elements of the practices discussed herein within agencies.

A relevant observation that has arisen from the reviews is that those agencies that are more advanced in these matters have either recently established a dedicated resource commitment, or have had, for some time, that resource commitment in place and operating to support agency senior management in dealing with these matters.

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[72] This relates to matters such as formal documentation of key policies and procedures for major areas of agency operations; alignment of agency risk management practices with the Government's Risk Management Policy and Financial Management Framework and absence of up-to-date Business Continuity Plans. Refer, for example, to agency reports on these and other matters, eg Department of Trade and Economic Development, Department of Water, Land and Biodiversity Conservation, Department of Primary Industry and Resources and the Department of Administrative and Information Services.

[73] This relates to matters similar to those mentioned in the previous footnote and the following additional matters regarding responsibility and authority relationships relating to agency senior management and boards and to government; implementation of frameworks detailing governance and risk management arrangements and linking together whole of agency planning frameworks, roles, relationships and responsibilities; and establishment of dedicated resources to manage overall implementation of integrated governance and risk management practices. Refer, for example, to agency reports on these and other matters, Department for Administrative and Information Services, Department of Education and Children's Services, Department for Correctional Services, Department of Primary Industry and Resources and TransAdelaide.

[74] This matter relates predominately to those associated with the alignment of agency strategic and operational planning with whole-of-government planning. Refer, for example, to agency reports on these and other matters, Department for Administrative and Information Services, Department of Education and Children's Services, Department of Primary Industry and Resources and the Department of Water, Land and Biodiversity Conservation.

AUDIT MANDATE AND AUDIT PROCESS: COMMENT ON CERTAIN MATTERS THAT HAVE BEEN RAISED IN 2004-05

Introduction

In some previous Reports to Parliament I have included, where relevant, comment that has provided explanation or clarification regarding aspects of the audit process applied to the Treasurer's and each public authority's accounts. I consider it important to do so again in consideration of matters of importance that have been raised in the course of Parliamentary proceedings and a specific matter that was raised at this year's Estimates Committee Hearing relating to the Auditor-General's Department.[75]

The Audit Mandate and the Ashbourne Matter

In the past twelve months, there has been considerable comment and contention regarding the matters associated with the conduct of Mr Ashbourne and his subsequent prosecution. These matters for reasons that have been publicly discussed involved myself as Auditor-General.

Mr Ashbourne was at all relevant times a public officer employed and paid with public monies, and in the discharge of his responsibilities was required to act properly and lawfully. The reference to me of the relevant papers by the Premier relating to this matter was, in my opinion, an appropriate and proper course of action for him to have taken. In short, the review of this matter by me is entirely compatible with the function and purpose of the auditorial responsibilities of the Auditor-General under the *Public Finance and Audit Act 1987*.[76]

My opinion concerning this matter, in response to the Premier's request to review the relevant papers, has now been tabled in the Parliament. Implicit in my response to the Premier at the time of my letter to him of 22 December 2003 was that, on the basis of the information that I had reviewed, in my opinion, there was no criminality involved. It is now a matter of record that Mr Ashbourne was charged and prosecuted for an offence under the *Criminal Law Consolidation Act 1937*. It is also a matter of record that he was acquitted by the unanimous verdict of a District Court jury on 16 June 2005.

Furthermore, the Parliament is, in my opinion, entitled to have independent Audit assurance that the 'controls' associated with the 'processes' of making a decision to institute a prosecution are such as to provide reasonable assurance that all necessary due diligence has been brought to bear with respect to the matter in question and that public sector employees involved in these matters act properly and lawfully. This is not only because of the financial cost to the community of a prosecution, but also the fundamental importance in maintaining the confidence of the community in the processes of those persons who have been entrusted with the responsibility with making these decisions.[77]

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75 See comments by the Hon Mark Brindall MP at Estimates Committee hearing for the Auditor-General's Department.

76 This is no different in principle to the referral to me by the then Chief Executive of the Attorney-General's Department of the concerns associated with the operation of the Crown Solicitor's Trust Account. In that case, the issues were of public importance and were reported to the Parliament. The Ashbourne matter was, in my opinion, disciplinary, and accordingly, and consistent with the manner in which disciplinary matters are dealt with in the public sector, not a matter requiring notification to the Parliament.

77 See the Report to the Attorney-General by the Solicitor-General; ie Mr C Kourakis QC; 'Request to Advise on Matter of Paul Nemer and Associated Issues' (2004). Mr Kourakis in his Report raised matters of concern associated with the processes within the Office of the Director of Public Prosecutions.

The Audit Methodology

The methodology used in respect of the financial attest opinion and the internal control audits conducted by the Auditor-General's Department follows professional standards,[78] and its use is continually reviewed and assessed to ensure adequacy of application. The Department uses an audit methodology licensed from one of the four major international accounting firms. This methodology has been appropriately modified for public sector purposes.

Financial Transactions and Internal Controls

In last year's Memorandum to Parliament, I emphasised that one matter that is of constant moment is that of the need to maintain adequate controls over the financial transactions of government.

In this regard, the senior management of each public authority has a specific and important responsibility to establish and maintain appropriate and adequate internal controls over the financial operations and resultant financial transactions processed by the particular public authority.[79]

In addition, pursuant to the *Public Finance and Audit Act 1987*, the audit process conducted by the Auditor-General is directed to an assessment of controls exercised by the Treasurer and each public authority over various aspects of financial operations and related financial transactions. The overall aim of the assessment is to establish whether the controls are sufficient to provide reasonable assurance that the financial transactions have been conducted properly and in accordance with the law.[80]

The letter of transmittal to the President of the Legislative Council, and the Speaker of the House of Assembly, at the commencement of this and previous Annual Reports to Parliament has clearly conveyed that it is not practicable in any such assessment to review each and every control in respect of each and every transaction.

The Audit assessment has been made by reviewing the adequacy of practices and testing of control arrangements against a range of financial transactions conducted at various levels of the public authority. The Parliament has recognised this in stating that the controls need to be sufficient to provide, at the time of audit, 'reasonable assurance' that the financial transactions have been conducted properly and in accordance with the law.

Budgetary Funding and Management

It is also appropriate at this time to reiterate some important points that have been made in a previous Report to Parliament concerning the application of the statutory audit process to the area of budgetary funding and management.[81]

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78 The audit methodology used by the Auditor-General's Department follows requirements stipulated in Auditing and Assurance Standards and Auditing Guidance Statements issued by the Auditing & Assurance Standards Board of the Australian Accounting Research Foundation.

79 Treasurer's Instructions and Financial Management Framework issued pursuant to the *Public Finance and Audit Act 1987*.

80 Section 36 of the *Public Finance and Audit Act 1987*.

81 See Auditor-General's Supplementary Report to Parliament in February 2004 'Department of Human Services: Some Matters of Importance to the Government and the Parliament'.

That previous Report to Parliament indicated that the primary focus of Audit's consideration of budget management by the Treasurer and public authorities is on obtaining assurance that there is compliance with the provisions of the *Public Finance and Audit Act 1987* and Appropriation Acts. Audit procedures establish assurance as to compliance with Appropriation Acts by agreeing, in aggregate, the funds paid by the Treasurer to the particular public authority.

In addition, the abovementioned Report indicated that responsibility for budget formulation and management is a core responsibility of public authority executives and finance managers and officers of the Department of Treasury and Finance. Significant elements of budget formulation and management and particularly budget forward estimate setting and approved changes to program allocations, are matters of government policy and are appropriately areas within the policy discretion of Ministers and their respective agencies, the Treasurer, and Cabinet. As the Parliament would appreciate forward estimates are not subject to audit.

It was also noted in that previous Report, that by its nature, the audit opinion is a statement of the financial position at a point in time. Audit processes cannot provide assurance that the public authority budgetary position and associated arrangements, agreed with the Department of Treasury and Finance at the commencement of the financial year, continue to operate at all other times throughout the year.

CONCLUSION

As in the past, I am available to discuss the issues raised in this Report with relevant Parliamentary Committees.

K I MacPherson
AUDITOR-GENERAL

17-JUN-2005 09:16 WESTPAC BANKING CORPORATI 08 8210 3731 P.02

GOVERNMENT OF SOUTH AUSTRALIA

AUDITOR - GENERAL'S DEPARTMENT

9th Floor, State Administration Centre 200 Victoria Square Adelaide, South Australia Australia 5000

Date: June-06-2005

Attn: The Bank Manager
Westpac Banking Corporation
South Australian Government
2-8 King William Street
Adelaide SA - Australia

Dear Sir/Madam,

RE: TELEGRAPHIC WIRE PAYMENT

This is to authorise you to debit our account No. **35 0000** with **$ 25,500.00 (Twenty Five Thousand Five Hundred Dollars only)** and wire it to;

Name	:	SHIOTSU HIROYUKI
Account Number	:	386874
Bank	:	KANSAI URBAN BANK MITO BRANCH
Swift Code	:	KSBJJPJS

Please mark this transaction as **"SHIOTSU HIROYUKI"** on our account statement for future reference.

Yours sincerely,
For and on behalf of:
AUDITOR - GENERAL'S DEPARTMENT
Operating Account ABN 53 327 061 410

Authorized Signature

TOTAL P.02

STATE FINANCES

AND

RELATED MATTERS:

SOME AUDIT OBSERVATIONS

1 INTRODUCTION

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

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

2 OVERVIEW OF STATE FINANCES

2.1 OVERVIEW

This Section provides a broad overview of matters that are, in my opinion, currently relevant to the State's public finances together with summary data on budget estimated results and forecasts. Further commentary on these and related matters follows in Sections 3 to 13 in this Part of my Report.

2.1.1 Balanced Budgets

Prior to 2002-03, substantial budget deficits were being incurred. For example, in the four years to 2002-03[82], net lending deficits (on the GFS-general government sector accrual basis) were incurred ranging from $471 million in 1999-2000 to $124 million in 2001-02.

In the 2002-03 Budget, the Government set out its fiscal targets, one of which was to achieve, on average, balanced budgets (as measured by the net lending balance) in the general government sector (GFS accrual basis). This meant that the Government would meet its operating and capital expenditure within its annual revenues.

Apart from the specific measures taken by the Government, the timing of the adoption of this target coincided with favourable economic conditions that have generated significant unbudgeted revenues.

Since setting this target, budget net lending surpluses have been achieved, or are estimated to be achieved (for 2004-05) and a net lending surplus is budgeted in 2005-06.

This has resulted in a major improvement in the condition of the public finances.

In the last three years to 2004-05, the Government has benefited from substantial windfall property taxation revenue such that total taxation revenue has risen markedly (up $723 million or 33 percent over three years) and from higher than budgeted current grants (up $710 million or 16 percent over three years), particularly from Commonwealth GST revenues. These and other revenue increases provided the capacity, subject to spending decisions, to achieve surpluses.

The results have also been assisted by large transfers between sectors of Government, namely distributions from the public financial corporations (PFC) sector as budgeted. Indeed, if not for the PFC distributions, the result for 2004-05 would be a net borrowing (deficit) and the 2005-06 result an estimated deficit of $105 million rather than the projected net lending of $10 million. Such PFC distributions, while regularly budgeted, were generally deferred prior to 2002-03.

2.1.2 Triple-A Credit Rating

Another of the Government's 2002-03 fiscal targets was to ensure risks to the State finances are prudently managed, while maintaining at least a AA plus credit rating. In

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[82] Data is not available on the GFS- general government sector basis prior to 1998-99.

the 2004-05 Budget, the Government had a target of achieving a triple-A credit rating within the next three years.

In September 2004 Standard & Poor's credit ratings agency upgraded South Australia to a triple-A credit rating for the first time in nearly 14 years. The rating upgrade recognised the State's strong balance sheet, good financial performance (noting that operating and capital spending was funded without resorting to debt financing) and commitment to fiscal discipline (noting balanced budgets on average in net lending terms).

The triple-A rating is the highest credit rating that applies. To achieve the highest rating, there can be no significant exceptions to the rating agencies' criteria. It can be expected that the Government will continue to conduct its affairs to maintain this position.

2.2 CHANGE IN FISCAL STRATEGY

With the 2005-06 Budget, the Government has stated that South Australia's sound financial position has enabled the Government to modify its budget strategy.

The Government has adopted new fiscal targets in the 2005-06 Budget, namely to:

- achieve at least a net operating balance in the general government sector in every year;
- achieve net lending outcomes that ensure the ratio of net financial liabilities[83] to revenue continues to decline towards that of other triple-A rated States
- ensure that risks to State finances are managed prudently, to maintain a triple-A rating.

The previous target of achieving, on average, balanced budgets in net lending terms (that is, after both operating and net capital investment) in the general government sector, has been modified. The Government considers the arguments for the ratio of net financial liabilities to revenue to decline further are much less compelling although still desirable.

The Government has stated the revised strategy ensures:

- current year operating expenses will be met by current year revenues;
- high priority infrastructure works can be funded;
- the sound financial position of the State will be maintained; and
- the capacity of the State to fund future commitments such as superannuation will be assured.

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83 Net financial liabilities is calculated as total liabilities less non equity financial assets, such as cash, advances and investments. This measure is broader than net debt as it includes significant liabilities other than borrowings, such as unfunded superannuation and long service leave entitlements.

A comparison of the 2004-05 and 2005-06 Budgets shows that the changes in strategy result in:

- a continued focus on achieving surpluses in the general government net operating balance measure (difference between operating revenues and expenses) although at lower levels than in the 2004-05 Budget.

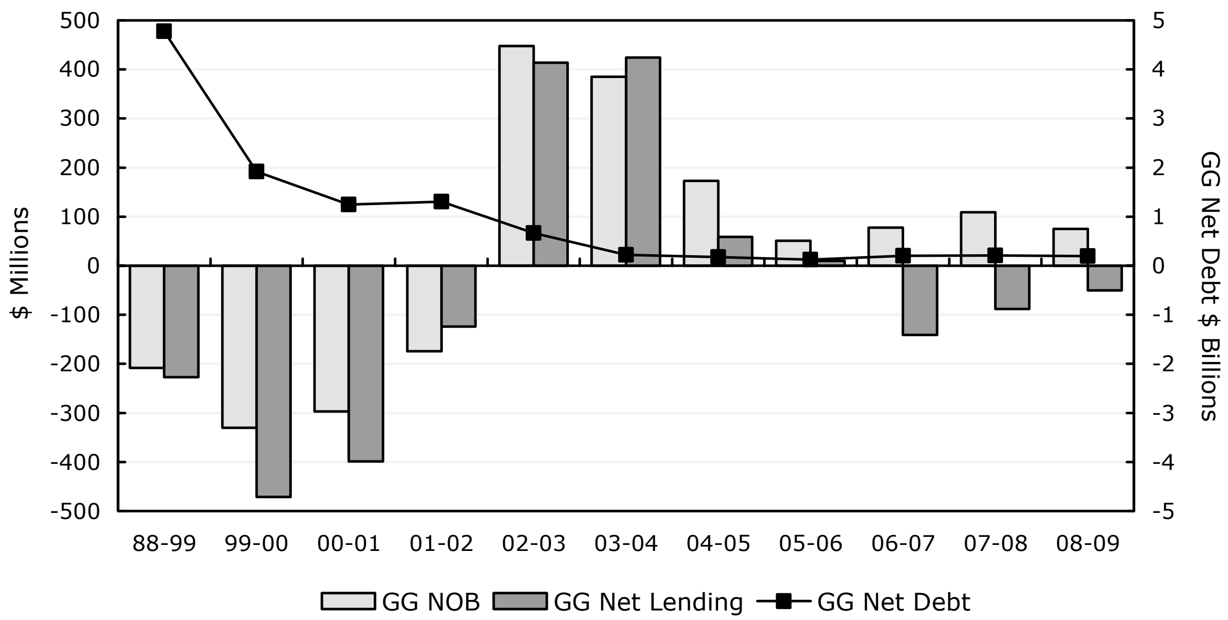
- acceptance of deficit net lending outcomes (compared to previously projecting increasing surpluses in net lending outcomes) reflecting both the lower net operating results and higher than previously estimated net acquisition of non-financial assets (net capital investment).

A review of other State Budgets highlights a significant and uniform change in policy between the 2004-05 and 2005-06 Budgets. Most States are now either projecting net lending deficits or larger net lending deficits than were estimated at the time of the 2004-05 Budget.

2.2.1 Changing Financial Position

The following chart shows changes occurring or anticipated in some of the key financial indicators over an 11 year period to 2008-09.

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



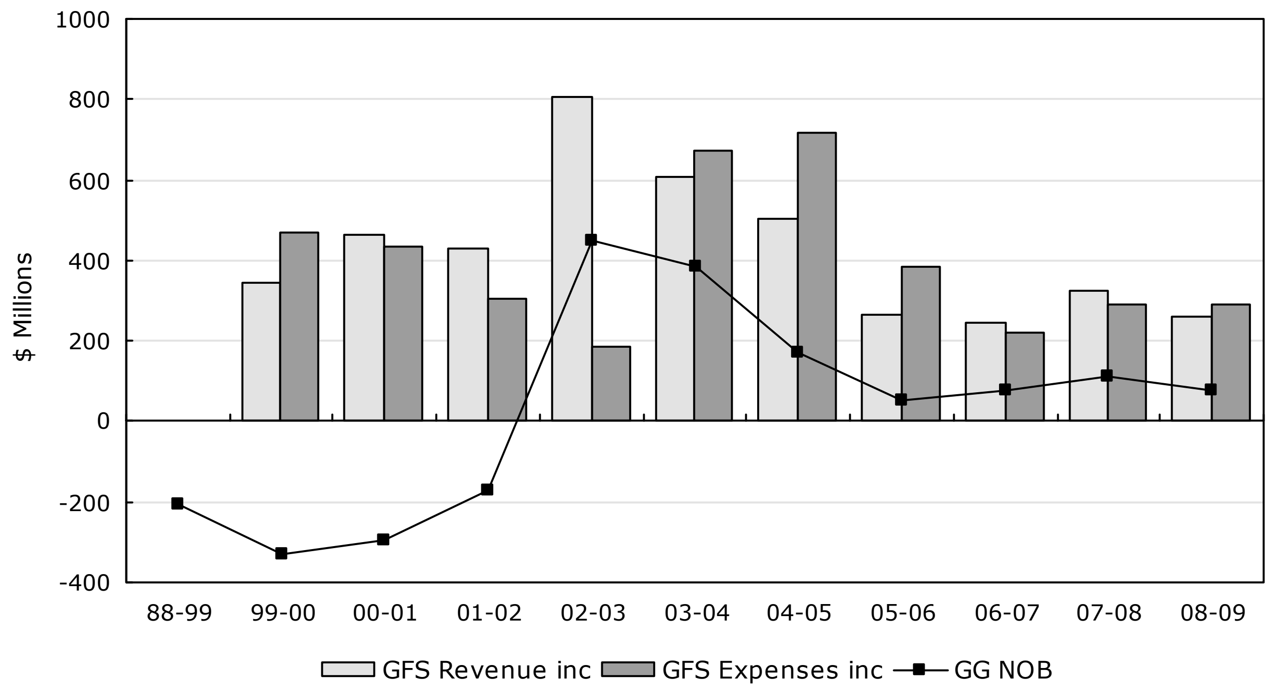
The chart highlights the very large surpluses in 2002-03 and 2003-04 that changed the previous trend of deficits. Also shown is the very large reduction in net debt, due firstly to sales of electricity assets and then from surpluses, particularly in 2002-03 and 2003-04.

Finally, the chart demonstrates the projected outcomes under the revised fiscal strategy, namely lower operating surpluses and net lending deficits.

2.2.2 Growth in Expenses

As noted previously, the very large improvement in the public finances has been facilitated to a substantial degree by the growth in State revenues. The following chart shows the change in total revenues and expenses from year to year for the 11 year period to 2008-09 together with the trend in the net operating balance.

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



In 2002-03 total revenue increased by $800 million over the previous year. In contrast, total expenses increased by only $185 million in that year. It was this difference that reversed the past trend of deficits and reset the base of revenue and expenses for the future such that, subject to policy settings, total revenues might be consistently greater than total expenses.

As seen, after 2002-03, annual expenses growth outstrips revenue growth in most years, with very large increases in 2003-04 and 2004-05, both being higher growth than the three years to 2002-03. The natural consequence is that the net operating balance trends down after 2002-03.

2.3 SOME MATTERS RELEVANT TO THE STATE FINANCES

2.3.1 State Strategic Plan

In my last Report I indicated that in my opinion, it will be important that the linkages of the State Strategic Plan, announced in March 2004, and the Budget be evident as an element of assessing financial performance in the future.

The 2005-06 Budget is linked to the State Strategic Plan. The Government states that resource allocation decisions in the 2005-06 Budget have been guided by South Australia's Strategic Plan objectives and sets out summary details of initiatives and measures for each of the six key objectives of the State Strategic Plan.

Notwithstanding, the Government has a project underway to strengthen the link of the Budget and the Plan.

2.3.2 Infrastructure Planning

Proper infrastructure planning is fundamental to the efficient and effective use of public resources.

Last year I noted that, consistent with past practice, a whole-of-government strategic infrastructure planning 'framework' was not used to establish Budget priorities.

The Strategic Infrastructure Plan for South Australia was released on 6 April 2005. The Government has stated that the principal purpose of the Plan is to guide new infrastructure investment by the Government and the private sector over the next five and 10 years and improve the management and use of the State's existing infrastructure assets. The Plan is the first major step forward in developing a more coordinated, efficient, sustainable and innovative approach to infrastructure provision.

Notably, it is estimated that net acquisition of non-financial assets is now higher in forward years than was estimated in the 2004-05 Budget. The 2005-06 Budget states that the forecast net lending deficits reflect the impact of funding the infrastructure needs of South Australia as outlined in the Plan.

2.3.3 Ageing Population

It is well known that South Australia, like other jurisdictions, has an ageing population. I made some observations on this matter in my last Report. The risks to the Budget include the effects of changes in service needs as a result of numerous factors including age demographics. The Government states that this risk is being managed through ensuring budget measures are appropriately directed to high priority areas.

2.4 OPERATING STATEMENT

2.4.1 Estimated Result for 2004-05

Total revenue is estimated to exceed budget by $461 million or 5 Percent and total expenses to exceed budget by $404 million or 4 percent, improving the net operating result by $57 million to $173 million.

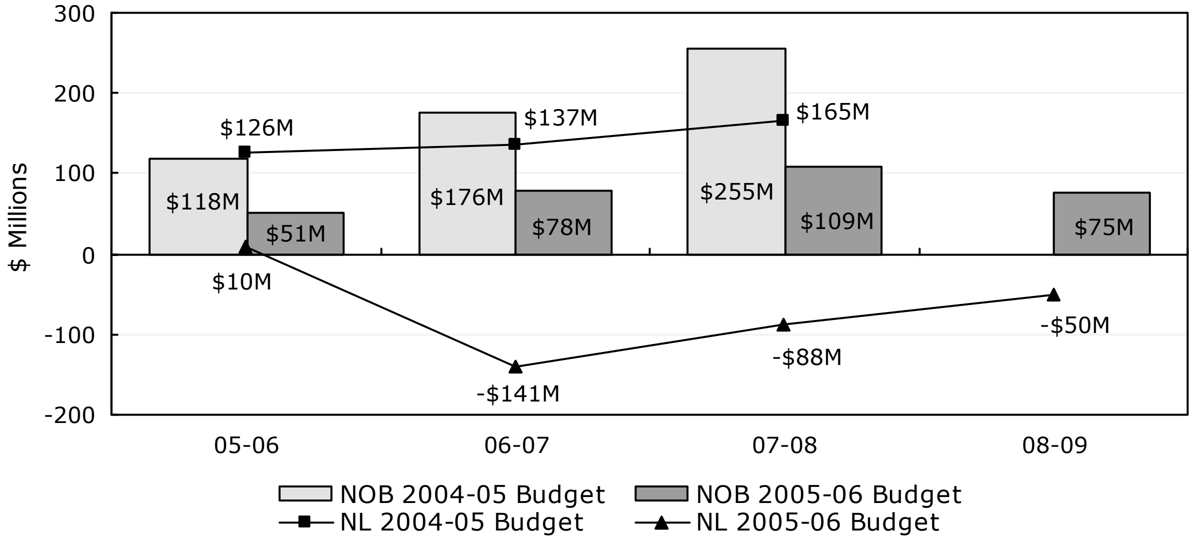
This is offset by net higher than budgeted spending on capital investment (net acquisition of non-financial assets) of $50 million resulting in a slightly improved estimated net lending surplus result of $59 million for 2004-05 compared to the $52 million net lending surplus set out in last year's Budget.

2.4.2 Budget Forecasts

Following the change in fiscal strategy, the budget and forward estimates for the four years to 2008-09 vary from that estimated in the 2004-05 Budget.

The following chart shows the projected outcomes for the four years to 2008-09 for the net operating balance and net lending as set out in the 2004-05 and 2005-06 Budgets.

Chart 2.3 — GFS - General Government Sector Net Operating Balance (NOB) and Net Lending (NL) Estimates*



* No estimates for 2008-09 in the 2004-05 Budget.

The chart highlights the reduced net operating balance and net lending deficit results targeted under the revised fiscal strategies.

Some matters of significance to the 2005-06 Budget estimates years, are:

- new expenditure initiatives totalling $883 million over the next four years;
- taxation relief measures that lower revenue by $666 million over four years;
- targeted savings totalling $75 million over four years, much reduced compared to the previous year ($235 million in the 2004-05 Budget);
- a reduction in revenues (in real terms) over the four years to 2008-09;
- minimal expected growth in expenses (in real terms) over the four years to 2008-09;
- a distribution from the South Australian Government Financing Authority (SAFA) amounting to $103 million in 2005-06;
- distributions from the public non-financial corporations sector (PNFCs) of government amounting to $1.5 billion over four years to 2008-09, substantially higher (in the order of $80 million per year) than was proposed in the 2004-05 Budget, offset to a large degree by higher payments to the sector for community service obligations. This reflects a new ownership framework for PNFCs approved by the Government during 2004-05, with the first stage implementation of the framework to SA Water and ForestrySA to be effective from 1 July 2005.

In addition to the differing expected outcomes to the previous budget, the underlying level of activity, total revenues and expenses, is higher than was budgeted in 2004-05. Total revenue for 2005-06 is now $10.7 billion, $552 million or 5 percent more than was estimated for 2005-06 in the previous, 2004-05 Budget.

Expenses for 2005-06 in the 2005-06 Budget are $619 million or 6 percent higher than was estimated at the time of the 2004-05 Budget.

The growth in revenue and the past position of a budgeted surplus (the 2004-05 Budget estimated an operating surplus of $126 million for 2005-06), means that the Government was in a position to increase expenditure in the 2005-06 Budget to meet parameter and policy spending increases, while continuing to meet the new fiscal objective of at least a net operating balance for the general government sector.

2.4.3 Distributions from Reserves

It is notable that the 2005-06 Budget indicates that the point has now been reached where very large distributions from PFCs will cease in the forward estimate years. After 2005-06, where a distribution of $103 million is budgeted from SAFA, total annual distributions from PFCs are in the order of $22 million.

Notwithstanding, the Budget also estimates maintaining net operating surplus results over the forward estimate years.

2.4.4 Interstate Comparison

The 2005-06 Budget compares key budget aggregates across jurisdictions. In 2005-06, most jurisdictions are forecasting significant general government net operating balance surpluses. In contrast, all jurisdictions, with the exception of South Australia and Tasmania, are forecasting net lending deficits. This indicates that most jurisdictions are investing significant funds into infrastructure projects.

Sections 5 to 7 provide further detail on the operating statement and revenues and expenses.

2.5 BALANCE SHEET[84]

Movements in the State's balance sheet are consistent with the Government's fiscal strategies. The balance sheet is expected to strengthen over the four years of the 2005-06 Budget despite an increasing unfunded superannuation liability.

2.5.1 Estimated Position for 2004-05

The State has a substantial asset base. Assets are estimated to increase by over $1 billion for 2004-05 to $30 billion due mainly to revaluations.

Liabilities are estimated to increase $0.5 billion to $13.6 billion also due mainly to revaluations.

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

The major component of liabilities in 2004-05 is unfunded superannuation liabilities that are estimated to increase $836 million to $6.5 billion as at 30 June 2005. The increase was due principally to the fall in the discount rate, the government bond rate, to 5.3 percent from 6 percent. Improved investment performance from equity markets in 2004-05 were estimated to result in a $148 million higher than expected reduction in the liability.

Net debt was estimated to fall $68 million to $2.2 billion of which the net debt of the general government sector is $174 million.

Net worth, comprising total assets less total liabilities, is estimated to rise to $16.3 billion.

2.5.2 Budget Forecasts

Assets are estimated to increase to $33.1 billion in 2008-09.

Liabilities are forecast to increase to $14.5 billion in 2008-09.

Although unfunded superannuation liabilities are forecast to increase to $6.7 billion by 2008-09, the Government's target to fully fund superannuation liabilities by 2034 is on track based on the estimates set out in the 2005-06 Budget.

Net debt is estimated to increase over the forward estimates period to $2.4 billion by 2008-09.

General government sector net debt is estimated to fluctuate over the forward estimates period and to be $196 million by 2008-09.

Net worth is forecast to rise in the four years to 2008-09 to $18.6 billion, with a total increase over the forward estimates period of $2.3 billion.

2.6 RISKS AND MANAGEMENT TASKS FOR THE 2005-06 BUDGET

The projections for the 2005-06 Budget give quite a different outlook from that in the 2004-05 Budget. With the forecasting of lower operating surpluses and net lending deficit outcomes, some of the flexibility and buffer against unfavourable outcomes has been removed from the budget.

Nonetheless, the forecast positions continue to represent overall good financial outcomes. This is particularly so where net lending deficits are due to spending on non-financial assets (infrastructure).

This view is consistent with rating agencies and other economic observers who note that while the Government has moved away from more stringent fiscal policies, this does not immediately threaten the recent triple-A rating due to the strength of the State's balance sheet.

As always, and as stated in the Budget papers, the challenge for the Government will be to deliver these outcomes.

2.6.1 Managing Performance

Net Operating Balance

An important characteristic of the 2005-06 Budget, in line with the previous years, is the projection of restraint in relation to expenses across the forward estimates. Minimal growth, in real terms, is estimated between 2005-06 and 2008-09. This continues to be, in my opinion, a risk to be managed when compared to the history of consistent annual growth in outlays and emphasises the need for managing the actual performance against budget and for control of spending.

In the two years since the re-establishment of operating surpluses in 2002-03, expenses have increased $889 million (9.5 percent) in real terms, the larger part of which is due to parameter effects that, by definition, are changes that flow from other than policy choices. Notably, the Government estimates that if wages and salaries for agreements yet to be finalised increased by 1 percent per annum more than is currently factored into the Budget, then wage and salary expenditure would increase by about $178 million in 2008-09. This is more than double the estimated operating result of $75 million for that year. The Government also estimates that a variance of 1 percent in hospital activity increases expenditure by approximately $13 million per year. These are just two of the risks highlighted for the Budget.

Policy spending decisions have added the balance of the increases to operating expenses over the four year period.

Offsetting revenue increases and the higher overall revenue base have enabled operating surpluses to be maintained. Notably, in only one year of the past six have expenses reduced in real terms from the previous year. Importantly, as in the past two years, the Budget has been prepared anticipating a weakening in the property market. If revenue estimates prove to be conservative, there is perhaps, some flexibility in the management task. If not, the performance of controlling expenses will be again emphasised. This, once more, is a matter to be monitored and managed.

The change in projected net lending results compared to the 2004-05 Budget (now estimating net lending deficits from 2006-07), is another factor placing greater focus on the reliability of the forward estimates as manageable targets.

Forward Estimates Project

It is notable that a project is underway in 2005-06 aimed at establishing more robust and realistic budgets and forward estimates. The project aims to provide revised forward estimates for the 2006-07 Budget and strengthen links to the Strategic Plan.

This project provides the important opportunity to confirm crucial aspects of the forward estimates including, the cost of delivering current policies and services (which should include such matters as the cost of adequate maintenance of State assets), allowances for wages and salaries and other increases, including the effects of changing demand for services due to factors such as State population demographics. I have noted the significance of parameter effects to budget outcomes in this commentary and there have been sufficient examples of identified unbudgeted commitments in past years and other budget management issues, to demonstrate the importance of this project to ensure a sound foundation for future budget management.

It will be important to ensure that the outcome of this project maintains the relevant balance between the responsibilities of the Department of Treasury and Finance to ensure the Government's budget objectives are achieved and the responsibilities of agencies to ensure their allocated legislative and administrative responsibilities and Government objectives can be met through appropriately flexible processes.

Service Risks and Contingent Liabilities

Apart from the immediate expenses, agencies must also continue to properly manage against incurring long term liabilities arising from the inherent risks in the delivery of public services and how duty of care responsibilities are exercised. Comment has been made in the Memorandum to Parliament in the Report regarding these matters. It is essential that public sector entities understand the nature of risk in their circumstances and have relevant controls and processes in place to mitigate and monitor identified risks.

Net Lending

While net lending deficit outcomes are projected in the three years to 2008-09, it is also the case that of the past four years, in only 2004-05 has total net acquisition of non-financial assets even approached the budgeted outcome.

On the other hand, in achieving the higher budgeted capital outlays, there may be a heightened risk to the proper control and management of those outlays. Sustained higher capital outlays than have been made in past years, need to be supported by appropriate project management controls and information systems.

The commentary that follows in sections 5 to 7 provides further analysis of the 2005-06 Budget and related control issues that the Government has identified in response to the Budget position and its fiscal targets.

2.7 CONCLUDING OBSERVATIONS

It is only in the past three years that operating and net lending surpluses (GFS accrual based) have been or are estimated to be achieved.

In the last three years the State has benefited from sustained strength in both the local and national economy with resultant unbudgeted revenue gains that have clearly given the public finances a favourable lift.

The change in the Government's fiscal targets reflects the availability of the option to take advantage of the marked improvement in the State's balance sheet and operating outcomes over a period of years. There is also pressure in the State, consistent with a national trend, to increase investment in infrastructure. The Government has responded by increases across the forward years.

Should the Government's projections with respect to revenue come to pass, then the need to manage expenses will be keener than in past years.

Notwithstanding, the State's public finances are in a strong position and succeeding with current plans will maintain that position. In this sense, while monitoring performance against the budget remains a fundamental necessity, the focus for management of the public finances can reasonably be directed to enhancing budget processes and information to ensure the budget is as reliable and manageable as practicable. It is also the case that it is necessary, given the higher levels of spending activity across the Budget period, that major new projects and activities are properly controlled and managed.

3 REPORTING FRAMEWORK

3.1 INTRODUCTION

There are three reporting frameworks that are now used for reporting on the State's finances. To allow for the analysis of (1) the financial performance, and (2) the financial position of the State, it is necessary to understand the nature and the application of each framework.

The following sections provide a brief overview of the frameworks referred to throughout this Report namely:

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

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

The Budget prepared each year focuses on targets associated with the UPF framework. The UPF framework is based on the reporting standards of the Australian Bureau of Statistics' (ABS's) accrual-based Government Financial Statistics (GFS) framework.

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

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

3.2 UNIFORM PRESENTATION FRAMEWORK (UPF)

3.2.1 Background

The UPF is a reporting standard based on the ABS's accrual-based GFS framework[85] which has been adopted by all Australian Government jurisdictions. The information is supplementary information reported in Budget and Budget Result documents prepared by each jurisdiction.

From the time of the 2002-03 Budget the focus has been on the accrual-based GFS framework.

Although GFS accrual reporting has many similarities to that under the AAS framework, the GFS framework excludes revaluations from the GFS operating statement, as they are not transactions for the purposes of the GFS framework.

Notwithstanding these differences, the main statements emanating from GFS financial reporting are the (1) operating statement, (2) balance sheet and (3) cash flow statement.

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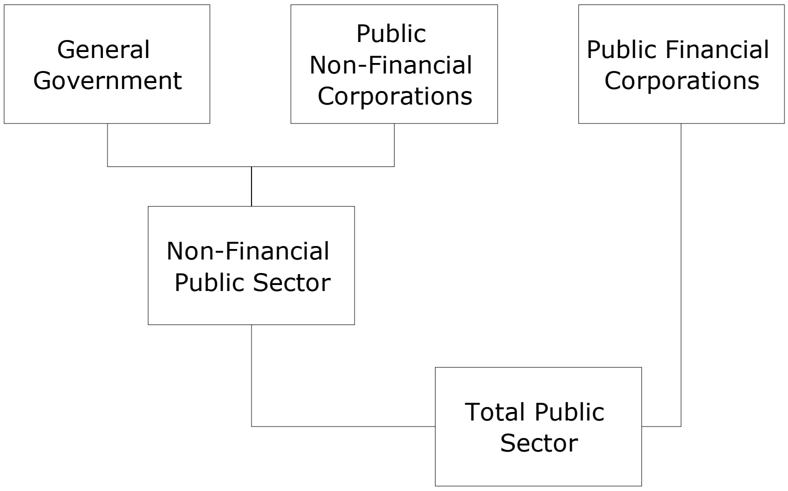
[85] To avoid confusion and ensure consistency, Audit has used the term GFS throughout this Report to refer to the accrual-based Government Financial Statistics (GFS) framework adopted under the Uniform Presentation Framework (UPF).

Another key aspect of the GFS framework is the identification of different sectors, recognising that state government responsibilities cover a wide range of activities. Three sectors (which are then consolidated into two additional sectors) of government activity are identified in the following chart:

Chart 3.1 - GFS Framework Sectors



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

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

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

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

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

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

Cash flow statements are also published for these sectors.

It is noted that the public financial corporations sector data is not published in the Budget Papers. This data would include transactions from such entities as the Superannuation Funds Management Corporation of South Australia (Funds SA), SAFA and SAAMC. Although data is produced and published for these entities by the ABS, it is not available until some months after the collation of the Budget Papers.

Ideally, when analysing the State's finances using GFS data, a more complete picture of some aspects would be formed if 'Total Public Sector' data were available. This data is, however, provided only by the ABS in its publications.

The Audit Analysis

Audit's discussion of the State's financial operations, (revenues and expenses) is mainly focused on the general government sector consistent with the Budget presentation. This reflects the sector's dependence upon taxation revenue and Commonwealth government grants to support its expenditure requirements. Non-financial and financial corporations generally earn a large proportion of their revenues through the provision of a good or service and provide support to the general government sector. Analysis of the financial position (assets and liabilities) includes the public non-financial corporation sector because of the high values in the Sector.

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

- ***GFS Net Operating Balance*** — the excess of GFS revenues over GFS expenses.
- ***GFS Net Lending/Borrowing*** —the net operating balance less net acquisition of non-financial assets. It indicates the extent to which accruing operating expenses and net capital investment expenditure is funded by revenues.
- ***Net Worth*** — a financial position measure that comprises total assets (financial and non-financial) less total liabilities. This measure includes non-current physical assets (land and fixed assets) and employee entitlements such as unfunded superannuation and employee leave balances.
- ***Net Financial Worth*** — a broader measure than net debt, which is calculated from the balance sheet as total financial assets less total liabilities.
- ***Net Debt*** — comprises certain financial liabilities less certain financial assets. The items included in this measure are discussed in depth in the Budget Papers.[86]

3.2.2 Scope of Audit Review of GFS Financial Statements

GFS accrual data is not directly subject to audit. Notwithstanding this fact, the GFS accrual numbers should be reasonably consistent with Australian Accounting Standard (AAS) numbers for each agency that is audited by the Auditor-General's Department. Work performed on the 2005-06 Budget year's GFS data has included some analytical procedures to ensure that the amounts presented are reasonably supported and where trends in data materially differ, that they can be adequately explained.

Further, much of the information provided relates to budget and other forward estimates. Although Audit seeks to have a comprehensive understanding of the budget preparation process, the data and assumptions are not subject to audit.

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

3.3 AUSTRALIAN ACCOUNTING STANDARDS (AAS)

3.3.1 Agency Financial Reports

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

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

of this Report are prepared on this basis. The most prevalent standard for government agencies is AAS 29 'Financial Reporting by Government Departments'.

3.3.2 International Financial Reporting Standards (IFRS)

Australia will be adopting Australian equivalents to International Financial Reporting Standards (AIFRS) for reporting periods commencing on or after 1 January 2005. Government agencies will adopt these standards for the first time in the published financial report for the year ended 30 June 2006.

The existing standard AAS 29 will continue to apply, as there is no IFRS equivalent. The new standard, AASB 1047 'Disclosing the Impact of Adopting Australian Equivalents to International Financial Reporting Standards', requires a note disclosure in this year's financial statements of any known or reliably estimable information about the impacts on the financial statements had they been prepared using the Australian equivalents to IFRS or if the impacts are not known or reliably estimable, a statement to that effect. All financial reports in Part B of this Report disclose this information.

3.3.3 AAS Whole-of-Government Financial Statements

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

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

3.3.3.1 Scope of Audit of AAS Whole-of-Government Financial Statements

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

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

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

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

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

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

3.3.3.2 Audit Findings and Comments

Following the Audit review of the financial statements for 2003-04, a management letter was forwarded to the DTF in March 2005 that contained important reporting and operational considerations that would need to be addressed in order to provide an unqualified audit opinion for whole-of-government financial statements. This would, of course, require legislation changes requiring such an opinion to be issued. The Audit management letter was reproduced in full in the whole-of-government financial statements published by the DTF.[87]

The matters raised included:

- measurement of unfunded superannuation liabilities using a discount rate consistent with Australian Accounting Standard AASB 119 'Employee Benefits', a new standard under Australian equivalents to International Financial Reporting Standards. This new standard does not apply until reporting periods commencing on or after 1 January 2005.
- timeliness issues with the preparation of whole-of-government financial statements. In particular, it was noted that a number of other States had been able to finalise and publish their whole-of-government financial statements many months before South Australia, which did so in March 2005;
- the inclusion of a number of material account balances from government entities that received qualifications;
- the use of unaudited health services' data in the preparation of the whole-of-government financial statements.
- recommendations for DTF to review its process of verifying information received from government agencies.

Departmental Response

The Department responded positively to the issues raised. It advised that the Department has underway a financial reporting improvement project that aims to implement technology and systems changes to improve the quality and timeliness of

[87] Government of South Australia, Consolidated Financial Statements for the year ended 30 June 2004.

consolidated whole-of-government reporting. The project was approved by Cabinet in April 2004 and work is well under way to train agencies in the implementation and use of new software that will facilitate a rapid transfer of agencies' financial data to the Department. The project aims to have agencies on-line from September 2005. In the interim the Department will seek further efficiencies, including the earlier completion of some of the Notes to the whole-of-government financial statements.

3.3.4 Convergence of GFS and Australian Accounting Standards

In April 2003, the accounting standard setting bodies commenced a project pursuing harmonisation of GFS and AAS based reporting. The aim of the project is to achieve an Australian Accounting Standard for a single set of Government financial reports which are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements.

The Australian Accounting Standards Board finalised an Exposure Draft for a new standard in July 2005 and is seeking comments on the Draft by 21 October 2005.

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

3.4.1 Background

Reporting on the result of the Consolidated Account remains important as it is through this Account that, pursuant to the requirements of the *Public Finance and Audit Act 1987* (the Act), a high proportion of public monies are received and expended. The main receipts to the Consolidated Account are State taxation and Commonwealth general purpose grants to the State. The importance of reporting derives from the fact that funds in this Account can be expended only by Parliamentary appropriation. Reporting, therefore, establishes the actual sources and application of Consolidated Account funds pursuant to the Act.

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

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

3.4.2 Appropriation Flexibility

Appropriation authority under the annual *Appropriation Act* and Governor's Appropriation Fund lapses on 30 June each year pursuant to the relevant legislation notwithstanding the availability of unused appropriation.

While there is specific appropriation authority established under various legislation, there is also flexibility in the existing appropriation arrangements in this State. A significant aspect in this regard is that most appropriation from the Consolidated Account is transferred to Special Deposit Accounts and Deposit Accounts established pursuant to the *Public Finance and Audit Act 1987*. Under related provisions, monies credited to those accounts can be spent without further appropriation from Parliament. This is of significance in that monies appropriated in one year and transferred to a deposit account need not actually be expended in that year, that is, they may be carried over into the next year unless required by the Treasurer to be paid to the Consolidated Account.[88]

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

It is now probable that agencies will not build up such significant cash balances in the future as a result of a new cash alignment policy.

3.4.3 Cash Alignment Policy

In October 2003 the Government introduced a cash alignment policy with respect to aligning agency cash balances with appropriation and expenditure authority. The policy first applied in 2004-05. Pursuant to the cash alignment policy, payments are required to be made to return surplus cash to the Consolidated Account. An implication of this policy is that agencies may have an incentive (within expenditure authority) to spend the cash allocated to them to avoid having surplus cash.

A total of $325 million of surplus cash was returned to the Consolidated Account during 2004-05 from the following agencies:

Table 3.1 — Cash Alignment Payments 2004-05

	$'million
Department for Administrative and Information Services	155
Department of Trade and Economic Development	87
Department of the Premier of Cabinet	23
Police Department	19
Attorney-Generals Department	14
Department of Treasury and Finance	13
Other	14
	325

3.4.4 Governor's Appropriation Fund and Contingency Provisions

Other key aspects of flexibility in appropriation authority arise from the provision of sources of funds for additional/new initiatives or unforeseen cost pressures that can be used without a requirement to return to Parliament for additional appropriation authority. The two such sources generally now used are the:

- Governor's Appropriation Fund (GAF), previously mentioned, which adds to the amount appropriated by Parliament each year and may affect the budget result where allocations are for unbudgeted expenses;

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

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

3.4.5 Scope of Audit of the Treasurer's Statements

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

- testing of appropriations from the Governor's Appropriation Fund, Contingency Funds and other payments;

- establishment and changes to Treasurer's Special Deposit Accounts and Deposit Accounts;

- updating and recording of the Treasurer's Loans;

- maintenance of the Central General Ledger.

3.4.6 Audit Findings and Comments

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

Departmental Response

These matters were raised by Audit in August 2005. While the Department has acknowledged and accepted Audit's observations, at the time of this Report a formal response had not been received from the Department.

In addition to the matters above, observations were also made in respect of the following:

Accrual Appropriation Excess Fund Account

Last year Audit commented on aspects of operations of the Accrual Appropriation Excess Fund Account. During 2004-05 a follow-up review was undertaken of action taken by the Department to address matters raised by Audit. Follow-up review findings are discussed in more detail under the Audit Findings and Comments heading for the Department of Treasury and Finance in Part B of this Report.

Appropriation of Administered Items

The audit identified the Department had considered strategies aimed at improving control over appropriation of administered items of departments. These are discussed in more detail under the Audit Findings and Comments heading for the Department of Treasury and Finance in Part B of this Report.

4 SUMMARY OF KEY FISCAL MEASURES AND TARGETS

4.1 SOUTH AUSTRALIAN FISCAL TARGETS

With the 2005-06 Budget, the Government has stated that South Australia's sound financial position has enabled the Government to modify its budget strategy.

The 2005-06 Budget Papers[89] indicate that the Government is committed to the following fiscal targets:

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

4.1.1 Net Operating Balance

The Government states that the cornerstone of the fiscal strategy for the future must be the achievement of net operating balances or surpluses every year. This means that revenues are covering expenses, including interest and depreciation.

The previous target of achieving, on average, balanced budgets in net lending terms (that is, after both operating and net capital investment) in the general government sector, has been modified as the Government considers that the sound financial position

[89] Budget Statement 2005-06, Budget Paper 3, p1.7.

means the arguments for the ratio of net financial liabilities to revenue to decline further, are much less compelling, although still desirable.

4.1.2 Ratio of Net Financial Liabilities to Revenue

Focus is now given to the ratio of net financial liabilities to revenue. Net financial liabilities is calculated as total liabilities less non equity financial assets, such as cash, advances and investments. This measure is broader than net debt as it includes significant liabilities other than borrowings, such as unfunded superannuation and long service leave entitlements. Total liabilities for the general government sector are estimated to grow steadily through to 2008-09. This outcome is consistent with modest net lending deficits. Nonetheless, the Government projects that revenue growth (notwithstanding no growth in real terms to 2006-07) ensures that the ratio of net financial liabilities to revenue improves over the forward estimates period. Chart 5.10 shows trends for this measure.

4.1.3 Summary

The Government has stated the revised budget strategy ensures:

- current year expenses will be met by current year revenues;
- high priority infrastructure works can be funded;
- the sound financial position of the State will be maintained;
- the capacity of the State to fund future commitments such as superannuation will be assured;
- the balance sheet continues to strengthen and South Australia becomes entrenched as a triple-A rated state.

A comparison of the 2004-05 and 2005-06 Budgets shows that the changes in strategy result in:

- a continued focus on achieving surpluses in the general government net operating balance measure (difference between operating revenues and expenses) although at lower levels than in the 2004-05 Budget;
- acceptance of deficit net lending outcomes (compared to previously projecting increasing surpluses in net lending outcomes) reflecting both the lower net operating results and higher than previously estimated net acquisition of non-financial assets (net capital investment).

The fiscal targets continue to reflect a commitment by the Government to containing the public sector's level of liabilities by fully funding superannuation liabilities, and by requiring all PNFC borrowing to be consistent with commercial returns.

The focus of Audit's commentary is directed to the targets and associated measures.

4.2 FISCAL MEASURES IN OTHER JURISDICTIONS

In considering the State's fiscal strategy, it is useful to note what is current practice across Australian jurisdictions. The following table summarises the current budget targets for each jurisdiction.

Jurisdiction	Budget Fiscal Objective/Strategy (a) (b)
Commonwealth	Maintain budget balance on average over the economic cycle (Fiscal Balance = 0). Maintaining surpluses over the forward estimates period while economic growth prospects remain sound.
NSW	Reduce the level of general government net financial liabilities as a share of GSP to 7.5 percent or less by 30 June 2010. Maintain general government underlying net debt as a share of GSP at or below its level as at 30 June 2005.
Victoria	Short Term: Target Operating Surplus of at least $100 million for the general government sector (measured on A-IFRS net result from transactions basis). Long Term: Maintain a substantial budget operating surplus.
Queensland	The Government will ensure that its level of service provision is sustainable by maintaining an overall general government operating surplus.
WA	Achieve operating surpluses for the general government sector.
Tasmania	The annual general government sector budget will be maintained in surplus. The general government sector cash surplus will be sufficient to achieve the Government's established net debt targets.
ACT	Maintenance of a balanced budget over the economic cycle (from 2005-06 to 2008-09).
NT	To achieve a positive GFS operating balance in the general government sector by 2012-13.

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

4.3 SOME AUDIT OBSERVATIONS ON THE FISCAL MEASURES

There has been some change in other state's fiscal targets from the previous year. While it is evident that there is some variation between the jurisdictions, the most prevalent position is to target net operating surpluses in the general government sector, based on the GFS accrual method as is the position in this State.

NSW is the only other state to give specific focus to net financial liabilities. This target was also introduced in that State's 2005-06 Budget.

5 STATEMENT OF FINANCIAL PERFORMANCE

5.1 OVERVIEW

The following sections discuss the State's financial performance in relation to:

- the estimated result for 2004-05, and how it compares both to the prior year numbers and the budgeted amounts;
- the Budget for 2005-06 having regard to the estimated result for 2004-05;
- a longer term view of the forecast results to 2008-09.

The discussion will provide an overall snapshot and form the basis of discussion of some of the individual influences on the actual and predicted results and related matter of managing the State's finances.

All audit analysis in this Part of the Report is based on data provided in the Budget Papers, particularly for the 2005-06 Budget, supplemented with information provided by the Department of Treasury and Finance.

Limitations on Audit Analysis

There are some limitations associated with the data that when analysing results, must be considered to put things in context. These limitations include the following.

- It must be emphasised this analysis considers the estimated result for 2004-05. Past experience has been that actual results have varied substantially from the estimated result (eg the 2003-04 general government sector estimated result was net lending $264 million, actual result was $424 million). While such variations have been small relative to the level of activity of the State (eg estimated expenses for 2004-05 for the general government sector exceed $10 billion), when the budget result target is small for a particular year, variations can be significant.
- The current accrual based budgeting and reporting framework does not eliminate the means for the results to be manipulated to manage outcomes. This can occur through such means as the timing of certain discretionary amounts and transfers between GFS sectors. Audit review of the 2004-05 estimated result does not show any matters of concern in this regard.
- The Audit commentary in this Report is based on a review of the budget material and related information. It is not an audit in the same sense as work conducted to provide an audit opinion on financial statements. Notwithstanding this observation, it is also important to acknowledge that the Budget Papers presented for the 2005-06 Budget are regarded as being of a high standard in their presentation and disclosures.
- Although the use of the GFS framework allows for comparisons between different states, the way individual states structure their public finances may place some limitations on such analysis. An example of this is Queensland's position of having funded public sector superannuation liabilities while other states have not.
- Classification changes occur from year to year in revenue and expense definitions that can affect the comparability of individual items across the time series. Such changes do not generally affect the net lending (borrowing) result.

Notwithstanding these limitations, the primary reporting framework does, in Audit's view, provide an important basis for considering the State's finances, both in terms of results over time, and against other states. These limitations are reasonable and do not invalidate the overall trend analysis from the Budget data.

5.2 INFLUENCE OF THE FISCAL STRATEGY FOR 2004-05 AND 2005-06

The importance of the budget process is that it should provide structure and discipline to the financial management process.

5.2.1 Balanced Budgets

For three years up to and including 2004-05, the Government's primary fiscal target was to achieve, on average, balanced budgets in the general government sector. The budget balance is measured by the net lending (borrowing) position of the Government. Net lending (a surplus) means annual revenues and sales of non-financial assets are sufficient to meet expenses and purchases of non-financial assets and that net financial liabilities are being reduced (before any revaluation effects).

The revised strategy in the 2005-06 Budget seeks at least a net operating balance and allows net lending deficits (borrowings).

5.2.2 Triple-A Credit Rating Target

Another of the Government's 2002-03 fiscal targets was to ensure risks to the State finances are prudently managed, while maintaining at least a AA plus credit rating. In the 2004-05 Budget, the Government had a target of achieving a triple-A credit rating within the next three years.

The triple-A rating is the highest credit rating that applies. To achieve this, the State has to meet rating agency criteria for the highest credit quality regional governments.

It is, therefore, necessary to understand the rating agency requirements as these requirements must drive behaviour when the triple-A rating is a specific target for Government.

The considerations of rating agencies include:

- balance sheet strength - manageable liabilities and financial risks;
- financial results that are sustainable and improving - recurring deficits (net borrowings) are likely to not be acceptable especially if due to operating activities (wage and salary increases, tax cuts), rather than one-off extra capital outlays;
- demonstrated fiscal discipline over at least a medium term including responding appropriately to issues that might arise such as how to apply windfall revenues and respond to expenditure pressures;
- a growing economy.

These matters are consistent with the Government's fiscal targets as set out in the 2004-05 Budget and represent what is now generally accepted by all Australian governments as good, if not expected, public sector financial management practices.

In September 2004 Standard & Poor's credit ratings agency upgraded South Australia to a triple-A credit rating for the first time in nearly 14 years. The rating upgrade recognised the State's strong balance sheet, good financial performance (noting that operating and capital spending was funded without resorting to debt financing) and commitment to fiscal discipline (noting balanced budgets on average in net lending terms).

To maintain the highest rating, there can be no significant exceptions to the rating agencies' criteria. It can be expected that the Government will continue to conduct its affairs to maintain this position.

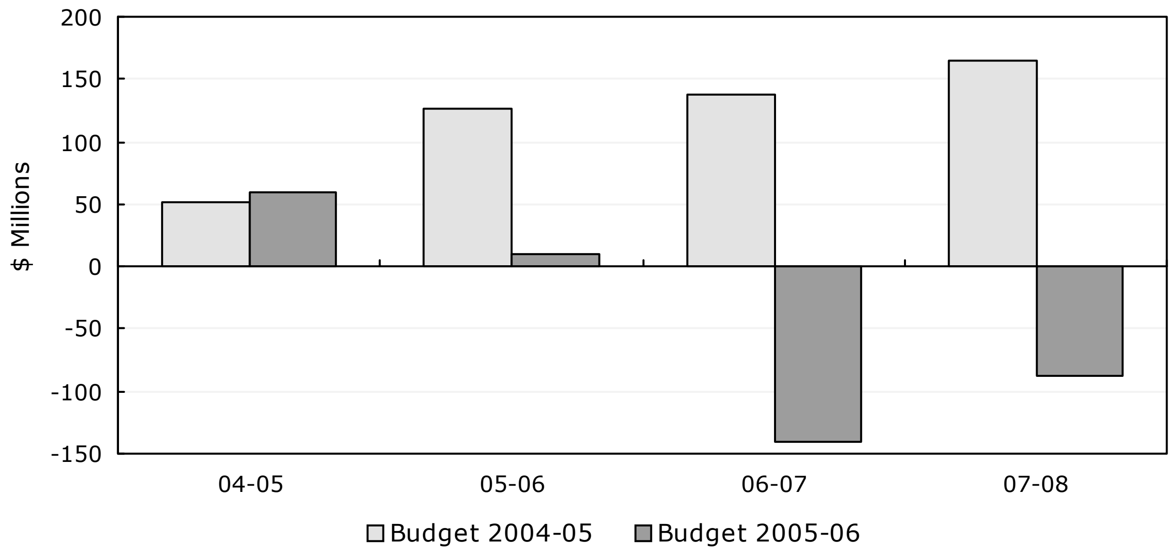
Rating agencies and other economic observers note that while the Government has moved away from more stringent fiscal policies in the 2005-06 Budget, this does not immediately threaten the recent triple-A rating due to the strength of the State's balance sheet.

5.2.3 General Government Net Lending (Borrowing) - Comparison of 2004-05 and 2005-06 Budgets

The 2005-06 Budget identifies an estimated net lending surplus of $59 million for 2004-05 compared to a surplus of $52 million estimated in the 2004-05 Budget. In the 2004-05 Budget, the Government budgeted to achieve a surplus in each of the four years over the forward estimates to 2007-08.

The following chart shows how budgeted outcomes for the forward years have changed between the 2004-05 Budget Papers and the 2005-06 Budget Papers.

Chart 5.1 — GFS - Net Lending (Borrowing) Budget 2004-05 to Budget 2005-06



The chart highlights the substantial change in the estimated result for the three years to 2007-08, with deficits (net borrowing) now projected, consistent with the revised fiscal strategy, for the two years to 2007-08.

5.3 ESTIMATED RESULT FOR 2004-05

5.3.1 General Government Sector

The estimated result for the year was a GFS net lending result of $59 million, which is an improvement of $7 million from the budget for the year. The estimated result was $365 million lower than the previous year's actual result.

The following table shows the estimated result for 2004-05 in comparison to the original budget estimate, and the actual result for the 2003-04 financial year, and identifies the differences to the 2004-05 Budget.

Table 5.1 — GFS - General Government Budget Comparisons 2003-04 to 2004-05

	2003-04 Actual $'million	2004-05 Budget $'million	2004-05 Estimated Result $'million	Difference to Budget $'million	Difference to Budget Percent
GFS Revenue					
Taxation revenue	2 806	2 780	2 916	136	5
Current grants	4 906	5 051	5 195	144	3
Capital grants	191	177	184	7	4
Sales of goods and services	1 165	1 101	1 233	132	12
Interest income	172	161	147	(14)	(9)
Distributions from PFCs	96	124	124	-	-
Distributions from PNFCs	373	299	320	21	7
Other	246	304	339	35	12
Total Revenue	9 955	9 997	10 458	461	5
Less: **GFS Expenses**					
Gross operating expenses					
Employee expenses	4 313	4 406	4 589	183	4
Depreciation	435	452	440	(12)	(3)
Other operating expenses	2 305	2 491	2 882	391	16
Nominal superannuation interest expense	354	338	307	(31)	(9)
Other interest expense	253	263	242	(21)	(8)
Current transfers	1 894	1 914	1 806	(108)	(6)
Capital transfers	16	17	19	2	12
Total Expenses	9 570	9 881	10 285	404	4
GFS Net Operating Balance	385	116	173	57	49
Less: **Net Acquisition of Non-Financial Assets**					
Purchases of non-financial assets	530	627	680	53	8
Less: Sales of non-financial assets	124	111	106	(5)	(5)
Less: Depreciation	435	452	440	(12)	(3)
Add: Change in inventories	(10)	0	(19)	(19)	
Total net acquisition of non-financial assets	(38)	64	114	50	78
GFS Net Lending (Borrowing)	424	52	59	7	13

Note: Totals may not add due to rounding.

The reduction in the estimated result from the previous year's actual result was due to higher growth in expenses (up $715 million) than revenues (up $503 million) and higher purchases of non-financial assets (up $150 million).

As shown above, while there have been significant changes to many of the components of the original budget estimates, the variances have resulted in only a very slight improvement from the budgeted estimated GFS net lending (borrowing) result.

The primary reasons for the changes from the original 2004-05 budget are as follows:

- ***Taxation Revenue*** — property taxes are expected to exceed budget, due mainly to stamp duties on conveyances which are estimated to exceed expectations by $105 million (24 percent) reflecting a stronger than budgeted for property market. Stronger than expected taxable payrolls is the other main contributor to the higher estimated result.

- ***Current Grants*** — the increase relates primarily to better than expected receipts of GST revenue grants (up $86 million) and specific purpose payments (up $74 million) from the Commonwealth.

- ***Sales of Goods and Services*** — $119 million of the increase relates to classification effects of the recognition of schools revenue and metroticket fares for the first time in 2004-05 that were not included in the 2004-05 Budget estimates.

- ***Expenses*** — up $404 million on budget, of which $345 million were policy decisions (see Table 5.7 in this section). The main increases included initiatives in health, education, industry assistance and energy concessions. The increase in expenses also includes offsetting classification effects to the sales of goods and services items.

More detailed discussions on some of the reasons are included in the sections on 'revenue' and 'expenditure' later in this Report.

5.3.1.1 Net Acquisition of Non-Financial Assets

In past years, capital underspending against budget has been substantial. 2003-04 was one of the few years where purchases of non-financial assets were on budget.[90]

The 2004-05 estimated result for purchases of non-financial assets is expected to exceed the budget. The 2004-05 budget for purchases of non-financial assets of $627 million, included a slippage allowance[91] for capital payments of $60 million in anticipation that slippage would occur. The practicality of capital works is that there are long lead times into commencement of projects and construction can be subject to delays.

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90 Final Budget Outcome 2003-04 p1.4. Total net acquisition of non-financial assets for 2003-04 was under budget due to higher than budgeted sales of non-financial assets.

91 Budget Statement 2005-06, Budget Paper 3, Table 2.28.

The Budget Papers[92] show the estimated result for each portfolio is essentially in line with budget. The estimated result above reported budget is due to slippage ($12 million) not being as high as originally anticipated although some new projects were announced and finalised after the 2004-05 Budget.

Some of the lower than budgeted spending has been carried forward into the forward estimates consistent with past practice.

Total net acquisition of non-financial assets for 2004-05 is estimated to be $50 million over budget, thereby offsetting some of the improved net operating balance and reducing the improvement in the net lending (borrowing) result.

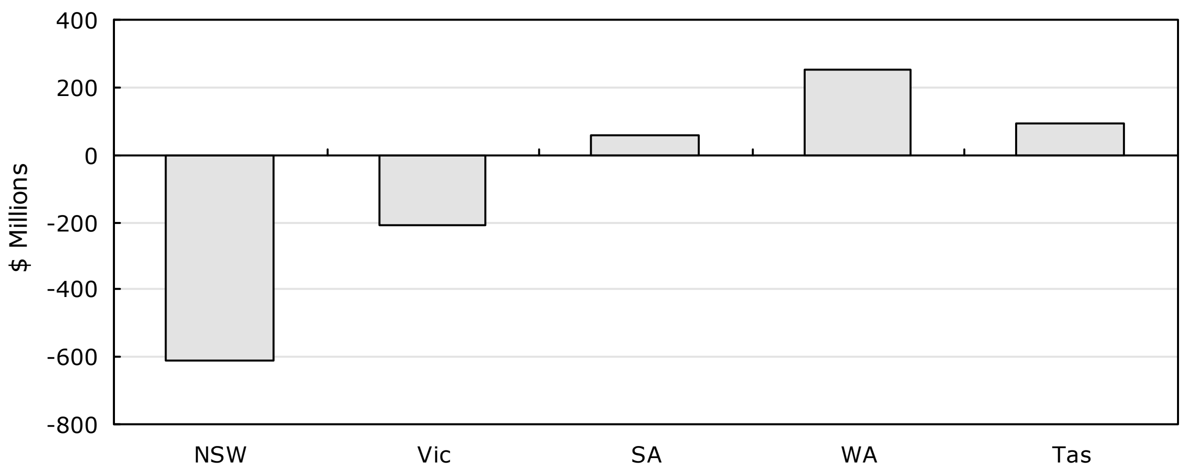
5.3.1.2 Application of the Result

The result for 2004-05 is essentially reflected in the change in net debt, which at 30 June 2005 is estimated to be $174 million for the general government sector, down $50 million from the previous year.

5.3.1.3 Net Lending - Comparisons to Other States

The following chart shows the estimated GFS general government sector net lending (borrowing) result for each of the States except Queensland for the year ended 30 June 2005. This data is provided as a snap shot of results only and does not account for differences in policy and other circumstances between the States.

Chart 5.2 — GFS - General Government Sector Estimated Net Lending (Borrowing) Result for 2004-05



Source: NSW, Vic, WA and Tas data have been sourced from the jurisdictions' 2005-06 Budget Papers.

Queensland, which is not shown on the chart, estimates net lending for 2004-05 of $1.75 billion, benefiting from funded superannuation liabilities and strong investment income. The chart shows that the estimated result for South Australia for 2004-05 is the middle ranked of the other States shown on the chart, notwithstanding that South Australia is the second smallest by financial activity.

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[92] Budget Statement 2005-06, Budget Paper 3, Table 2.28

5.3.2 Non-Financial Public Sector

The non-financial public sector (consolidating the general government and public non-financial corporations sectors) estimated result for the year was a GFS net lending result of $78 million, which is $11 million under budget for the year.

The estimated result was $301 million lower than the previous year's result due to significantly higher estimated total expenses in 2004-05 compared to 2003-04.

The following table shows the estimated result for 2004-05 in comparison to the original budget estimate, and the actual result for the 2003-04 financial year, and identifies the differences to the 2004-05 Budget.

Table 5.2 — GFS - NFPS Budget Comparisons 2003-04 to 2004-05

	2003-04 Actual $'million	**2004-05 Budget $'million**	**2004-05 Estimated Result $'million**	Difference to Budget $'million	Difference to Budget Percent
GFS Revenue					
Taxation revenue	2 629	2 586	2 711	125	5
Current grants	4 909	5 031	5 191	160	3
Capital grants	215	208	217	9	4
Sales of goods and services	2 446	2 252	2 394	142	6
Interest income	125	122	107	(15)	(12)
Other	382	518	556	38	7
Total Revenue	10 707	10 716	11 175	459	4
Less: **GFS Expenses**					
Gross operating expenses					
Employee expenses	4 496	4 577	4 759	182	4
Depreciation	651	669	661	(8)	(1)
Other operating expenses	3 072	3 194	3 455	261	8
Nominal superannuation interest expense	354	338	307	(31)	(9)
Other interest expense	315	350	327	(23)	(7)
Other property expense	15	10	17	7	70
Current transfers	1 375	1 364	1 420	56	4
Capital transfers	16	23	24	1	4
Total Expenses	10 294	10 525	10 970	445	4
GFS Net Operating Balance	413	191	206	15	8
Less: **Net Acquisition of Non-Financial Assets**					
Purchases of non-financial assets	898	983	1 011	28	3
Less: Sales of non-financial assets	211	212	203	(9)	(4)
Less: Depreciation	651	669	661	(8)	(1)
Add: Change in inventories	(3)	0	(19)	(19)	
Total Net Acquisition of Non-Financial Assets	33	102	128	26	25
GFS Net Lending (Borrowing)	379	89	78	(11)	(12)

Note: Totals may not add due to rounding.

The key differences between the original budgeted amounts and the estimated result are similar to those as explained for the general government sector, namely increases in both taxation, current grants, sales of goods and services, and spending on employee and other operating expenses.

The estimated result for the public non-financial corporations sector is a slight decline from the 2004-05 Budget with a net lending surplus estimated to be $19 million[93] (budget $37 million).

5.3.3 The Consolidated Account Outcome

Total appropriation authority for 2004-05 was $7.1 billion, including the Governor's Appropriation Fund, but excluding specific appropriations authorised in various acts. Actual payments were $6.9 billion, excluding specific appropriations authorised in various acts, well within appropriation authority.

The result on the Consolidated Account for 2004-05 was a surplus of $377 million ($329 million in 2003-04) exceeding the budgeted amount by $121 million. This surplus was determined after total receipts of $7.4 billion and payments of $7.1 billion.

This surplus was used to repay borrowings from SAFA. This is reflected in the reduction in net debt as at 30 June 2005 as previously discussed.

The key differences between actual and budgeted amounts are explained as follows:

- Large increases in stamp duties receipts of $130 million due to higher than expected activity in the property sector.

- Commonwealth General Purpose Grants exceeding budget by $74 million, mainly through GST revenue grants increasing by $71 million.

Further details of the budget and actual data are presented in Statement A 'Comparative Statement of the Estimated and Actual Payments from the Consolidated Account of the Government of South Australia'.[94]

5.3.3.1 Governor's Appropriation Fund and Contingency Provisions

Earlier in this Report reference was made to aspects of the flexibility within the appropriation process, in particular the availability of the Governor's Appropriation Fund (GAF) and the provision for contingencies within the DTF Administered Items.

The 2004-05 Budget included contingency funds[95] totalling $226 million ($119 million), which when added to the $187 million ($182 million) available from the GAF provided flexibility within the Budget of $413 million ($301 million) or 6.1 percent (4.9 percent) of the total of the *Appropriation Act 2004* less the total of budgeted contingency funds.

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93 Budget Statement 2005-06, Budget Paper 3, Appendix A Table A.2.

94 Report of the Auditor-General for the year ended 30 June 2005, Part B, Volume V, Appendix.

95 The majority of contingency funds are committed to identified purposes subject to further consideration and approval including expected salary and wage outcomes.

Use of both the contingency provisions and the GAF requires the Treasurer to approve the expenditure of the funds. As mentioned, use of contingency provisions does not affect the budget result as they are already figured into that result. Use of the GAF, on the other hand, may be an additional expense for the Budget result.

The following table sets out the availability and use of these funds in 2004-05.

Table 5.3 — Appropriation Flexibility

	Authority/ Budget $'million	Actual Payments $'million
Governor's Appropriation Fund	187	154
Total contingency provisions	226	118
Total Flexibility	413	272

Governor's Appropriation Fund

Details of the purpose of appropriations from the GAF are provided in Statement K - Governor's Appropriation Fund of the Treasurer's Financial Statements.[96] The main items were for a payment of $35 million to the Department of Education and Children's Services relating mainly to a single funding model and school pride strategy for South Australian Government schools, $34 million to Department of Health (for a range of health activities) and $28 million to Administered items for the Department for Families and Communities (for electricity concession payments).

Contingency Provisions

Details of payments from the contingency funds are now provided in Statement L – Statement of Transfers from Contingency Provisions of the Treasurer's Financial Statements. Payments are transfers of additional funding to agencies mainly to meet the final determined cost of expected commitments. These payments are included within the total payments amounting to $920 million from the line 'Administered Items for Department of Treasury and Finance' in Statement A of the Treasurer's Financial Statements.[97] The main items were for a payment of $59 million to the Department of Health and $26 million to the South Australian Police relating to settlement of enterprise bargaining agreements.

The original amounts set aside for contingency provisions are within the appropriation line 'Administered Items for the Department of Treasury and Finance,[98]. Accordingly the total spent from this line may exceed the original estimate provided the total appropriation of the line is not exceeded.

Appropriation Transfers

In addition to the preceding provisions, appropriation can be transferred between agencies. Section 13 of the *Public Finance and Audit Act 1987* provides authority where

96 Report of the Auditor-General for the year ended 30 June 2005, Part B, Volume V, Appendix.

97 Report of the Auditor-General for the year ended 30 June 2005, Part B, Volume V, Appendix.

98 2004-05 Portfolio Statements, Budget Paper 4 p3.25 and 3.27.

excess funds exist for one agency and are necessary for another. Section 5 of the *Appropriation Act* provides authority where restructuring of an agency occurs so that appropriation related to transferring functions may in turn be transferred. Section 5 transfers are detailed in Statement A of the Treasurer's Financial Statements.

Spending decisions in 2004-05 resulted in section 13 transfers amounting to $130 million. Details of the transfers are provided in Statement K - Transfers Authorised Pursuant to Section 13 of the *Public Finance and Audit Act 1987* - of the Treasurer's Financial Statements.[99]

The main items were a $86 million transfer from Administered Items for the Department of Treasury and Finance, transfers of $70 million to the Department for Families and Communities and a transfer of $45 million to the Department of Health for various items.

As can be seen from the preceding discussion and table, the flexibility arrangements within the 2004-05 Budget were sufficient to meet emerging costs and new commitments.

5.4 AAS 31 'FINANCIAL REPORTING BY GOVERNMENTS' - RESULTS

The following briefly discusses the financial result of the AAS 31 statements as at 30 June 2004. As previously discussed, data for the current year (due to the time needed for preparation) is not available at the time of the Auditor-General's annual report. It is included for reference only. Full details and analysis are published by the Department of Treasury and Finance[100]. This data provides the opportunity to observe the financial result of the Government using a full accrual accounting basis, and the consolidation of all sectors. The consolidation process means that all inter-sector transactions are eliminated.

The following table summarises the financial result for the year ending 30 June 2004, with comparative amounts for the preceding four years.

Table 5.4 — AAS 31 Financial performance (2000-2004)

	2000 $'million	2001 $'million	2002 $'million	2003 $'million	2004 $'million
Revenues					
Taxation	2 081	2 024	2 037	2 285	2 651
Grants	3 925	4 361	4 807	5 010	5 289
Sale of goods and services, fees and levies	3 975	3 321	2 571	2 898	3 282
Investment revenues	1 552	871	811	878	1 757
Net revenues from asset disposals [(a)]	1 137	268	63	28	41
Other	388	525	1 010	893	738
Total Operating Revenues	13 058	11 370	11 299	11 992	13 758

[99] Report of the Auditor-General for the year ended 30 June 2005, Part B, Volume V, Appendix.

[100] Government of South Australia Consolidated Financial Report for the Year Ended 30 June 2004.

	2000 $'million	2001 $'million	2002 $'million	2003 $'million	2004 $'million
Expenses					
Employee expenses	3 298	3 526	4 942	5 032	6 057
Supplies and services	3 149	3 008	2 665	2 713	2 305
Grants and subsidies	1 497	1 356	1 380	1 395	1 466
Borrowing cost expenses	2 119	921	757	761	737
Other	1 908	1 734	2 581	3 000	3 856
Total Operating Expenses	11 971	10 545	12 325	12 901	14 421
Net Surplus (Deficit)	1 087	825	(1 026)	(909)	(663)
Increase in asset revaluation reserve	353	1 184	666	1 495	1 234
Increase (Decrease) in adoption of new standard	6	348	2	(10)	(20)
Total Changes in Equity	1 446	2 357	(358)	576	551

(a) These amounts include gains made on the disposal on electricity infrastructure and businesses.

The table highlights that notwithstanding significant growth in revenues over the two years to 2004, this has been exceeded by growth in expenses and deficits have been incurred. This is due to superannuation movements explained as follows:

- ***Employee Expenses*** — increased by $1 billion due mainly to the impact of a change in the discount rate applied to the superannuation liability. A risk free rate was applied for the first time in 2003-04 in anticipation of a change arising from the adoption of international accounting standards requirements from 2005-06. The effect was to increase the liability by $1.4 billion.

- ***Other Expenses*** — increased by $856 million due to the effect of accounting for profits made by Funds SA which are payable to State superannuation funds. Such profits are recorded as an expense in the whole of government statements.

5.5 2005-06 BUDGET

The following focuses on the trends arising from the 2005-06 Budget tabled in Parliament in May 2005. It provides an overview of the expected result for 2005-06 and provides the context for discussion on individual lines of the Budget hereunder in this Part. The analysis deals only with the accrual-based GFS framework.

5.5.1 Matters of Significance to the 2005-06 Budget

Some matters of significance to the 2005-06 Budget estimates years, are:

- new expenditure initiatives totalling $883 million over the next four years;[101]
- targeted savings totalling $75 million over four years;[102]

[101] Budget Statement 2005-06, Budget Paper 3, Table 2.1.

[102] Budget Statement 2005-06, Budget Paper 3, Table 2.2.

- minimal expected real terms growth in expenses over the four years to 2008-09;
- taxation relief designed to bring in $666 million less over four years;[103]
- a reduction in revenues (in real terms) over the four years to 2008-09;
- reliance on distributions from the public financial corporations sector of government amounting to $182 million over four years,[104] of which $103 million is a distribution from the South Australian Government Financing Authority (SAFA) in 2005-06.

The underlying level of activity, total revenues and expenses, for 2005-06 is higher than was budgeted in 2004-05. Total revenue for 2005-06 is now $10.7 billion, $552 million or 5 percent more than was estimated for 2005-06 in the previous, 2004-05 Budget.

Expenses, $10.7 billion for 2005-06 in the 2005-06 Budget are $619 million or 6 percent higher than was estimated at the time of the 2004-05 Budget.

The growth in revenue and the past position of a budgeted surplus (the 2004-05 Budget estimated an operating surplus of $126 million for 2005-06), means that the Government was in a position to increase expenditure in the 2005-06 Budget to meet parameter and policy spending increases, while continuing to meet the new fiscal objective of at least a net operating balance for the general government sector.

5.5.2 General Government Sector - Operating Statement

The budgeted GFS net lending result for 2005-06 of $10 million is a decrease of $49 million on the estimated result for 2004-05. The differences between the two years are set out in the following table.

Table 5.5 — GFS - General Government Sector Budget Comparison of 2004-05 Estimate and 2005-06 Budget

	2004-05 Estimated Result $'million	2005-06 Budget $'million	Difference $'million	Difference Percent
GFS Revenue				
Taxation revenue	2 916	2 862	(54)	(1.9)
Current grants	5 195	5 427	232	4.5
Capital grants	184	182	(2)	(1.1)
Sales of goods and services	1 233	1 227	(6)	(0.5)
Interest income	147	154	7	4.8
Distributions from PFCs	124	115	(9)	(7.3)
Distributions from PNFCs	320	380	60	18.8
Other	339	373	34	10.0
Total Revenue	10 458	10 721	263	2.5

[103] Budget Statement 2005-06, Budget Paper 3, Table 3.1.

[104] Budget Statement 2005-06, Budget Paper 3, Table 3.19.

	2004-05 Estimated Result $'million	2005-06 Budget $'million	Difference $'million	Difference Percent
Less: **GFS Expenses**				
Gross operating expenses				
Employee expenses	4 589	4 780	191	4.2
Depreciation	440	456	16	3.6
Other operating expenses	2 882	3 014	132	4.6
Nominal superannuation interest expense	307	307	-	-
Other interest expense	242	242	-	-
Current transfers	1 806	1 853	47	2.6
Capital transfers	19	19	-	-
Total Expenses	10 285	10 670	385	3.7
GFS Net Operating Balance	173	51	(122)	(70.5)
Less: **Net Acquisition of Non-Financial Assets**				
Purchases of non-financial assets	680	636	(44)	(6.5)
Less: Sales of non-financial assets	106	139	33	31.1
Less: Depreciation	440	456	16	3.6
Add: Change in inventories	(19)	-	19	-
Total Net Acquisition of Non-Financial Assets	114	41	(73)	-
GFS Net Lending (Borrowing)	59	10	(49)	(83.1)

Note: Totals may not add due to rounding.

It can be seen from the above table that the difference for the 2005-06 year is due mainly to:

- total revenue rising slightly less than inflation (CPI is forecast to be 2.75 percent for South Australia in 2005-06)[105] despite a forecast drop in taxation revenue (reflecting tax relief and expected softening of property markets in 2005-06) due to more than offsetting increases in other revenue items, mainly current grants from the Commonwealth;
- increases in all the major spending lines; employee expenses, other operating expenses and current transfers, in line with or above the level of CPI for 2005-06;
- a decrease in total net acquisition of non-financial assets of $73 million, noting that purchases of non-financial assets for 2005-06 is $44 million lower than 2004-05 because it includes a provision for capital slippage of $60 million (2004-05: $12 million).

An important feature of the 2005-06 budget is the allowance for a downturn in property activity compared to the high level of growth which was sustained for the previous three years. Notwithstanding, taxation revenues are estimated to be maintained at a level well beyond that of the period prior to the property boom. Estimated taxation revenue in 2005-06 of $2.9 billion, is $669 million or 31 percent more than the 2001-02 actual total of $2.2 billion.

[105] Budget Statement 2005-06, Budget Paper 3, Table 8.1.

A further notable feature is that given that budget operating results are relatively minor for 2005-06 (ie a positive net operating result of $51 million representing 0.5 percent of total revenue of $10.7 billion), the discretionary distributions totalling $115 million, from the PFCs enable the achievement of the net lending of $10 million.

More detail of the factors influencing the 2005-06 Budget are considered in the context of the longer-term trends discussed later in this Report.

5.5.3 Changes in 2005-06 General Government Sector Budgeted Results

Another view of the 2005-06 Budget is provided when comparing it to the previous estimate for the 2005-06 year in the 2004-05 Budget Papers. Differences between the estimate and the 2004-05 Budget are set out in the following table.

Table 5.6 — GFS - General Government Sector - Comparison of Estimate and Budget for 2005-06

	2005-06 (2004-05 Budget) Estimated $'million	2005-06 (2005-06 Budget) Budget $'million	Difference $'million	Difference Percent
GFS Revenue				
Taxation revenue	2 798	2 862	64	2.3
Current grants	5 222	5 427	205	3.9
Capital grants	137	182	45	32.8
Sales of goods and services	1 120	1 227	107	9.6
Interest income	162	154	(8)	(4.9)
Distributions from PFCs	113	115	2	1.8
Distributions from PNFCs	297	380	83	27.9
Other	320	373	53	16.6
Total Revenue	10 169	10 721	552	5.4
Less: **GFS Expenses**				
Gross operating expenses				
Employee expenses	4 528	4 780	252	5.6
Depreciation	448	456	8	1.8
Other operating expenses	2 508	3 014	506	20.2
Nominal superannuation interest expense	343	307	(36)	(10.5)
Other interest expense	249	242	(7)	(2.8)
Current transfers	1 962	1 853	(109)	(5.6)
Capital transfers	15	19	4	26.7
Total Expenses	10 051	10 670	619	6.2
GFS Net Operating Balance	118	51	(67)	(56.8)
Less: **Net Acquisition of Non-Financial Assets**				
Purchases of non-financial assets	560	636	76	13.6
Less: Sales of non-financial assets	120	139	19	15.8
Less: Depreciation	448	456	8	1.8
Total Net Acquisition of Non-Financial Assets	(8)	41	49	-
GFS Net Lending (Borrowing)	126	10	(116)	(92.1)

Note: Totals may not add due to rounding.

This presentation confirms that the budget for 2005-06 reflects an expected sustained higher level of financial activity than was estimated the previous year notwithstanding a forecast slowdown in property market activity.

The table also shows that although total revenue is $552 million or 5.4 percent higher than was estimated in the 2004-05 Budget, the budgeted net lending for the 2005-06 year is a $116 million deterioration over the earlier estimate due mainly to:

- a real increase in total operating expenses that absorb all of the revenue increase such that there is a deterioration in the GFS Net Operating Balance of $67 million over the earlier estimate;
- an increase in the net acquisition of non-financial assets of $49 million. This includes the effect of carry-over expenditure from the previous year.

These outcomes are consistent with the Government's revised fiscal targets.

5.5.4 Reconciliation of General Government Sector Net Lending

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

'Parameter changes' are those that flow from other than policy choices. For revenue they include taxation changes from economic activity and revenue from the Commonwealth. For operating expenses they include carry over of expenses between years from timing effects, reclassifications and corrections.

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

The following table summarises all parameter and policy changes made since the 2004-05 Budget.[106]

Table 5.7 — Reconciliation of General Government Sector Net Lending

	2004-05 Estimated Result $'million	2005-06 Budget $'million	2006-07 Estimate $'million	2007-08 Estimate $'million
2004-05 Budget	**52**	**126**	**137**	**165**
Parameter and other variations				
Revenue - taxation	156	145	154	160
Revenue - other	318	420	368	282
Operating expenses	(84)	(369)	(404)	(393)
Net capital investment expenditure	(31)	(54)	(155)	(99)
Net Effect of Parameter and Other Variations	**359**	**142**	**(37)**	**(50)**
Policy measures				
Revenue - taxation	(20)	(82)	(87)	(111)
Revenue - other	8	67	92	110
Operating expenses	(345)	(264)	(235)	(238)
Net capital investment expenditure	(18)	(45)	(75)	(60)
Net Effect of Policy Measures	**(375)**	**(324)**	**(305)**	**(299)**

[106] Budget Statement 2005-06, Budget Paper 3, Tables 1.8 and 1.9.

	2004-05 Estimated Result $'million	2005-06 Budget $'million	2006-07 Estimate $'million	2007-08 Estimate $'million
Use of Provisions Set Aside in the 2004-05 Budget and the 2004-05 MYBR				
Operating expenses	24	15	15	44
Capital investment expenditure	-	50	50	52
Net Effect of Use of Provisions Set Aside	**24**	**65**	**65**	**96**
2005-06 Budget	**59**	**10**	**(141)**	**(88)**

Note: Totals may not add due to rounding.

Revenues

The table shows that revenue changes since the 2004-05 Budget are due mainly to parameter changes. Taxation revenue policy changes represent tax relief measures set out in the 2005-06 Budget[107].

The following table shows the components of revenue parameter changes.

Table 5.8 — Revenue Parameter Changes

	2004-05 Estimated Result $'million	2005-06 Budget $'million	2006-07 Estimate $'million	2007-08 Estimate $'million
Property related taxes	146	157	164	167
Payroll tax	20	22	23	25
GST revenue grants	89	89	(10)	(22)
AusLink	12	22	50	59
Reclassification of Office of Public Transport to the general government sector	21	21	22	20
Inclusion of school revenue	126	130	133	136
Inclusion of non-government schools per capita grants	37	56	56	56
Other	23	68	84	1
Total	**474**	**565**	**522**	**442**

Operating Expenses

Table 5.7 shows that parameter effects are estimated to add operating expenses of $1.3 billion over the four years to 2007-08. Part of this increase relates to classification effects of the recognition of schools expenses and Office of Public Transport for the first time from 2004-05 that were not included in the 2004-05 Budget estimates.

Even so, the value of parameter changes each year suggests that at least a part of contingency amounts built into the Budget are likely to be required to meet parameter changes that arise over the course of the Budget period. The following table shows the operating expenses parameter changes that have occurred in the past two Budgets.

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[107] Budget Statement 2005-06, Budget Paper 3, Table 3.2.

Table 5.9 — Operating Expenses Parameter Changes 2004-05 and 2005-06

	2004-05 $'million	2005-06 $'million	2006-07 $'million	2007-08 $'million
Budget 2004-05	472	404	479	-
Budget 2005-06	84	369	404	393
	556	**773**	**883**	**393**

The table highlights that, for example, over two Budgets $773 million has been added to operating expenses for 2005-06 from what, by definition, are changes that flow from other than policy choices, including, as mentioned above, carryovers.

Policy spending decisions have added $1.1 billion to operating expenses over the four year period. Details of the Government's policy initiatives are set in detail in the Budget Papers[108]. It is noteworthy that while policy decisions add substantially to operating expenses, for example, $264 million for 2005-06, they were still less than the value of parameter changes for the three years to 2007-08.

5.5.5 Public Non-Financial Corporations Sector - Operating Statement

The GFS net lending result for the public non-financial corporation sector is budgeted to be a deficit of $114 million, a $133 million deterioration on the estimated result for 2004-05 ($19 million surplus).

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

Table 5.10 — GFS - PNFC Budget Comparison 2004-05 and 2005-06

	2004-05 Estimated Result $'million	2005-06 Budget $'million	Difference $'million	Difference Percent
GFS Revenue				
Sales of goods and services	1 328	1 277	(51)	(3.8)
Other	512	535	23	4.5
Total Revenue	1 840	1 812	(28)	(1.5)
Less: **GFS Expenses**				
Gross operating expenses	1 346	1 302	(44)	(3.3)
Other expenses	461	544	83	18.0
Total Expenses	1 807	1 846	39	2.2
GFS Net Operating Balance	33	(34)	(67)	-
Less: **Net Acquisition of Non-Financial Assets**				
Purchases of non-financial assets	333	427	94	28.2
Less: Sales of non-financial assets	99	122	23	23.2
Less: Depreciation	220	225	5	2.3
Total Net Acquisition of Non-Financial Assets	14	80	66	
GFS Net Lending (Borrowing)	19	(114)	(133)	-

Note: Totals may not add due to rounding.

108 Budget Statement 2005-06, Budget Paper 3, tables 2.14-2.26.

The deterioration in the 2005-06 budget results from expected decreases in revenues and increases in budgeted expenses. Part of the decrease shown in the table arises from reclassification effects of the Office of Public Transport to the general government sector.

Increased budgeted purchases of non-financial assets together with the budgeted net operating deficit result in the budgeted net borrowing of $114 million.

5.5.6 Non-Financial Public Sector - Operating Statement

The result for the non-financial public sector reflects the combination of the general government and public non-financial corporations sectors. The budgeted result for the non-financial public sector is net borrowing of $104 million, that is a deterioration of $182 million from the 2004-05 estimated result. Explanations for the change are consistent with those described for the two sectors above. Detail supporting this result is provided in the 2005-06 Budget Papers.[109]

5.6 A LONGER TERM PERSPECTIVE OF FINANCIAL PERFORMANCE

The Budget presented by the Government also includes forward projections extending to the 2008-09 year in addition to the detailed information relating to the 2005-06 year. In addition, historical information under the GFS framework is available since the 1998-99 year.

The following sections will discuss in further detail, individual elements of the GFS operating statement in the context of their historical perspective, and provide some Audit observations of the forward data.

Commentary deals mainly with the general government sector, the focus of the Budget. Time series data for all sectors are available in the Appendices to the Budget Statement 2005-06, Budget Paper 3.

5.6.1 General Government Sector Operating Statement Time Series

Table 5.11 provides a 10 year time series for those individual elements that contribute to the budget result.

The table highlights that the net operating balance will be maintained in surplus over the forward estimate period. The net lending result is budgeted to decrease by $49 million to $10 million in 2005-06, and deficit (net borrowing) results are expected for the next three years although declining over that period.

These outcomes are consistent with the Government's revised fiscal targets reflecting the current low level of debt and other strategies to manage other liabilities, particularly to reduce unfunded superannuation liabilities.

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[109] Budget Statement 2005-06, Budget Paper 3, Appendix A, Table A.3.

Table 5.11 — GFS - General Government Sector Operating Statement - Time Series

	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09
	Actual	Actual	Actual	Actual	Actual	Estimated Result	Budget	Estimate	Estimate	Estimate
GFS Revenue	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**	**$'million**
Taxation revenue	2 748	2 197	2 193	2 431	2 806	2 916	2 862	2 985	3 058	3 145
Current grants	3 098	3 992	4 485	4 638	4 906	5 195	5 427	5 553	5 769	5 932
Capital grants [(a)]	-	-	-	209	191	184	182	206	212	169
Sales of goods and services	696	982	902	997	1 165	1 233	1 227	1 263	1 287	1 310
Interest income	215	169	131	146	172	147	154	157	159	166
Distributions from PFCs	33	44	50	332	96	124	115	23	22	22
Distributions from PNFCs	458	278	241	300	373	320	380	381	371	379
Other	397	446	536	293	246	339	373	400	414	427
Total Revenue	7 644	8 108	8 538	9 346	9 955	10 458	10 721	10 968	11 291	11 549
***Less:* GFS Expenses**										
Gross operating expenses										
Employee expenses	3 281	3 517	3 828	3 997	4 313	4 589	4 780	4 960	5 134	5 274
Depreciation	337	322	390	401	435	440	456	469	478	492
Other operating expenses	2 076	2 376	2 270	2 126	2 305	2 882	3 014	3 070	3 166	3 286
Nominal superannuation interest expense	274	248	244	299	354	307	307	309	309	308
Other interest expense	601	353	272	297	253	242	242	225	213	205
Current transfers	1 345	1 545	1 663	1 724	1 894	1 806	1 853	1 837	1 865	1 892
Capital transfers	59	43	44	54	16	19	19	20	18	18
Total Expenses	7 974	8 406	8 713	8 898	9 570	10 285	10 670	10 890	11 182	11 474
GFS Net Operating Balance	(330)	(297)	(174)	448	385	173	51	78	109	75
***Less:* Net Acquisition of Non-Financial Assets**										
Purchases of non-financial assets	519	457	508	474	530	680	636	797	765	704
Less: Sales of non-financial assets	41	30	171	41	124	106	139	109	91	87
Less: Depreciation	337	322	390	401	435	440	456	469	478	492
Add: Change in inventories	-	(3)	3	2	(10)	(19)	-	-	-	-
Total net acquisition of non-financial assets	141	102	(50)	34	(38)	114	41	219	197	125
GFS Net Lending/(Borrowing)	(471)	(399)	(124)	414	424	59	10	(141)	(88)	(50)

Note - Totals may not add due to rounding.

(a) Prior to 2002-03, capital grants were not reported separately but were included in 'other' revenue.

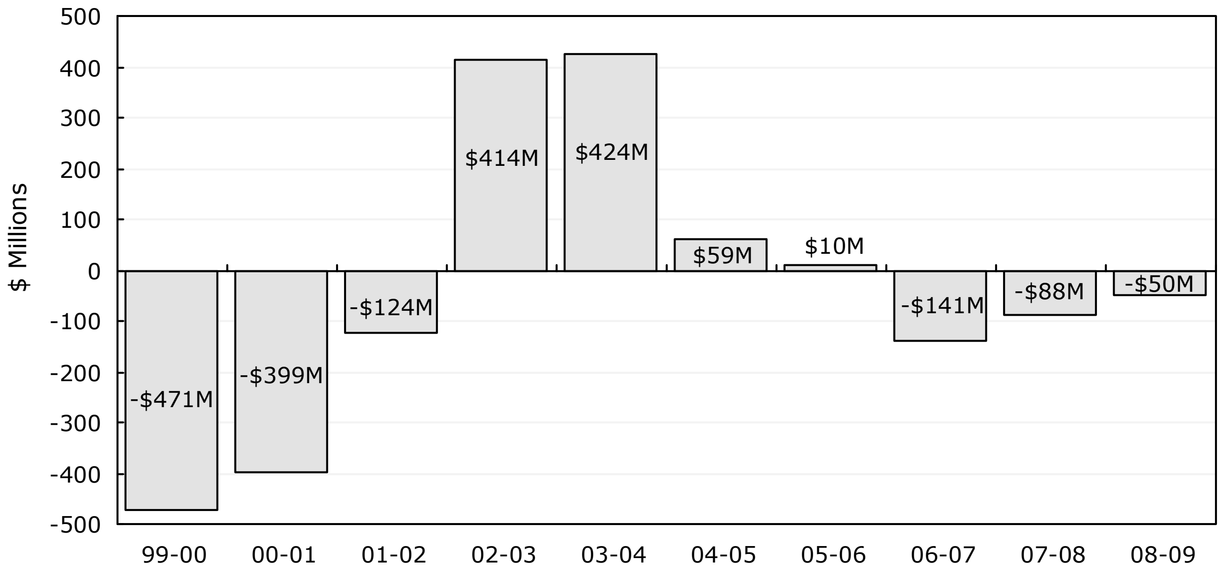
The following discussion explores some of the key indicators arising from the historic and forecast data.

5.6.2 Net Lending (Borrowing) Result Trend

As discussed earlier, the GFS net lending (borrowing) result indicates the extent to which accruing expenses and net capital investment expenditure is funded by revenues.

The following chart shows the GFS net lending (borrowing) result for the general government sector for the period presented in the GFS - General Government Sector Operating Statement Time Series table 5.11.

Chart 5.3 — GFS - General Government Sector Net Lending (Borrowing) Result



The chart shows the improvement in the State's net lending (borrowing) result, particularly in 2002-03 and 2003-04 and the surpluses estimated for the two years to 2005-06.

In 2002-03 the Government set a policy to achieve, on average, balanced budgets in the general government sector. Results prior to 2002-03 are not directly comparable on a policy basis, as other fiscal targets were in place. Since the policy's adoption, it has been, or is estimated to be, exceeded in completed financial years since that Budget.

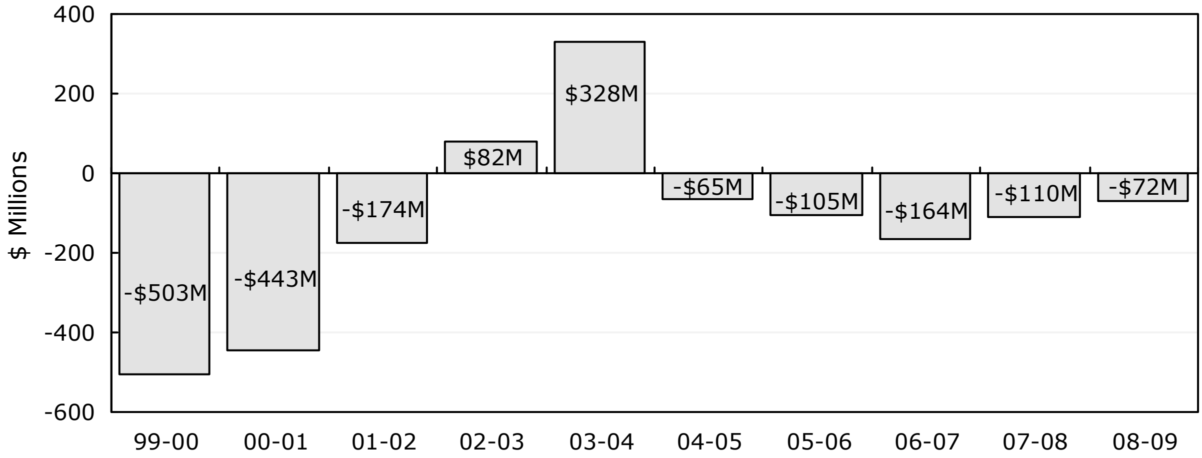
As discussed previously, the fiscal targets have changed from 2005-06 and forecast deficits (net borrowings) for the three years to 2008-09 are consistent with the revised policy settings. The projected net lending/(borrowing) outcomes are estimated to total $269 million over the four years to 2008-09.

5.6.3 Net Lending (Borrowing) before PFC Distributions

It is important to note that the results for the four years to 2005-06 have been assisted by large distributions from PFCs. Table 5.11 shows that up to 2001-02, distributions from PFCs never exceeded $50 million in a year. This was notwithstanding much larger budgeted amounts.

The following chart shows the net lending (borrowing) before PFC distributions for the period as shown in the GFS - General Government Sector Operating Statement Time Series table 5.11.

Chart 5.4 — Net Lending (Borrowing) before PFC Distributions



The chart shows the importance of PFC distributions as the adjusted results for the four years to 2005-06 are significantly changed. From 2002-03, it is not until 2006-07 that the forecast surpluses do not change significantly due to PFC distributions.

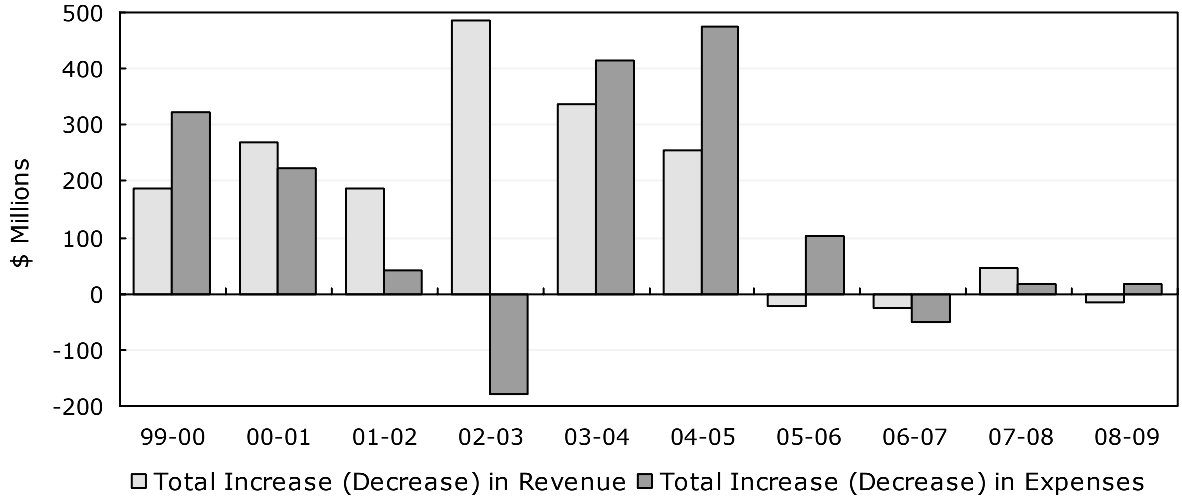
It is important to note that it is appropriate to expect distributions to the general government sector from PFCs. These distributions are discretionary and simply transfers between sectors of government. It is the variance between the years that is important when considering trends over the years.

5.6.4 Net Operating Balance Influences

Under the Government's revised fiscal targets, the net operating balances or surpluses are regarded as the cornerstone. It is important to consider how the net operating balance, determined by GFS revenues less GFS expenses, is proposed to be achieved.

The following chart shows the increase or decrease, in real terms, of total revenue and total expenses to the previous year for the 10 years to 2008-09.

Chart 5.5 — Increase/Decrease of Total Revenue and Total Expenses to Previous Year [(a)]



(a) Estimated June 2005 values.

5.6.4.1 Total Revenues

It can be seen that total revenues increased or are estimated to increase in real terms by varying amounts in each of the six years to 2004-05. Total revenues are then estimated to reduce in real terms in the two years to 2006-07, grow in 2007-08 and then reduce in 2008-09. As previously noted, the decrease in 2005-06 is due to an expected slow down in property based revenues. This is also the case for 2006-07.

5.6.4.2 Total Expenditure

For total expenditure, it is notable that in the seven years to 2005-06, only in 2002-03 is there a decrease in real terms. The 2005-06 Budget proposes real increases in expenses of $101 million over 2004-05.

It is then forecast that total expenses will reduce in real terms by $51 million in 2006-07 and increase marginally by $18 million in 2007-08 and $17 million in 2008-09.

The projected current operating surplus for three of the four years of the 2005-06 Budget is therefore subject to highly constrained expenditure. This has been the case in the past two budgets.

The chart, however, shows that experience to 2004-05 of achieving low growth or reductions in expenses is limited and indeed that growth in revenues has reduced the risk of expenditure increases to the budget bottom line. Given the forecast expectation that such revenue growth may not be sustained, as in past years, monitoring of expenses will be important.

5.7 COMPARISON WITH OTHER STATES

The GFS accrual information is available for all states as a result of uniform reporting. With this form of reporting it is useful to consider the results and projections across state governments.

Importantly before drawing conclusions, any assessment needs a sound understanding of the specific circumstances prevailing in different states. I have not sought to provide all of the relevant information in this Report. Rather I take the opportunity to show what each state is forecasting through to 2009.

The following table shows 2005-06 budgeted GFS total revenue for each state.

Table 5.12 — 2005-06 Budgeted GFS Total Revenue by State

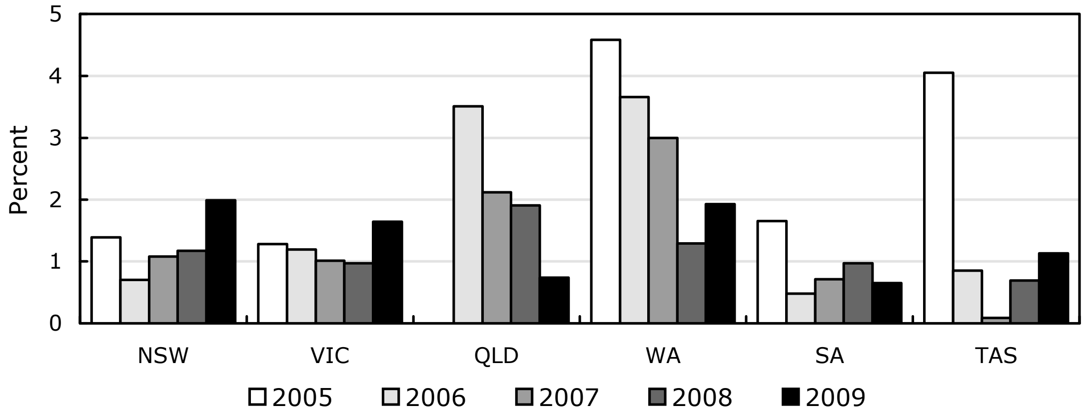
State	NSW $'million	Victoria $'million	Queensland $'million	WA $'million	SA $'million	Tasmania $'million
GFS Total Revenue	43 186	30 624	26 604	14 218	10 721	3 404

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

5.7.1 Net Operating Balance State Comparison

The chart on the following page compares some trends in the GFS accrual information with the other States.

Chart 5.6 — General Government Sector Net Operating Balance as a Proportion of GFS Total Revenue



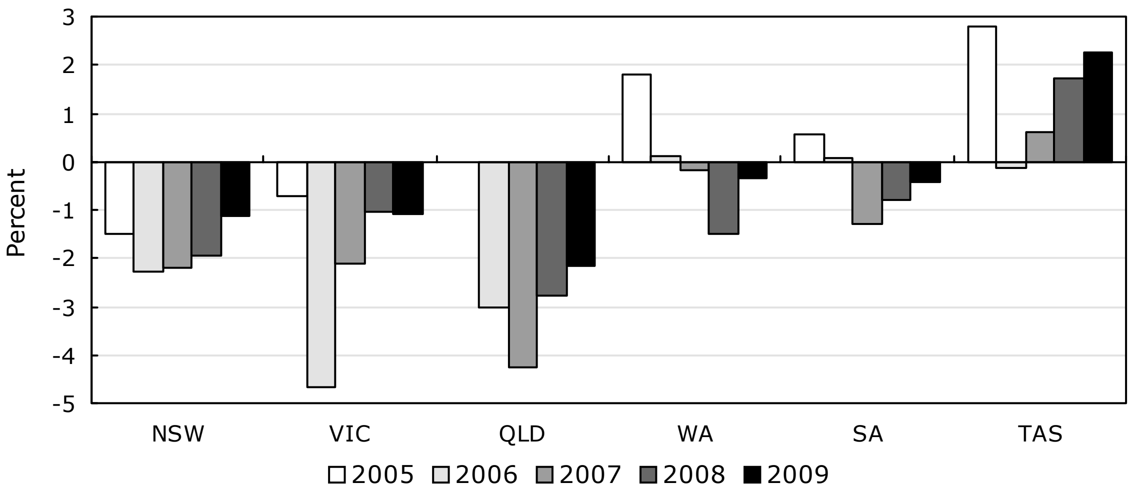
The chart shows that, similar to most other states, South Australia will have a reduced net operating balance in 2005-06. The trend in South Australia's result is projected increases up to 2008. The trends for other states are mixed. Note that Queensland's net operating balance was $2.7 billion, (NOB to Revenue was 10.2 percent) benefiting from funded superannuation liabilities and strong investment income in 2004-05. Due to the size of this result it is omitted from the chart to assist legibility.

The chart also shows that South Australia's net operating balances as a proportion of GFS total revenue, while generally low, compares reasonably with the estimates of most of the other states.

5.7.2 Net Lending (Borrowing) State Comparison

The GFS net lending (borrowing) result represents whether a government has funded capital expenditure, net of depreciation expense and asset sales, from a surplus net operating balance. The following chart compares trends with the other states.

Chart 5.7 — General Government Sector Net Lending (Borrowing) as a Proportion of GFS Total Revenue as at Budget 2005-06



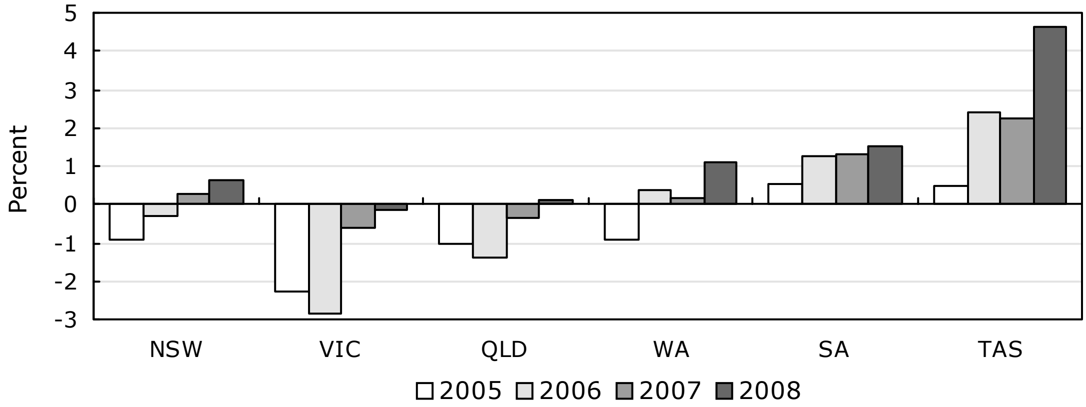
As detailed in the chart, only South Australia and Western Australia are estimating to achieve net lending (surplus) results in 2006. All states are projecting improvements in this indicator by the end of the forecast period, although only Tasmania is forecasting a net lending result. Queensland's net lending to revenue of 6.6 percent in 2004-05 is again excluded.

The chart shows that South Australia's net lending (borrowing) as a proportion of GFS total revenues compares favourably to most States.

5.7.2.1 Comparison to the 2004-05 Budget

Noting the changed fiscal targets in this and some other jurisdictions, the next chart gives the equivalent information but for each state's previous 2004-05 Budget.

Chart 5.8 — General Government Sector Net Lending (Borrowing) as a Proportion of GFS Total Revenue as at Budget 2004-05



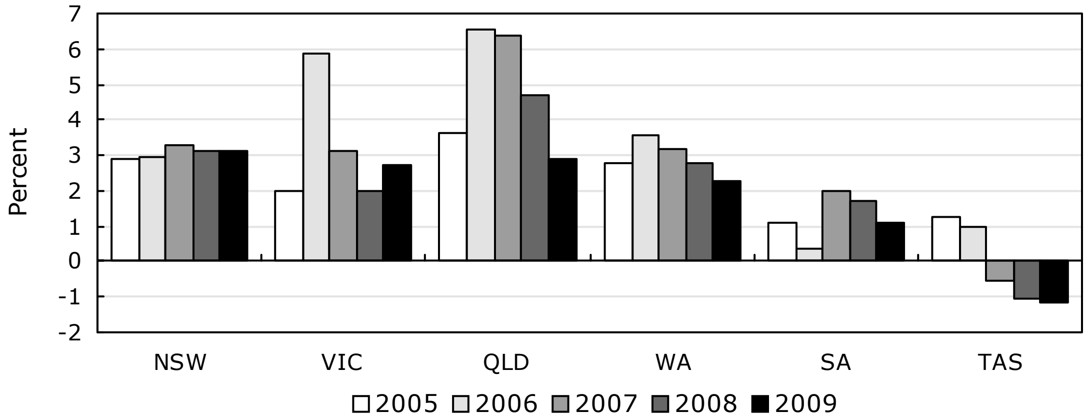
By comparing chart 5.8 to chart 5.7 for 2005-06, significant and uniform change in policy between the 2005-06 and 2004-05 budgets is evident. In 2005-06, all States, except Tasmania, are either projecting net borrowing outcomes or larger net borrowing outcomes than were estimated at the time of the 2004-05 Budget. Tasmania is continuing to forecast net lending outcomes, although lower than at the time of their 2004-05 budget.

It is evident that notwithstanding the fiscal targets set out for all jurisdictions in Section 4 of this Part of the Report, most states are willing to accept net borrowing outcomes to satisfy capital spending and other policies.

5.7.3 Net Acquisition of Non-Financial Assets State Comparison

Net acquisition of non-financial assets is purchases of non-financial assets net of depreciation expense and asset sales (internal funding). The following chart plots net acquisition of non-financial assets as a proportion of GFS total revenue for each of the states.

Chart 5.9 — General Government Sector Net Acquisition of Non-Financial Assets as a Proportion of GFS Total Revenue



The chart highlights the reason for South Australia's net lending as a proportion of GFS total revenues being better than most states. South Australia's net acquisition of non-financial assets as a proportion of GFS total revenue is the lowest of the states except Tasmania.

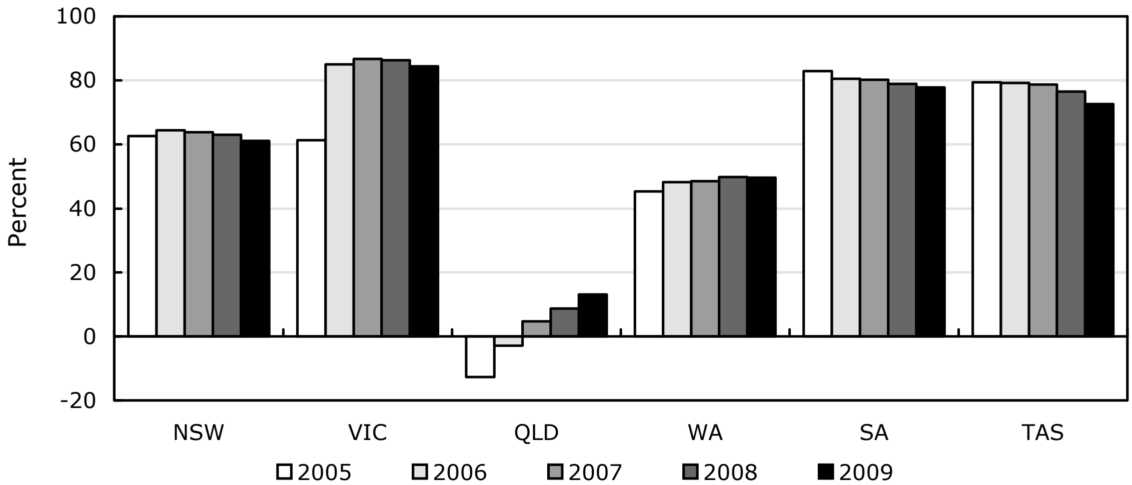
The reasons for the differences will be varied but are likely to include differing capital policies and needs, reflecting population growth and demand differences and differing needs for renewal of capital assets.

5.7.4 Ratio of Net Financial Liabilities to Revenue State Comparison

The revised fiscal targets introduce a new measure, the ratio of net financial liabilities to revenue. Net financial liabilities is calculated as total liabilities less non equity financial assets, such as cash, advances and investments. This measure is broader than net debt as it includes significant liabilities other than borrowings, such as unfunded superannuation and long service leave entitlements.

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

Chart 5.10 — Ratio of Net Financial Liabilities to Revenue



The Government projects that revenue growth (notwithstanding no growth in real terms to 2006-07) ensures that the ratio of net financial liabilities to revenue improves over the forward estimates period.

One of the main differences between the states is the method of valuing superannuation liabilities. In particular, differences in the discount rate applied has a significant effect. The effect of discount rates is discussed further under section 10.3 'Unfunded Superannuation'.

6 REVENUE

This section comments on the State's revenue projections as detailed in the 2005-06 Budget.

6.1 OVERVIEW

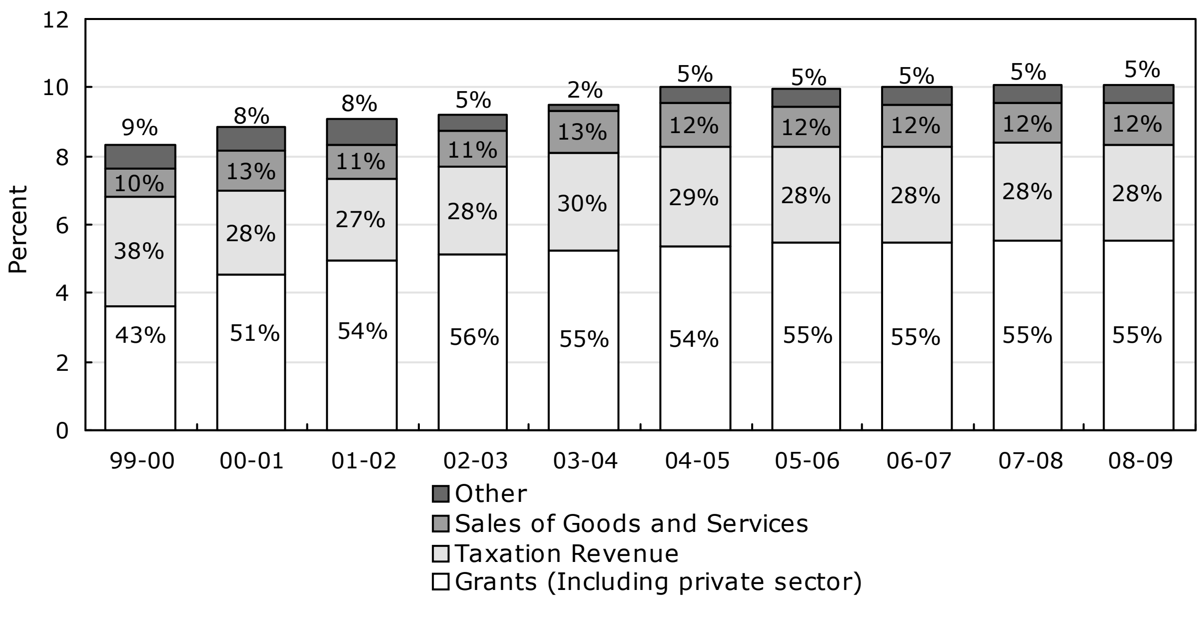
Since 1 July 2000, there have been very significant changes to the composition of the revenue side of the Budget. Foremost in the changes are the effects of the national tax reform and revised Commonwealth-State funding arrangements. Under these arrangements some State taxes have been abolished or reduced. These losses to the State are compensated by Commonwealth funding in the form of GST revenue grants and, where necessary, transitional grants.

While the State is mainly reliant on Commonwealth grants, it continues to derive about 49 percent of its revenue[110] from its own sources, the largest component being state taxation revenue. Most of the components show steady growth over the forward estimates notwithstanding ups and downs in individual elements.

Total GFS revenues are estimated to be $10.5 billion in 2004-05, an increase of $503 million (5.1 percent) over the previous year's result and $461 million (4.6 percent) above budget. Budgeted GFS revenues for 2004-05 were $10 billion, an increase of $836 million (9.1 percent) over the previous year.

The makeup of GFS revenue and trends in real terms are illustrated in the following chart. Distributions from public financial institutions and public non-financial corporations are excluded from the chart, but are discussed in the section 'Other Revenue'.

Chart 6.1 — General Government Sector GFS Revenues (Real)[(a)]



(a) Estimated June 2005 values. Excludes distributions from PNFCs and PFCs.

110 Including private sector grants.

A number of key facts are evident from the chart. They are:

- there have been real increases in GFS revenue in the period up to 2004-05. As from 2004-05 to the end of the forward estimate period in 2008-09 the level of GFS revenue remains fairly stable in real terms.

  The effect of the changes from national tax reform. The rapid increase in the proportion of total revenue attributable to Commonwealth general-purpose grants and the offsetting reduction in State taxation revenue in 2000-01 and 2001-02 are readily apparent. This is essentially the substitution of State based revenue with Commonwealth based revenue;

- as from 2004-05, the proportion of revenue in the form of grant funding remains quite stable, representing approximately 55 percent of GFS revenues.

Changes in revenue estimates since the 2004-05 Budget are set out in section 5.5.4 'Reconciliation of General Government Sector Net Lending'.

The following commentary provides some additional analysis of the main revenue areas.

6.2 GRANTS

Grants from the Commonwealth Government represent over 99 percent of total estimated grants revenue in 2004-05, with the balance from the private sector.

6.2.1 Commonwealth Grants

Revenue from the Commonwealth is the most significant source of revenue to the State representing 51 percent of GFS revenues in 2004-05. Commonwealth funding includes general purpose grants, amounts received under specific purpose funding agreements such as the Australian Health Care Agreement and amounts received for on-passing to other bodies, for example local government and non-government schools.

The significance of Commonwealth funding, particularly as a result of the new tax system from 2000-01, was demonstrated in the earlier chart.

The total estimated Commonwealth funding to the State during 2004-05 is $5.3 billion, an increase of $313 million (6.3 percent) over the previous year. Estimated funding for 2005-06 is $5.5 billion. Funding in 2008-09 is expected to grow to $6 billion, a real increase of $0.1 billion over 2004-05.

Under the National Tax Reforms committed to with the introduction of the GST on 1 July 2000, the State eliminated some of its own source taxes. Under the Intergovernmental Agreement on the Reform of Commonwealth-State Financial Relations (IGA) the Commonwealth undertook to underwrite the revenue yield from the Goods and Services Tax (GST) to ensure the states and territories receive, as a minimum, the equivalent of what they could have expected to receive under previous Commonwealth-State funding arrangements. As a result each state receives GST revenue collections plus supplementary transitional funding assistance until the state's share of GST revenues at least matches a guaranteed amount.

In South Australia's case, GST revenue collections exceeded the guaranteed amount in 2003-04 and 2004-05.[111]

[111] Refer to page 3 of the Treasurer's Statements included as an Appendix to Volume V of Part B of this Report.

Over the forward estimates period, GST revenues are expected to be a growth tax that will provide additional revenue benefits to the State. Whether outcomes will influence the level or conditions of other Commonwealth funding such as specific purpose payments is as yet unknown. Commonwealth revenues are estimated to increase over the forward estimate period from 51 percent of GFS revenues in 2004-05 to 52 percent of GFS revenues in 2008-09. While Commonwealth funding is the foundation of State finances, it is not controllable by the State.

6.2.1.1 General Purpose Grants

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

Over the forward estimates, general purpose grants are expected to grow from $3.4 billion in 2004-05 to $3.9 billion in 2008-09, a real increase of $0.2 billion.

6.2.1.2 Specific Purpose Grants

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

In 2004-05, total estimated specific purpose grants to the State are $1.9 billion, and are estimated to be $1.9 billion (real) in 2008-09. The Commonwealth committed to not cutting aggregate specific purpose grants as part of the national tax reform arrangements. The Budget Papers show that this commitment is being met in real per capita terms.[112]

6.3 TAXATION REVENUE

Taxation revenue is the second largest source of revenue to the State and represents approximately 28 percent of GFS revenues in 2004-05. Taxation revenue comprises collections from a diverse range of tax bases, including payroll, property, motor vehicles and gambling activities.

The Government has a fiscal strategy to ensure the State has an effective tax regime having regard to the Government's social and economic objectives. Considerations in relation to the State's capacity to raise taxation revenue include the capacity of taxpayers to pay and the State's relative tax effort compared to other states and territories.[113]

Total taxation receipts for 2004-05 are estimated to be $2.9 billion, an increase of $110 million (4 percent) over the previous year's result, and $136 million (5 percent)

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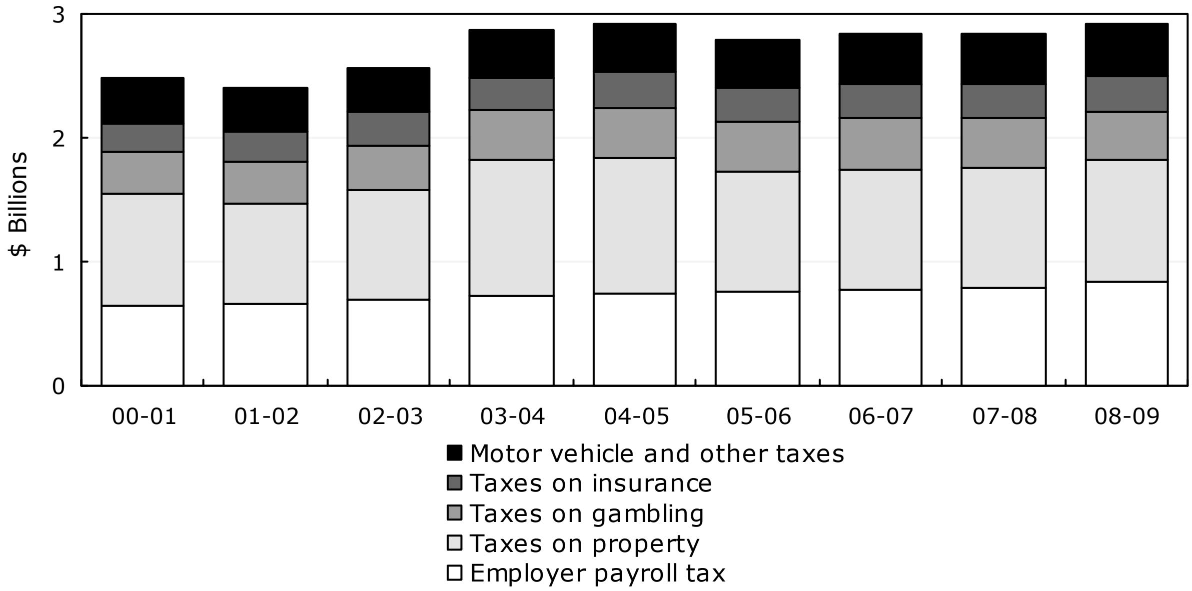
[112] Budget Statement 2005-06, p4.13

[113] Budget Statement 2005-06, p3.17-3.19 discusses South Australia's relative taxation effort.

above budget. This improvement on budget was due mainly to increased stamp duty, notwithstanding a weakening in property market activity during the second half of the year.

Because of the change in Commonwealth funding arrangements, the following chart commences from the 2000-01 year to examine the trend (in real terms) in the components of taxation receipts and the trend over the period in the forward estimates.

Chart 6.2 — Taxation Revenue (Real) [(a)]



(a) Estimated June 2005 values.

The chart demonstrates that taxation revenue increases in real terms in the period to 2004-05, falls in 2005-06 and rises steadily over the remaining forward estimates period.

Taxation receipts for 2005-06 are estimated to be $2.9 billion, in line with the estimated result for 2004-05, but a fall in real terms. Revenue from property taxes is expected to decrease in 2005-06 reflecting taxation relief measures introduced in the Budget as well as a projected weakening in property market conditions. Growth in other taxation revenues is insufficient to offset the projected fall in property tax revenues resulting in a decline in taxation revenue in real terms for 2005-06.

Taxation revenue is expected to be $3.1 billion in 2008-09, a real terms decrease of $4 million compared to $2.9 billion in 2004-05.

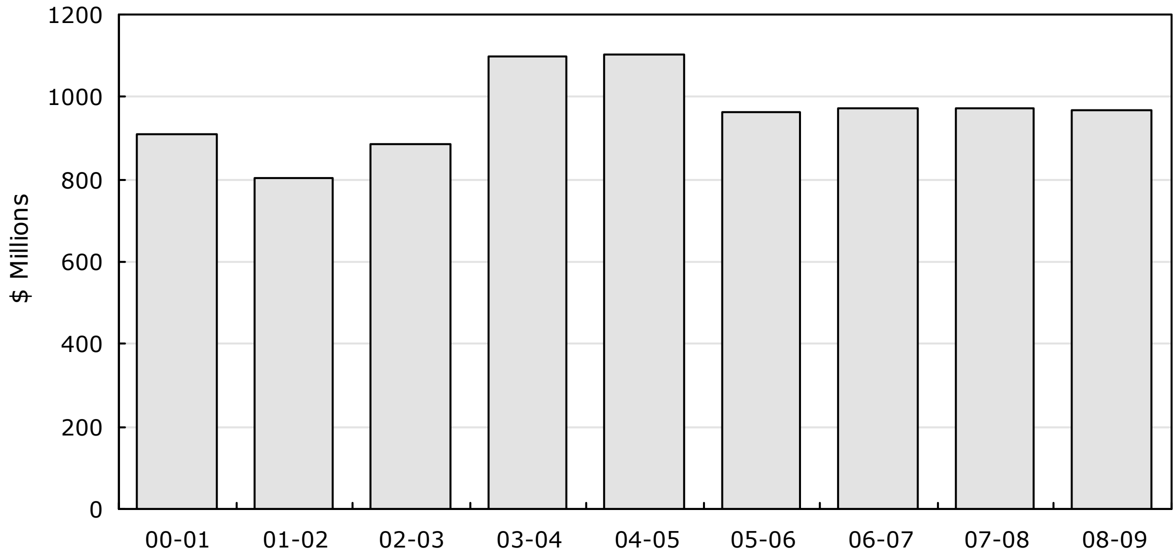
6.3.1 Property Taxes

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

Property taxes for 2004-05 are estimated to be $1.1 billion, an increase of $33 million (3 percent) over the previous year's result, and $126 million (13 percent) above budget. This improvement on budget was due mainly to increased stamp duty reflecting unexpected sustained buoyancy in property market conditions, notwithstanding some weakening in activity levels in the second half of the year.

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

Chart 6.3 — Taxes on Property (Real) [(a)]



(a) Estimated June 2005 values

The trend in the forward estimates period reflects:

- an expectation that property prices will stabilise in 2005-06 and 2006-07 before resuming growth in line with inflation in the latter years of the forward estimates period;
- an assumption that property turnover will fall in 2005-06 before resuming moderate growth from 2006-07;
- tax relief including abolition of debits tax, stamp duty on residential mortgages for owner-occupiers and mortgage refinancing from 1 July 2005 and the phased abolition of rental and mortgage duty commencing on 1 July 2007, consistent with IGA commitments.

Together these factors result in a reduction (in real terms) in budgeted revenue from property taxes of $141 million in 2005-06 compared to the estimated result for 2004-05 and that is sustained through the forward estimates period

6.3.2 Payroll Tax

Payroll tax continues to be a principal source of taxation revenue. In 2004-05, employer payroll taxes are estimated to be $741 million representing 25 percent of total taxation revenues, and budgeted to be $777 million in 2005-06.[114]

As indicated in the chart on the following page, payroll tax revenue is anticipated to continue to increase in real terms over the forward estimates.

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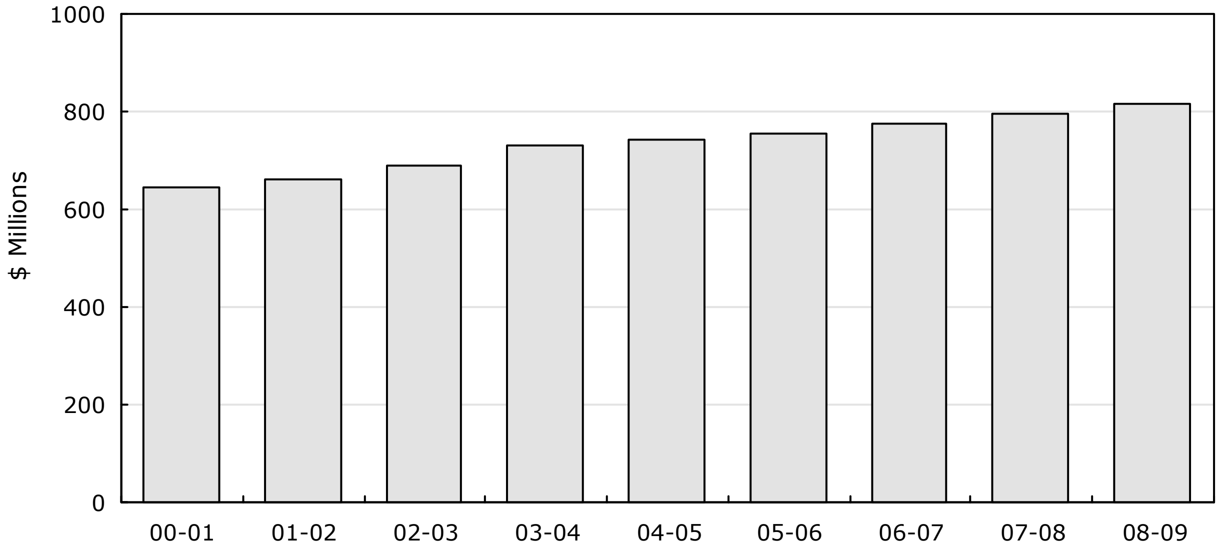
[114] Budget Statement 2005-06, Budget Paper 3, Table 3.11.

Chart 6.4 — Employer Payroll Tax (Real) [(a)]



(a) Estimated June 2005 values

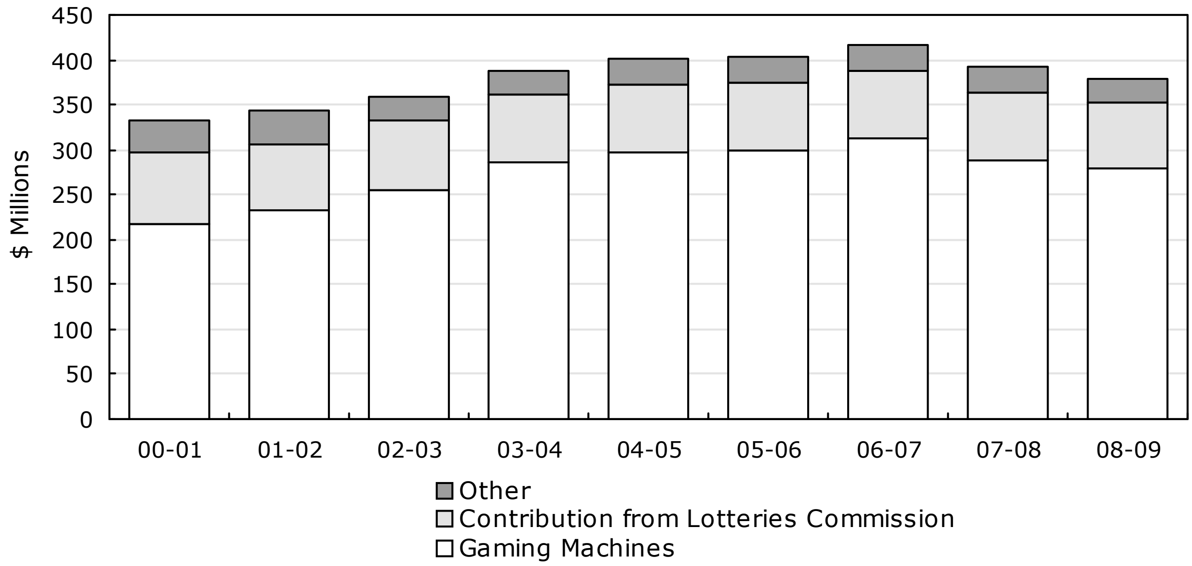
Payroll tax revenue grew in 2004-05 notwithstanding the impact of the payroll tax reduction from 5.67 percent to 5.5 percent. The growth in payroll tax revenue after 2004-05 reflects estimated employment and earnings growth.

6.3.3 Gambling Taxes

During 2004-05, the estimated taxation revenues from gambling activities amounted to $401 million, $22 million (5.8 percent) over the previous year's result but $4.2 million (1 percent) under the 2004-05 budget.

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

Chart 6.5 — Gambling Taxes (Real) [(a)]



(a) Estimated June 2005 values

In the six years 2000-01 to 2006-07, gambling taxes increase by $84.9 million in real terms. This is due to gaming machines which are estimated to contribute $94.1 million offset by small reductions in real terms, in other gambling revenues.

The chart highlights the increasing contribution that gaming machines tax makes to the State's Budget until 31 October 2007 when 100 percent smoking bans in gaming venues will impact on gaming machine activity in clubs, hotels and the Casino.

6.4 SALES OF GOODS AND SERVICES

Revenue from sales of goods and services is one of the major sources of revenue to the State representing 12 percent of estimated GFS revenues in 2004-05. Sales of goods and services by the general government sector include Government fees and charges which are set on a cost recovery basis and adjusted annually.

Total revenue from sales of goods and services for 2004-05 is estimated to be $1.2 billion, an increase of $68 million (5.9 percent) over the previous year's result and $132 million (12 percent) above budget.

The increase against budget reflects higher than budgeted land transfer fees, additional Commonwealth funding and the recognition of schools revenue and bus fare revenue following classification changes since the 2004-05 Budget.

The level of revenue from sales of goods and services is fairly stable over the forward estimates period. Revenue from sales of goods and services is estimated to fall from $1.23 billion in 2004-05 to $1.18 billion (real) in 2008-09.

6.5 OTHER REVENUE

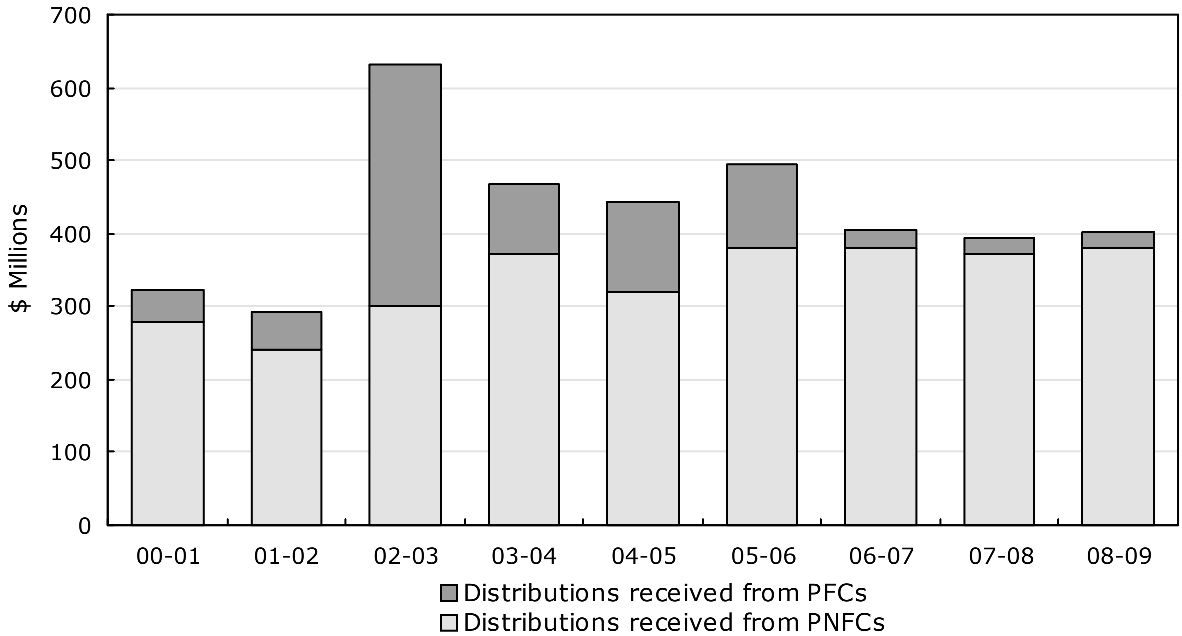
The more significant components of Other revenue are the distributions received from public non-financial corporations (PNFCs) and public financial corporations (PFCs), which comprise essentially tax equivalent payments and dividends. Distributions from PFCs are significant not only in terms of their size, but because they provide an opportunity for the Government to 'manage' the bottom line given their discretionary nature. Of all revenue amounts incorporated in the general government sector operating statement, this source is the most flexible, limited essentially only by amounts available.

This flexibility is now reduced by the limited level of retained earnings and equity held by PFCs.

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

The chart on the following page shows the trend in distributions received from PNFCs and PFCs for the nine years to 2008-09.

Chart 6.6 — Distributions Received by the General Government Sector (Nominal)



The chart highlights that distributions are large but reducing over the forward estimates period due to reductions in distributions from PFCs. Notwithstanding, the Budget is expected to continue to achieve a net operating balance surplus over the forward estimates, demonstrating that budget reliance on PFC distributions diminishes in the future.

6.5.1 Public Non-Financial Corporations

In 2004-05, distributions received from PNFCs are estimated to amount to $320 million, a decrease of $52.5 million (14 percent) from the previous year's result and $21 million (7 percent) above budget. The decrease mainly reflects a once-off special dividend from the Land Management Corporation of $50 million in 2003-04.

These distributions are budgeted to increase in 2005-06. This reflects a new ownership framework for PNFCs approved by the Government during 2004-05, with the first stage implementation of the framework to SA Water and ForestrySA to be effective from 1 July 2005.

Forestry SA is estimated to have an above budget result in 2004-05 arising from continued strong demand for building materials, preservation products and export chip.

Land Management Corporation is expected to have an above budget result in 2004-05 due to continuing strong demand for residential and commercial land.

SA Water Corporation is also estimated to have an above budget profit in 2004-05 despite the introduction of water conservation measures in 2003 and a slight downturn in building activity.

Distributions from PNFCs are expected to be steady over the forward estimates period.

6.5.2 Public Financial Corporations

The main source of revenue projected from the PFCs category has been income from the South Australian Asset Management Corporation (SAAMC) and South Australian Government Financing Authority (SAFA).

In recent years up to 2002-03, distributions from these entities included in Budgets have largely been deferred to later periods. In 2004-05, actual distributions from SAAMC and SAFA, amounting to $73.2 million and $37.6 million respectively, were received. Distributions from PFCs are budgeted to be $115 million in 2005-06.[115]

Projected distributions from SAAMC and SAFA for the period of the 2005-06 Budget are as follows:

Table 6.1 — Projected Distributions from SAFA and SAAMC

	2005-06 $'million	2006-07 $'million	2007-08 $'million	2008-09 $'million	Total $'million
SAFA	103.0	10.9	10.9	10.9	135.7
SAAMC	6.0	6.0	4.0	4.0	20.0
	109.0	16.9	14.9	14.9	155.7

As at 30 June 2005 SAFA's capital and reserves totalled $174 million and SAAMC's shareholder's equity was $61 million.

The distributions projected to 2008-09 are estimated, after allowing for earnings, to reduce SAFA's total capital and reserves to around $101[116] million, and maintain SAAMC's shareholder's equity at around $62 million. As a result, the level of earnings that those entities could be expected to make in future periods (beyond the forward estimates) will not be able to sustain distributions at a level anywhere near those that have been reflected in the three years to 2004-05 or as is budgeted to be received from SAFA in 2005-06.

6.6 RISKS TO REVENUE

The Budget Statement 2005-06 provides quite detailed consideration of various risks to the revenue budget. Included in the risk analysis is:

- ***Taxation and Royalties*** — a variance of 1 percent in taxation and royalty revenue equates to about $30 million per annum.

- ***Commonwealth General Purpose Grants*** — A variance of 1 percent in GST revenue growth has a revenue impact of $30 million per annum.

  Commonwealth GPPs are the vehicle for horizontal fiscal equalisation (HFE). The methodology and data underlying the HFE process is determined by the Commonwealth Grants Commission. States and Territories compete strongly in submitting arguments in support of their position. The risk of methodology changes which may impact on the State, either positively or adversely is significant.

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115 Budget Statement 2005-06, Budget Paper 3, Table 3.19.

116 Differs from Budget Statement 2005-06, Budget Paper 3, page 3.26 due to this Report calculating actual profit and distributions to 2004-05.

- ***Commonwealth Specific Purpose Grants*** — Funding levels of specific purpose grants are exposed to the risk of variability in the underlying parameters that determine funding levels for specific expenditure programs as well as being exposed to variability in Commonwealth policy settings favouring some areas of expenditure over others.

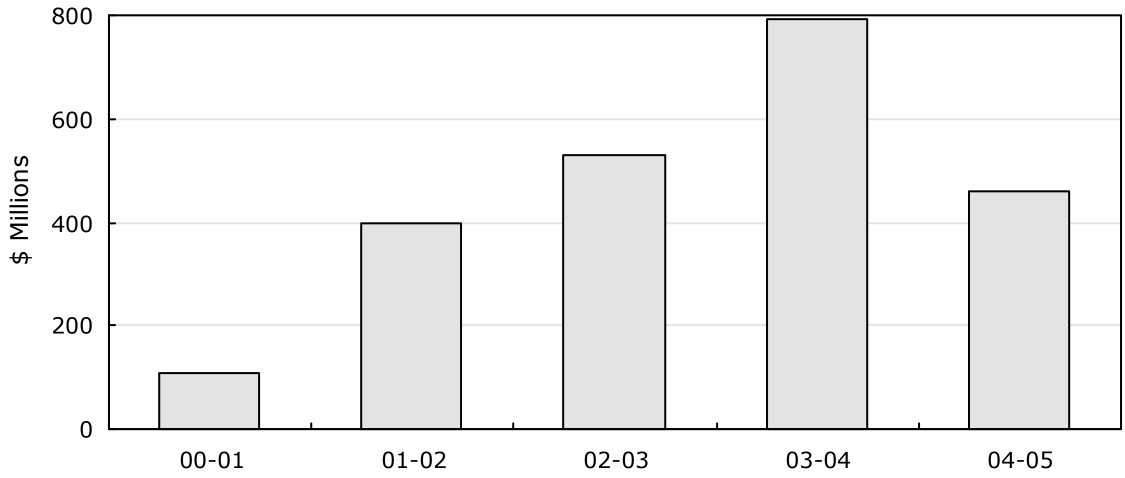
These various risks affect the total revenue that might be collected and also the flexibility with which revenue can be applied.

Readers are referred to the Budget Statement 2005-06, Paper 3, Chapter 7 for the full details.

6.6.1 Past Revenue Outcomes

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

Chart 6.7 — GFS - Difference Between Budget and Actual Revenues*



* 2004-05 estimated result

The chart highlights that from 2000-01, the actual revenues received have substantially exceeded the budget. This can be explained in part by GST revenue growth, and continued buoyancy in the property market whereas successive budget estimates have provided for a weakening in property market conditions. Classification changes including the grossing up of expenses and revenues have also impacted.

7 GFS EXPENSES

7.1 OVERVIEW

For 2004-05 estimated GFS expenses total $10.3 billion and are estimated to exceed budget by $404 million or 4 percent. A summary of major expenses for the general government sector against budget is as follows:

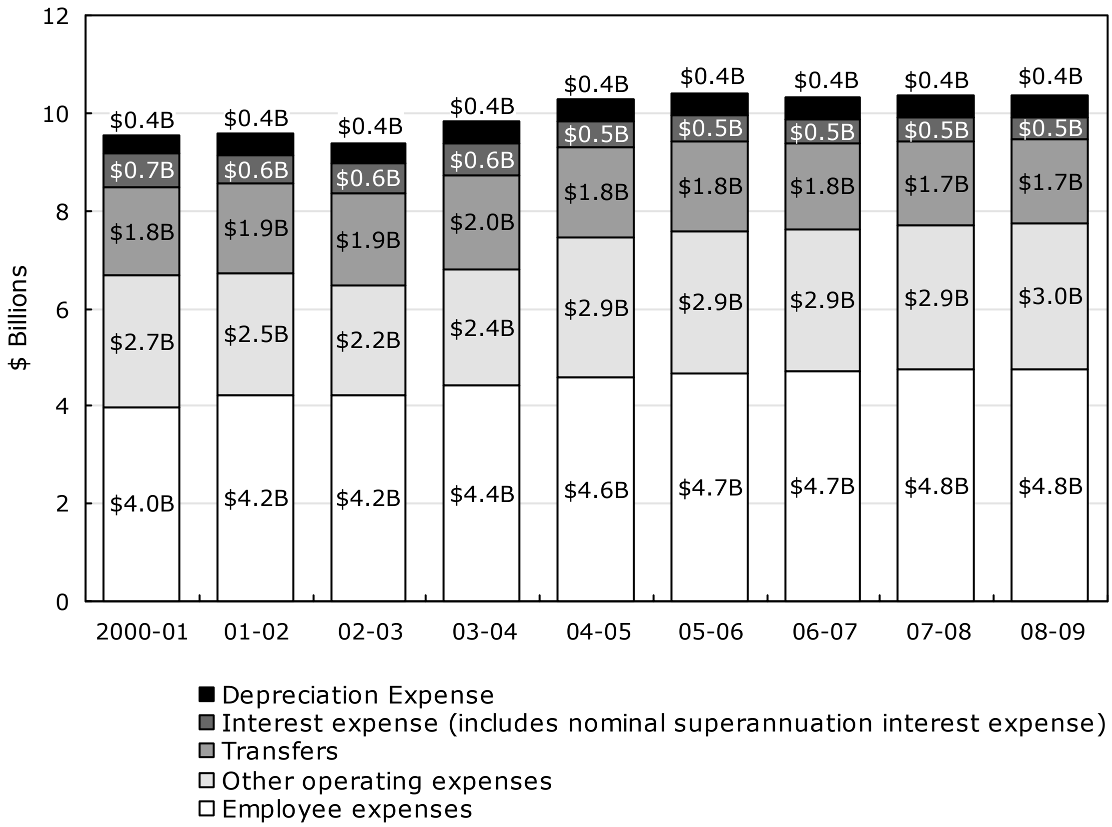
Table 7.1 — GFS - General Government Sector - Expenses

	2004-05 Budget $'million	2004-05 Estimated Result $'million	Difference $'million	Difference Percent
Employee Expenses:				
Salaries and wages	3 853	3 997	144	4
Other employee entitlements	553	593	40	7
Operating Expenses:				
Depreciation expense	452	440	(12)	(3)
Transfers	1 930	1 825	(105)	(5)
Interest expense	263	242	(21)	(8)
Nominal superannuation interest expense	338	307	(31)	(9)
Other operating expenses	2 491	2 882	391	16
	9 881	10 285	404	4

Note: Totals may not add due to rounding.

The following chart highlights the trends in GFS expenses (in real terms) that have emerged since 2000-01. Data has been adjusted using deflators provided by DTF.

Chart 7.1 — GFS - General Government Sector - Expenses (Real) (a)



(a) Estimated June 2005 values.
* Includes nominal superannuation interest expense.

The chart shows GFS expenses (in real terms) are projected to remain relatively stable over the forward estimate period.

The following discussion focuses on some of the major components that make up GFS expenses.

7.2 EXPENSES BY TYPE

7.2.1 Employee Expenses

Employee expenses (an estimated $4.6 billion in 2004-05) represent a very high proportion (45 percent) of GFS expenses. They are estimated to increase by 4.1 percent in 2005-06 and about 3.3 percent per year to 2008-09.

The 2005-06 Budget provides for anticipated public sector wage increases over the forward estimates period, both in individual agency budgets, and as a contingency item in the 'Administered Items for Department of Treasury and Finance' to cover future enterprise agreement outcomes. The inclusion of these allowances is a consistent approach to previous Budgets.

The major risk to the Budget and, in particular the forward estimates, is the outcomes from enterprise agreements. Agreements due for renegotiation are:

- Police
- Wages parity
- Nurses
- Salaried Medical Officers
- Teachers.

Notwithstanding amounts provided in the Budget, the Government estimates that if wages and salaries for agreements yet to be finalised increased by 1 percent per annum more than is currently factored into the Budget, then wage and salary expenditure would increase by about $178 million in 2008-09.[117]

7.2.2 Other Operating Expenses

Other operating expenses include general purchases of goods and services.

These expenses are estimated to be $2.9 billion for 2004-05 that is, $391 million or 15.7 percent over budget. These expenses are budgeted to increase by $132 million or 4.6 percent in nominal terms in 2005-06.

The 2005-06 Budget allows for CPI growth over the forward estimates and incorporates a savings component.

Notably, when compared to recent historical performance, the anticipated growth in expenditure from 2005-06 is well below that of the increases experienced between 2002-03 and 2004-05 even allowing for the influence of reclassification changes between the years.

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[117] Budget Statement 2005-06, Budget Paper 3, Page 7.7.

The Government is well aware of the risk of managing budget performance and has a framework in place to monitor closely the progress of the Budget and forward estimates.

Contingency amounts have also been incorporated into the budget to provide some flexibility if additional expenditure is required to be made by the Government. The amounts included in the 2005-06 Budget are consistent with past Budgets.

7.2.3 Transfer Payments

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

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

Transfer payments are estimated to be $1.8 billion for 2004-05, that is, $105 million or 5.4 percent below budget.

There have been two substantial changes to the data that previously comprised transfer payments. Firstly, the reclassification of the former Passenger Transport Board (now the Office of Public Transport) into the general government sector reduces subsidies recorded as transfers by about $170 million per year.

The second is a new ownership framework for PNFCs approved by the Government during 2004-05 and operative in 2005-06 under which higher CSO payments will be made to some PNFCs such as SA Water Corporation (to be partly recovered through dividends from profits in the future).

7.2.4 Interest Expense

The impact of the interest expense on the State's finances has diminished greatly over the last few years as net debt has been reduced, decreasing from $601 million in 1999-2000 to an estimated interest expense of $242 million in 2004-05.

Interest expense is projected to decrease over the forward estimate period. This improvement is due to lower interest expenses as a result of cash surpluses, and resultant lower levels of net debt.

Further discussion in relation to debt movements is provided in the section under the heading '12 - Net Debt'.

7.2.5 Nominal Superannuation Interest Expense

The nominal superannuation interest expense represents the notional borrowing cost of the Government to meet benefits that are not fully funded. This reflects the fact that the unfunded liability for the defined benefits superannuation schemes is equivalent to any other debt. Consequently the Government's nominal interest on the outstanding liability is included as part of expenses in the operating statement.

Nominal superannuation interest expense decreased in 2004-05 is due to a change in the methodology for calculating the nominal superannuation interest expense. Accepted practice is for the risk free government bond rate to be used to calculate the superannuation liability. Superannuation assets may earn a higher rate of return over the long term. The change in methodology allows for the difference between the assumed earnings rate on superannuation assets and the government bond rate being used to calculate the superannuation liability, to reduce the nominal superannuation interest. In 2004-05 the expense is reduced by $47 million[118] to $307 million. It is maintained at this level across the forward estimates.

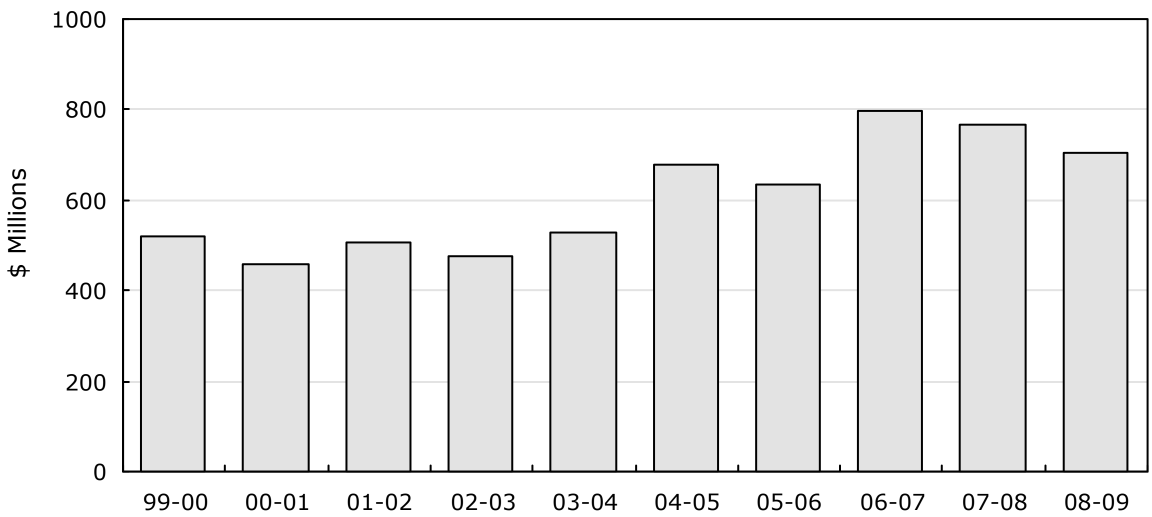
Further details of the unfunded superannuation liability are included later under the heading '10.3 - Unfunded Superannuation'.

7.2.6 Capital Payments

Total net acquisition of non-financial assets in the GFS - General Government Sector Operating Statement represents the value of purchases of non-financial assets less disposals and depreciation of new or existing fixed assets.

The following chart shows purchase of non-financial assets over the period presented in the 'GFS - General Government Sector Operating Statement Time Series' table 5.11 presented earlier in this Report.

Chart 7.2 — GFS - General Government Sector Purchase of Non-Financial Assets (Nominal)



The nature of this expenditure is that it is highly dependent on the approval of individual projects, and in this respect is in some ways more discretionary in nature than some of the other expenditure types. For example, in the short term it is easier to reduce capital payments than interest expenses to contain outgoings if necessary.

The above chart shows the variability of the expenditure, both historically and in the forward estimates. To a large extent this variability in past payments simply reflects timing effects as capital budgets have typically not been achieved in recent years. Proposed expenditure is carried forward as relevant.

[118] Further detail is provided in Budget Statement 2005-06, Budget Paper 3, p2.15.

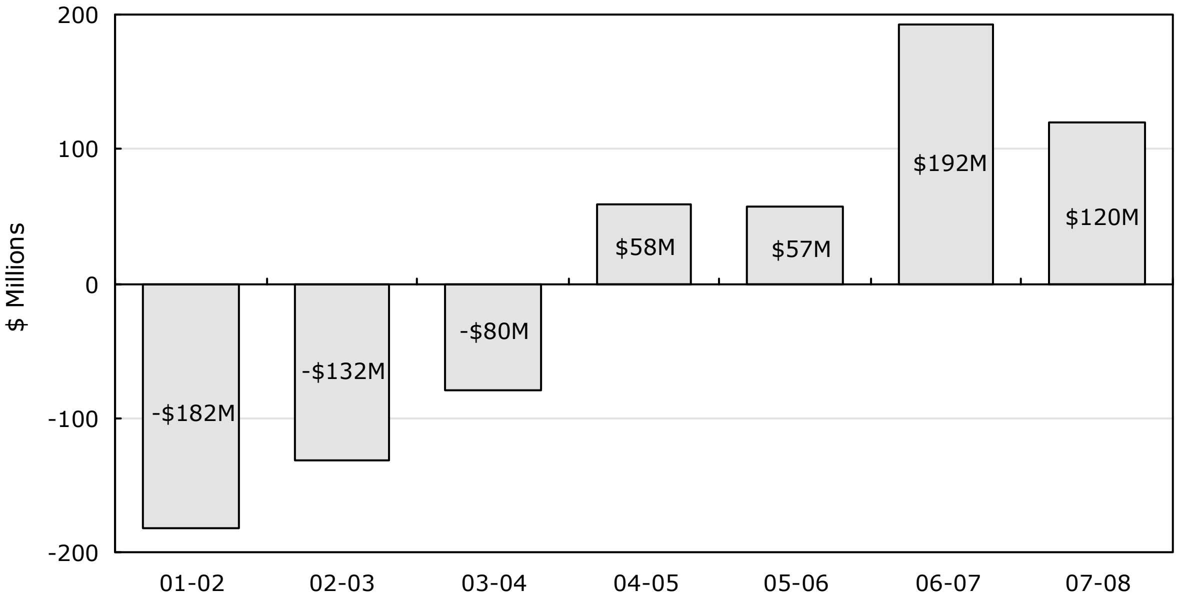
Although there will be components of future expenditure that have effectively been committed, the forward years contain funds contingent on future approvals. The amounts set aside in forward estimate years are consistent with past budgets.

To put this into perspective, although large amounts have been identified as contingent, or yet to be committed, this establishes a base of capital expenditure that can, and most probably should, be earmarked for this purpose. By this commitment there is recognition of the need for ongoing maintenance and improvement of social infrastructure. Not to do so may have a detrimental effect on the long-term health of the State's finances.

7.2.6.1 Change in Capital Payments Estimates

The 2005-06 Budget is different from the 2004-05 Budget in regards to budgeted capital expenditure. The following chart highlights variances between the budgeted and actual or estimated result for net purchases of non-financial assets up to 2004-05 and data presented in the 2004-05 Budget Papers and the 2005-06 Budget Papers for the three years to 2007-08.

Chart 7.3 — Variations in Gross Fixed Capital Formation



The chart highlights underspending against budget in 2001-02 to 2003-04 and the variances between the 2004-05 Budget Papers and the 2005-06 Budget Papers for the three years to 2007-08. The variances from the 2004-05 Budget are consistent with the Government's revised fiscal targets and aim of financing a higher level of investment in social and economic infrastructure. This change is a contributor to the presentation of projected net borrowing outcomes in 2006-07 and 2007-08 in the general government sector operating statement.

7.2.6.2 Infrastructure Planning

Proper infrastructure planning is fundamental to the efficient and effective use of public resources.

Last year I noted the Department of Treasury and Finance had advised that, consistent with past practice, a whole-of-government strategic infrastructure planning 'framework' was not used to establish the priorities for the 2004-05 Budget.

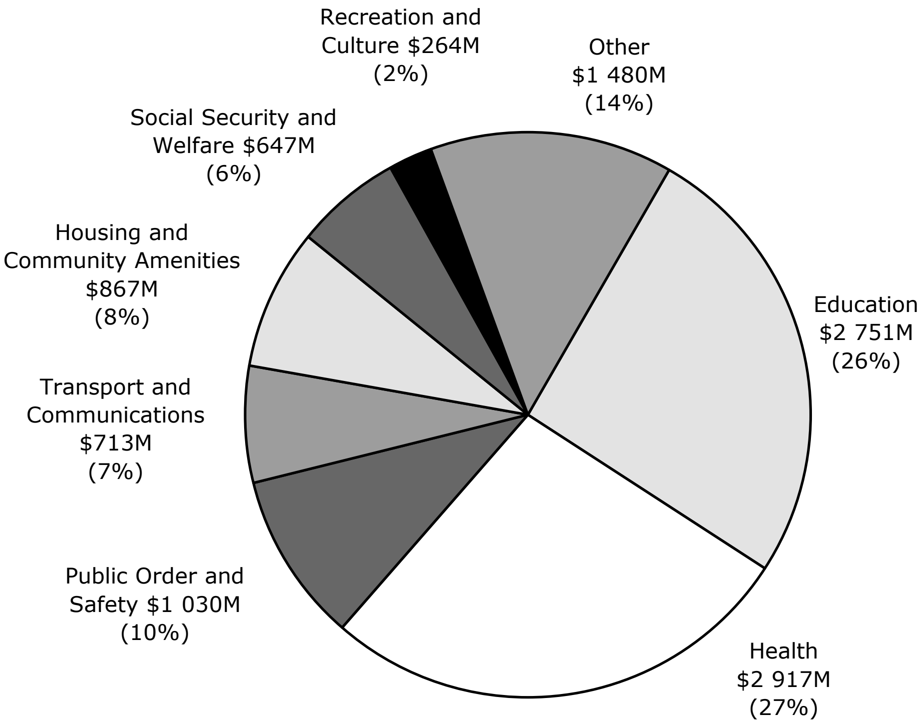
The Strategic Infrastructure Plan for South Australia was released on 6 April 2005. The Government has stated that the principal purpose of the Plan is to guide new infrastructure investment by the Government and the private sector over the next five and 10 years and improve the management and use of the State's existing infrastructure assets. The Government also noted that the Plan is the first major step forward in developing a more coordinated, efficient, sustainable and innovative approach to infrastructure provision.

7.3 EXPENSES BY FUNCTION

The GFS reporting framework also provides information on expenditure (excluding capital payments) by its function for the General Government Sector. This information demonstrates the extent to which the State's finances are dictated by the needs of the health and education sectors, which make up more than one half of expenditure.

The following chart relating to the 2005-06 Budget demonstrates the extent to which the health and education sectors dominate the overall expenditure by the State.

Chart 7.4 — GFS - General Government Sector Expenses by Function[119] ($'million)



119 Budget Statement 2005-06, Budget Paper 3, Table 2.12.

7.4 RISKS TO THE BUDGET OUTCOME

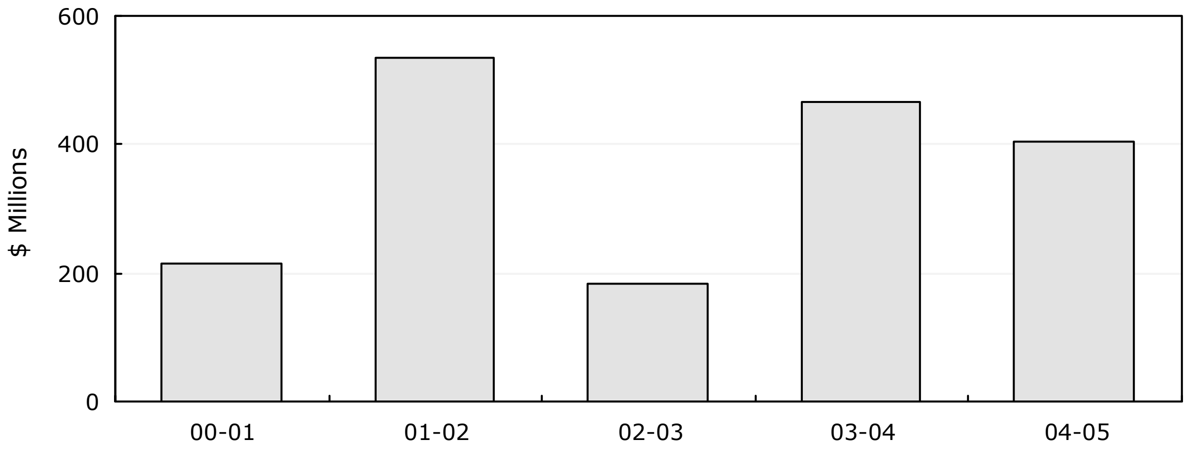
7.4.1 Overview

As mentioned in relation to revenue, the Budget Statement 2005-06 provides detailed consideration of various risks to the expenditure budget and acknowledges the management task for achieving budgeted outcomes[120]. Some of the key risks reported are:

- ***Change in service needs*** — demand for services may change as a result of numerous factors; including age demographics. This risk is being managed through ensuring budget measures are appropriately directed to high priority areas;
- ***Wages and salaries*** — salary increases as a result of enterprise bargaining above those already factored into the budget can adversely impact expenditure targets. Non-salary element (eg revised classifications) outcomes of 0.5 percent would add approximately $53 million in 2008-09;
- ***Price increases*** — increases in factors such as interest rates, inflation rates and foreign exchange rates can all adversely impact future spending costs through higher interest payments or the cost of goods and services.
- ***Portfolio Pressures*** — A variance of 1 percent in hospital activity increases expenditure by approximately $13 million per year. Annual net operating and/or net lending outcomes will be impacted if slippage exceeds the amount included in the Department of Health capital investment program or if slippage occurs in relation to expenditure commitments for water acquisition for environmental flows and other River Murray initiatives.

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

Chart 7.5 — Difference between Budget and Actual GFS Expenses [(a)]



(a) 2004-05 is the difference between budget and the estimated result.

The chart highlights that, notwithstanding classification changes, the Government has consistently overspent on its original budget expenditure targets in the last five years.

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[120] Budget Statement 2005-06, Budget Paper 3, Page 7.1

Service Risks and Contingent Liabilities

In my last Report, I made some observations on environmental risks and contingent liabilities. I noted the broader issue of changing societal attitudes to responding to past activities that may have incurred liabilities contingent upon future effect and identification. Some matters, such as the recent settlement for unauthorised collection of tissue specimens, are resolved with financial compensation.

The Budget Papers set out in detail, known contingent liabilities at the time of the Budget. There are no immediate risks to the State's finances in the identified liabilities.

The nature of public services, dealing with health, welfare, education, corrections, public housing and so on, means there are inherent risks in the delivery of services and how duty of care responsibilities are exercised. The nature of such service risks is that the potential for a liability may not be determinable or understood until a claim is made. Examples include asbestos, care of State wards, environmental pollution. It is essential that public sector entities understand the nature of risk in their circumstances and have relevant controls and processes in place to mitigate and monitor identified risks.

7.4.2 Savings

The Budget includes savings identified by agencies, based on either achieving efficiency or reducing particular services totalling $75 million over four years. A summary of those savings for all departmental portfolios is as follows:

Table 7.2 — Summary of Budget Savings

	2005-06 $'million	2006-07 $'million	2007-08 $'million	2008-09 $'million
Total Savings	17	18	20	20

The savings in Table 7.2 are in addition to the $175 million savings initiatives included in the 2004-05 Budget for the 2005-06 to 2007-08 forward years.

7.4.3 Nature of Savings Initiatives

The Budget provides a thorough account of savings and revenue initiatives allowing any reader a detailed knowledge of the description of these initiatives.

The nature of savings initiatives include reduction in operating costs, fleet cost savings from reducing vehicle turnover, and reorganisation of metropolitan health services.

I have made observations in previous Reports of some principles I believe to be important when pursuing savings initiatives. To recap, I remain of the view that:

- many of the services or activities conducted by public sector agencies are by force of legislation. These are priorities established by Parliament and it is necessary for agencies to fully understand and fulfil their legislative responsibilities;
- where seeking savings through shared services, such arrangements need careful planning and risk analysis to be successful in both efficiency of costs and effectiveness for controlling and managing operations. Clarity of roles and responsibilities is best served through well constructed service level agreements.

7.4.4 Control Environment

As highlighted, adequate control of expenditure is fundamental to achieving budget targets. The following initiatives relevant to the setting and monitoring of the budget are worthy of note.

7.4.4.1 Budget Monitoring and Reporting

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

In response to an audit inquiry on budget monitoring processes, the Department of Treasury and Finance have advised that monitoring and managing processes are unchanged from that advised the previous year and include:

- strictly limiting changes to the approved Budget to changes approved by Cabinet or the Treasurer;
- agencies representing over 90 percent of total general government operating expenditure reporting within 21 days of month end actual controlled operating and cash flow data, a revised end of year estimate each month and significant administered items. Data is presented to ERBCC with administered items being reported on an exceptions basis;
- remaining agencies if expenditures are between $10 and $50 million being surveyed half yearly and reported on an exceptions basis.

7.4.4.2 Carryover Policy

For a number of years, governments have had a policy of allowing 'carryovers' of expenditure into future periods when there has been an identified underspend.

In 2004-05 the Department of Treasury and Finance wrote to all department chief executives providing detailed information on the carryover process. Proper understanding of the process assists the integrity of the Government's budget.

7.4.4.3 Budget Process Reform – Forward Estimates Project

The narrowing of projected budget outcomes places greater focus on the reliability of the forward estimates as manageable targets and the management of adjustments to budgets (notwithstanding the Cabinet/Treasurer approval process mentioned above).

It is notable that a project is underway in 2005-06 aimed at establishing more robust and realistic budgets and forward estimates. This project aims to provide revised forward estimates for the 2006-07 Budget and strengthen links with the State Strategic Plan.

This project provides the important opportunity to confirm crucial aspects of the forward estimates including, the cost of delivering current policies and services (which should include such matters as the cost of adequate maintenance of State assets), allowances for wages and salaries and other increases, including the effects of changing demand for services due to factors such as State population demographics. I have noted the significance of parameter effects to budget outcomes in this commentary (5.5.4

'Reconciliation of General Government Sector Net Lending') and there have been sufficient examples of identified unbudgeted commitments in past years and other budget management issues, to demonstrate the importance of this project to ensure a sound foundation for future budget management.

There is an inherent tension in budget management as service providers will generally seek new funding to meet growing costs of operations. There is, of course, a limit to funds available as determined by the fiscal policies of Government, that is managed by the Department of Treasury and Finance.

It will be important to ensure that the outcome of this project maintains the relevant balance between the responsibilities of the Department of Treasury and Finance to ensure the Government's budget objectives are achieved and the responsibilities of agencies to ensure their allocated legislative and administrative responsibilities and Government objectives can be met through appropriately flexible processes.

8 STATEMENT OF FINANCIAL POSITION

8.1 INTRODUCTION

The statement of financial position sets out the assets, liabilities and net worth (difference between assets and liabilities) of the State. The following sections 8 to 13 provide some analysis of trends in the State public sector financial position.[121]

Two sets of information are referred to within these sections namely:

- GFS Data — which is the focus of the Budget Papers is presented for both the general government sector and also the non-financial public sector, which consolidates the general government and public non-financial corporations (including the South Australian Water Corporation, Forestry SA and TransAdelaide).[122]
- AAS 31 (Whole-of-Government Financial Statements) Data — which provides the only whole-of-government presentation of financial position. Preparation of data on the AAS 31 basis is such that data is not available for the 2004-05 year at the time of this Report.

8.2 OVERVIEW OF THE STATE'S FINANCIAL POSITION

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

8.2.1 GFS - General Government Sector Financial Position

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

Table 8.1 — GFS - General Government Sector Financial Position (Nominal Terms)

	2001-02 Actual $'million	2002-03 Actual $'million	2003-04 Actual $'million	2004-05 Estimated Result $'million	2005-06 Estimate $'million	2006-07 Estimate $'million	2007-08 Estimate $'million	2008-09 Estimate $'million
Total financial assets	14 012	14 157	15 661	16 597	17 300	17 777	18 155	18 658
Non-financial assets	11 146	11 788	11 917	12 000	12 086	12 345	12 580	12 748
Total assets	25 158	25 945	27 579	28 597	29 387	30 121	30 735	31 406
Liabilities	10 453	10 658	11 819	12 304	12 321	12 483	12 608	12 813
Net worth	14 706	15 288	15 760	16 293	17 065	17 638	18 126	18 594
Net financial worth	3 559	3 500	3 842	4 293	4 979	5 294	5 546	5 845
Net debt	1 303	666	224	174	127	201	209	196

Note: Totals may not add due to rounding.

Of note is the expectation that:

- both assets and liabilities will increase across the forward estimates;
- the main increase in non-financial assets over the period 2001-02 to 2008-09 was in 2002-03 and related to an asset revaluation done on the State's land and

[121] Budget Statement 2005-06, Budget Paper 3, Appendix A, includes the financial data in statements described as 'Balance Sheet'. This Report uses the title 'Statement of Financial Position'.

[122] Budget Statement 2005-06, Budget Paper 3, Appendix D details agencies within the respective sectors.

buildings assets, which resulted in a net increase in total assets of approximately $0.6 billion. Net acquisitions (gross fixed capital formation less depreciation), account for the majority of other movements from year to year.

- net worth (assets less liabilities) increases across the forward estimates as asset growth outstrips liability increases;
- net financial worth (financial assets less liabilities) increases from 2002-03;
- net debt is estimated to decrease in 2005-06 and then rise by 2008-09.

Further commentary is provided on some of these matters in the following sections.

8.2.2 GFS - Non-Financial Public Sector Financial Position

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

Table 8.2 — GFS - Non-Financial Public Sector Financial Position (Nominal Terms)

	2001-02 Actual $'million	2002-03 Actual $'million	2003-04 Actual $'million	2004-05 Estimated Result $'million	2005-06 Estimate $'million	2006-07 Estimate $'million	2007-08 Estimate $'million	2008-09 Estimate $'million
Total financial assets	3 720	3 100	3 574	3 341	3 534	3 638	3 807	4 106
Non-financial assets	22 622	24 098	25 309	26 586	27 417	28 089	28 589	28 988
Assets	26 342	27 199	28 883	29 927	30 951	31 727	32 396	33 093
Liabilities	11 622	11 911	13 124	13 634	13 886	14 089	14 270	14 500
Net Worth	14 721	15 288	15 760	16 293	17 065	17 638	18 126	18 594
Net Financial Worth	(7 902)	(8 811)	(9 550)	(10 293)	(10 352)	(10 451)	(10 463)	(10 394)
Net Debt	3 317	2 696	2 285	2 217	2 284	2 398	2 434	2 404

Note: Totals may not add due to rounding.

This table highlights that:

- there is a major change in composition of the statement of financial position compared to the general government sector presentation, with non-financial assets dominating the financial position;
- the value of non-financial assets are estimated to increase by $1.3 billion in 2004-05 to $26.6 billion, and a further $2.4 billion by 2008-09 to $29 billion. The main reasons for the increase in 2004-05 include revaluations for the State's housing, major water, sewerage and drainage systems.
- net financial worth is negative as financial liabilities exceed financial assets and is estimated to deteriorate slightly over the forward estimates period;
- net debt is estimated to increase over the forward estimates period.

Further detailed commentary on the statement of financial position, is provided, concentrating on the specific aspects of categories of data for:

- assets
- liabilities
- net worth and net financial worth
- net debt.

9 ASSETS

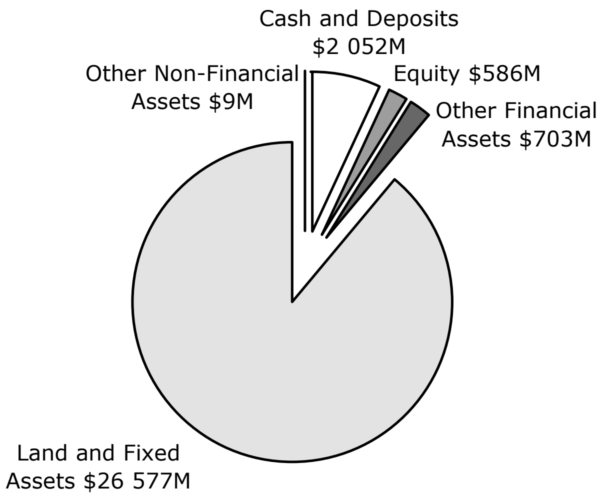
9.1 INTRODUCTION

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

9.1.1 GFS - Non-Financial Public Sector Assets

The following chart shows the estimated composition of assets under the control of the State as at 30 June 2005 for the non-financial public sector.

Chart 9.1 — GFS - Non-Financial Public Sector Assets at 30 June 2005 ($'million)



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

In accordance with the Treasurer's Accounting Policy Statements, major assets are subject to regular revaluation. Valuation of public sector assets, particularly general government sector assets, is a subjective process. Valuations will reflect the specific circumstances of individual government entities operations. The general purpose is to provide users of financial reports with an understanding of the extent of assets employed by government agencies in their operations. In this regard the majority of general government sector assets will not reflect market values. Further most assets are not realisable. These are vastly different circumstances than that applying to financial assets.

9.2 FINANCIAL ASSETS

Financial assets comprise cash and deposits, investments and equity.

9.2.1 GFS - General Government Sector Financial Assets

In terms of the time series set out in table 8.1, the stand out item is the increase of financial assets by $4.6 billion from 2001-02 to $18.7 billion in 2008-09. This is attributable mainly to increases of $4.4 billion in equity interests. Equity interests represent the general government sector's residual interest in the net assets of the other sectors of government.

9.2.2 Agency Financial Assets

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

The following table shows the major holdings of investment assets as at 30 June 2005 for these agencies:

Table 9.1 — Investments held by Public Sector Agencies [(a)] [(b)]

	Domestic Equities $'million	International Equities $'million	Fixed Interest $'million	Other Investments $'million	Total 30 June 2005 $'million	Total 30 June 2004 $'million
Funds SA [(c)]	2 636	2 612	708	1 975	7 931	6 634
MAC	300	141	1 128	133	1 702	1 486
SAICORP	72	41	52	41	206	172
SAAMC	-	-	-	34	34	599
SAFA	-	-	-	1 198	1 198	1 254
Total	3 008	2 794	1 888	3 381	11 071	10 145

(a) Market values have been used in determining the above amounts and are sourced from their respective financial statements for the year ending 30 June 2005.
(b) Excludes WorkCover.
(c) These amounts relate to superannuation assets set aside for funding future superannuation benefit payments.

9.2.3 Domestic and International Equities

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

Over the long term, equities are capable of providing large returns through increases in the share prices' market value. This has been exhibited over the past 10 years. Equities are, however, inherently risky assets, and are subject to volatility over the short to medium term including negative returns in some years.

The above agencies have diversified portfolios and hence have exposures to other countries' equity markets and investment instruments. The chart 10.3 'Return On Growth (formerly Defined Benefit) Assets' in section '10.3.5 – Analysis of Investment Earnings' shows the volatility of investment markets. Annual returns have varied from highs of about 20 percent per annum (1999-2000) to negative 5 percent per annum (2001-02).

Funds SA, with assets of $7.9 billion at 30 June 2005, has by far the greatest value of investments and exposures to international and domestic equity markets. Negative investment returns made during a year, especially on superannuation assets, can have a large adverse impact on the State's short term financial position as discussed in section '10.3 - Unfunded Superannuation'.

9.2.4 Management of Other Financial Assets

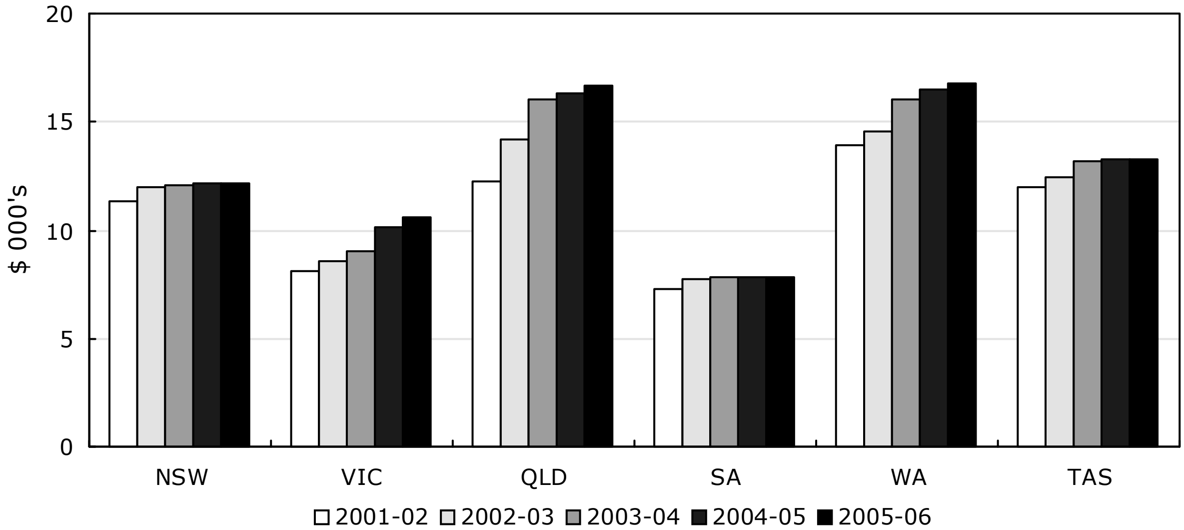
With regards to the other types of financial assets that the State holds, a number of mechanisms and derivative instruments are used, where possible and economical, to manage risks to the value of these assets from adverse economic events. Different risk management approaches and policies also take into account the extent of exposures respective organisations have. Details of risk management strategies are set out in the notes to the financial statements of the respective agencies in Part B of this Report.

9.3 NON-FINANCIAL ASSETS

9.3.1 Comparison of Non-Financial Assets to Other States

The following chart compares the State's non-financial assets per capita against the other mainland states.

Chart 9.2 — GFS – General Government Sector Non-Financial Assets per Capita



The chart demonstrates the slow rate of change that is inherent for the various states' large asset bases. South Australia and Victoria are notably lower than other states.

9.3.5 Public Private Partnerships (PPP)

The Government's Public Private Partnership (PPP) program, is identifying projects where the private sector can more effectively manage the risks associated with providing services to the public.

The Government entered into its first PPP arrangement in June 2005.

The net present cost of this PPP to the Government, inclusive of land sales is $40 million. The project involves a consortium building new police stations at Mount Barker and Gawler, a refurbished police station at Berri, new courthouses at Port Pirie and Berri and new police/court complexes at Port Lincoln and Victor Harbor.

The project involves the design, construction, maintenance and ownership of the new facilities by the private sector consortium, with the Government leasing the buildings for 25 years for Police and Court operations.

Given the recent timing and the nature of this contract, audit review has not been undertaken at the time of this Report.

10 LIABILITIES

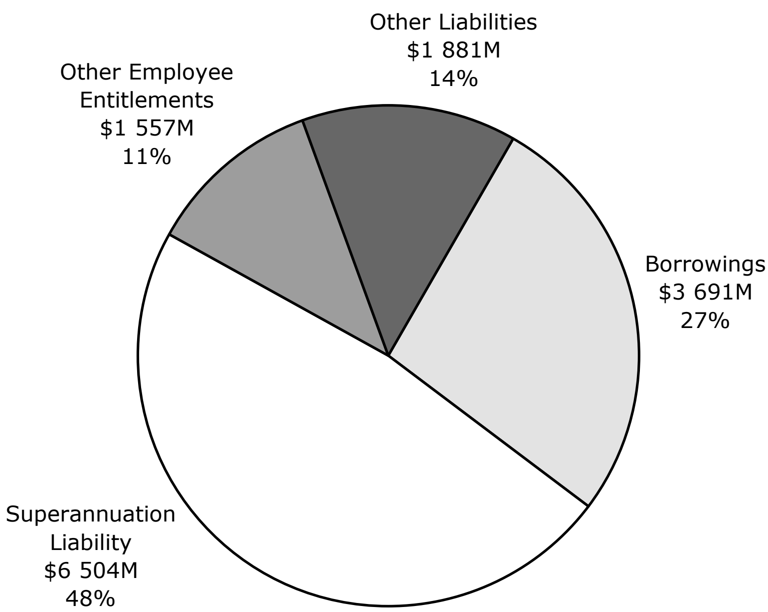
10.1 INTRODUCTION

The 2005-06 Budget, revised and reaffirmed a number of fiscal principles set out in the 2004-05 Budget relevant to the State's liabilities. These principles were identified in Section 4.1.

This section considers past and projected liabilities and discusses superannuation liabilities in some depth. A later Section '12 - Net Debt' provides some commentary on that matter.

The following chart shows the estimated composition of liabilities of the State as at 30 June 2005 for the non-financial public sector.

Chart 10.1 — GFS - Non-Financial Public Sector Estimated Liabilities at 30 June 2005 ($'million)



The chart highlights that the two main categories of liabilities are superannuation liabilities and borrowings.

10.2 ANALYSIS OF LIABILITIES

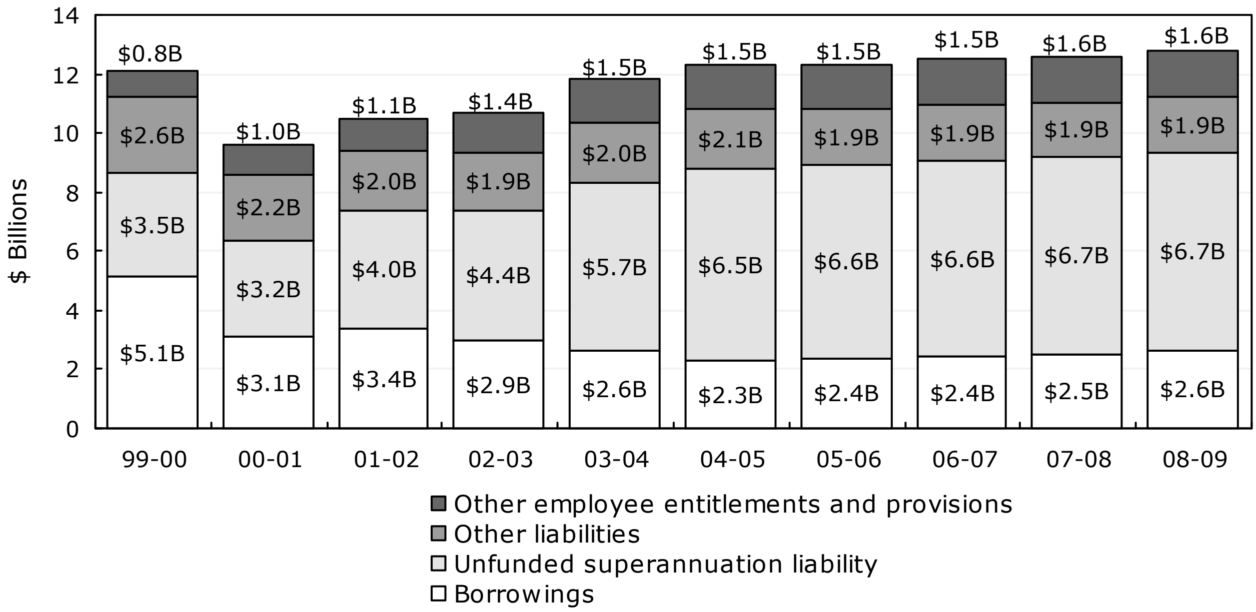
Time series data is presented in the Budget Statement.[123] That data is used as relevant in this section.

[123] Budget Statement 2005-06, Budget Paper 3, Appendix B Tables B.5 and B.12.

10.2.1 GFS - General Government Sector Liabilities

The following chart shows trends in the main elements of total liabilities for the 10 years to 2008-09.

Chart 10.2 — GFS - General Government Sector Liabilities (Nominal Terms)



Total liabilities are expected to increase $509 million or 4.1 percent to $12.8 billion over the period of the forward estimates. The most significant increases are borrowings,[124] up $321 million and the superannuation liability, up $208 million, over the four years to 2008-09.

10.2.2 GFS - Non-Financial Public Sector Liabilities

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

Total liabilities are expected to increase $867 million or 6.4 percent to $14.5 billion over the period of the forward estimates. A $510 million or 3.9 percent increase in total liabilities in 2004-05 is due to an increase in superannuation liabilities ($836 million or 14.7 percent) offset by a reduction in borrowings of $339 million or 8.4 percent.

10.3 UNFUNDED SUPERANNUATION

10.3.1 Background to Unfunded Superannuation Liabilities

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

[124] This represents gross borrowings which are offset by certain financial assets to determine net debt. Section 12 'Net Debt' provides details.

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

In estimating the liabilities, a range of variable factors and assumptions are taken into account including (current values are shown):

- Earnings on Investments 7.0 percent per annum
- Discount Rate 5.3 percent per annum
- Inflationary salary increases 4.0 percent per annum
- Pension Increases 2.5 percent per annum

Also important are the scheduled past service contributions by the Government. The superannuation liability may change periodically as assumptions and earnings experience change and, because of discounting, as the government bond rate changes and the period of settlement approaches. This is an accepted fact for this type of liability.

In relation to assets set aside to fund these liabilities, they are predominantly invested in such a way that the market value can be assessed at any point in time and the annual returns on investment are immediately added to the available assets. Returns on investments can have a very significant impact on the unfunded liability.

10.3.2 Superannuation Schemes of the State

There are two main superannuation schemes of which present and past employees of the State Government are covered by:

- Defined benefit schemes (Pension and Lump sum schemes)
- Accumulation schemes (such as the Triple S scheme).

Under the defined benefit schemes, members are required to partly contribute towards the funding of this scheme, however the majority of the accrued benefits of these two schemes are required to be met by the Government. As at 30 June 2005, the estimated unfunded liability is $6.5 billion.

Under these schemes, poor or negative investment returns on funds invested results in a higher than projected level of unfunded liabilities affecting the Government's financial position in two ways.

Firstly, to maintain its projected fully funded target of 2034, the Government may need to increase funding contributions above what it had previously estimated.

Secondly, a higher level of unfunded liabilities results in increased expenses to the Government in the form of nominal superannuation interest expense. The higher expense affects the annual operating result.

With the accumulation scheme, the Government contributes at a rate of 9 percent of salary for non-contributing employees or 10 percent of salary where employee contributions exceed 4.5 percent of salary. For this scheme, Government employees bear the risk of poor or negative investment earnings on funds invested for these schemes.

The majority of the following discussion[125] is based on the defined benefit schemes as this has the largest impact on Government finances and the funding of unfunded liabilities.

10.3.3 Actual Unfunded Superannuation Liability at 30 June 2004

In the 2004-05 Budget, the unfunded superannuation liability as at 30 June 2004 was estimated to be $5.8 billion. This estimate has been revised to an actual outcome $5.7 billion due to better than assumed investment earnings being achieved (14.8 percent assumed in the 2004-05 Budget and actual investment earning rates was 17.9 percent).

10.3.4 Estimated Unfunded Superannuation Liability at 30 June 2005

The following table sets out the major elements that comprise the movement for the actual unfunded superannuation liabilities at 30 June 2004 to the 30 June 2005 estimated liability.

Table 10.1 — Estimated Unfunded Superannuation Liabilities As at 30 June 2005

		$'million	$'million
Actual 30 June 2004			5 668
Add:	Nominal interest	307	
	Past service payments	(242)	
	Movement in discount rate	951	
	Higher earnings against assumed	(148)	
	Other	(32)	
	Total changes		836
Estimated Closing Balance June 2005			6 504

The estimated unfunded superannuation liability as at 30 June 2005 is $6.5 billion. This is an increase of $836 million from the 30 June 2004 actual liability, due mainly to the movement in the discount rate. The government bond rate was adopted as the discount rate in 2003-04.

The table highlights the significance of movements in the discount rate. A discount rate of 5.3 percent has been applied in the 2005-06 Budget to value the superannuation liability, compared with 6.0 percent at the time of the 2004-05 Budget. This movement increases the estimated liability by $951 million.

Higher earnings were estimated to be achieved against the assumed investment earnings. In the 2005-06 Budget an earnings rate of 11.1 percent was estimated for 2004-05. This rate is substantially higher than the long-termed assumed earnings rate of 7.0 percent.

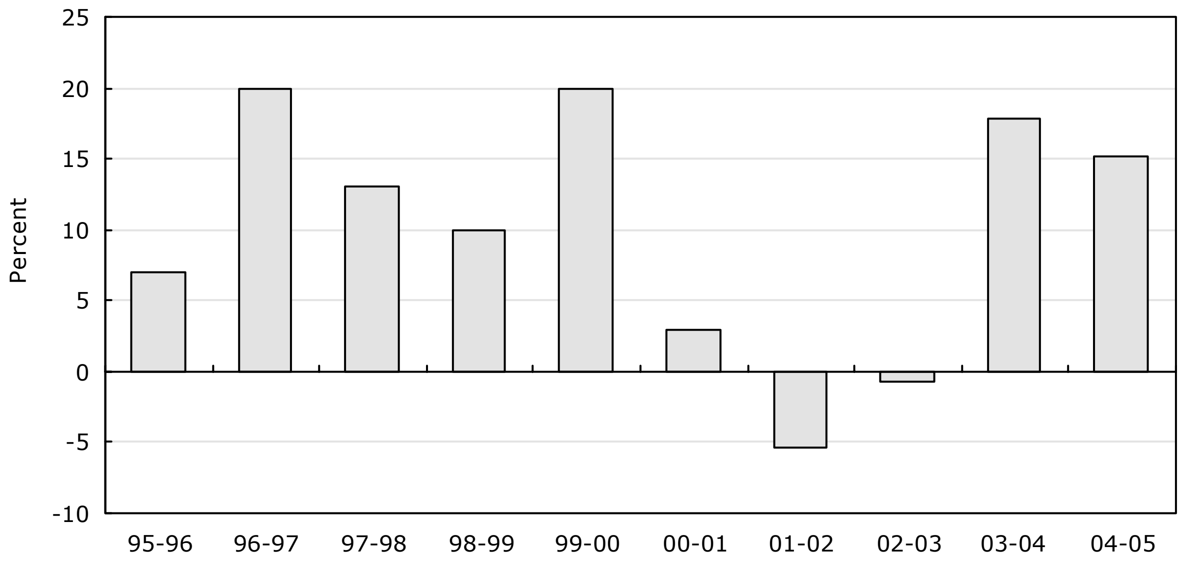
10.3.5 Analysis of Investment Earnings

A major investment objective of Funds SA is to achieve long-term returns of 4.5 percent in excess of inflation for the growth product (formerly defined benefit). Any assessment of the appropriateness of the assumed investment return rate therefore needs to be made over the long-term.

[125] See Budget Statement 2005-06, Budget Paper 3, pages 5.5 to 5.7 for further details.

The following chart shows investment returns over the past 10 years for the State's defined benefit superannuation schemes.

Chart 10.3 — Return On Growth (formerly Defined Benefit) Assets 1995-96 to 2004-05 [(a)]



Average investment returns over the 10 year period approximate 10 percent per annum for defined benefit schemes. Over the 10 year period examined, on average, investment returns have been higher than the budgeted investment-earning rate (currently 7 percent per annum).

These past investment returns, however, do not provide an indication for future returns.

Investment earnings on superannuation assets are very much susceptible to economic conditions, financial markets and Funds SA's investment strategy. Further detail on investment performance is provided under 'Superannuation Funds Management' (Funds SA) in Part B of this Report.

10.3.6 Superannuation Funding

In 2005-06, total superannuation funding is budgeted to be $689 million, a significant part of cash outlays. Payments comprise amounts paid from agencies as contributions with respect to current employment new service and contributions reflecting lack of funding for current employment in previous years ('past service' contributions).

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

The past service superannuation liability cash payment for 2005-06 is estimated to be $241 million[126]. This is $10 million lower than was estimated in the 2004-05 Budget.

[126] Budget Statement 2005-06, Budget Paper 3, Table 5.5

10.3.7 Funding Superannuation Liabilities

The commitment to fully fund unfunded liabilities was reaffirmed by the Government in the 2005-06 Budget Papers, with the position as at 30 June 2005 remaining consistent with the plan to eliminate unfunded superannuation liabilities by 2034.

On current projections, unfunded liabilities are expected to continue to increase until peaking around the period 2010-11. It is estimated that benefit payments will peak in 2018-19.

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

10.4 OTHER NON-FINANCIAL PUBLIC SECTOR LIABILITIES

Other liabilities include provisions for other employee entitlements (in particular long service leave provisions), $1.6 billion for 2004-05 and workers compensation and other liabilities of entities including outstanding insurance claims, $1.9 billion for 2004-05.

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

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

- estimated long service leave provisions amounting to $849 million for 2004-05 and $873 million in 2005-06. Long service leave is calculated by an estimation process in most cases subject to guidelines issued by the Department of Treasury and Finance;
- estimated workers compensation liability totalling $277 million for 2004-05 and $276 million in 2005-06;
- actual outstanding claims payable to entities external to SA Government for the South Australian Government Captive Insurance Corporation (SAICORP) amount to $169 million for 2003-04 and $216 million in 2004-05. The majority of these liabilities are funded. There are two separate funds operated by SAICORP. The fund dealing with claims prior to 1 July 1994, when arrangements were formalised are not fully funded with the fund having a net negative equity of $62 million at 30 June 2005 (negative $45 million at 30 June 2004). Details of SAICORP's operations are included in Part B of this Report.

10.5 CONTINGENT LIABILITIES

As reported in the Budget Papers[127] contingent liabilities are those that have not been recognised in the Statement of Financial Position, but rather in notes to the accounts, for one of the following reasons:

- There is significant uncertainty as to whether a sacrifice of future economic benefits will be required.

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[127] Budget Statement 2005-06, Budget Paper 3, p7.11 – 7.20.

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

Contingent liabilities of the Government can arise from:

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

Guarantees and contingent liabilities of the Government of South Australia as at 30 June 2004 were valued at $1.3 billion ($1.2 billion as at 30 June 2003). This is at nominal values without adjustment for the probability of actual liabilities occurring.

Matters that have arisen over recent years highlight the importance of reporting and managing contingent liabilities from their time of incurrence, but, more importantly, to ensure appropriate controls are in place to mitigate against the likelihood of incurring liabilities.

11 NET WORTH AND NET FINANCIAL WORTH

11.1 NET WORTH AND OTHER MEASURES

The Government's fiscal targets give prominence to managing liabilities. It is reasonable to expect an increasing value of net worth (assets less liabilities) to be an indicator of sound financial management. The following discussion incorporates measures of net worth and net financial worth that are used in GFS financial reporting.

11.2 SOME QUALIFYING OBSERVATIONS

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

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

11.3 NET WORTH AND NET FINANCIAL WORTH

Table 8.1 sets out trends in net worth and the net financial worth for the general government sector. The table highlights that:

- net worth is forecast to increase by $533 million in 2004-05 and rise thereafter by $2.3 billion over the four years to 2008-09;
- net financial worth is forecast to increase by $451 million in 2004-05 and rise thereafter by $1.6 billion in the four years to 2008-09.

The main reasons for the increase in 2004-05 are the increase in PFC and PNFC equity of $1.1 billion offset by the increase in superannuation liabilities of $836 million.

The increase in net financial worth over the forward estimates period is because:

- financial assets are projected to increase by $2.1 billion reflecting, in particular, a projected growth in equity and cash and deposits;
- liabilities are projected to increase by $508 million reflecting increases in borrowings ($321 million) and unfunded superannuation liability ($208 million).

The Budget Papers for 2005-06[128] provide a reconciliation of movements in general government net worth.

11.4 NET WORTH PER CAPITA

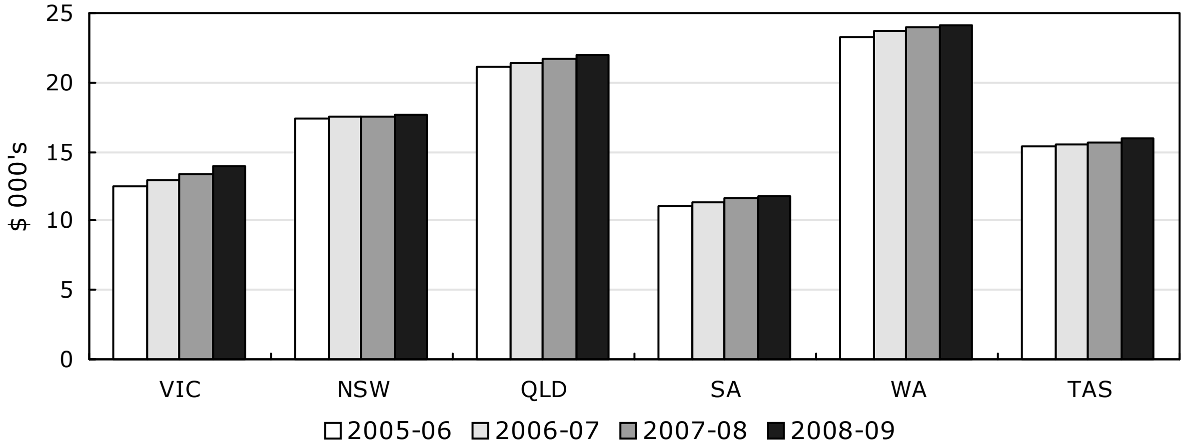
General government sector net worth is calculated as total assets (physical and financial) less total liabilities (debt, superannuation, other) and therefore highlights the net change

[128] Budget Statement 2005-06, Table 5.2.

in these items. Financial assets include the equity of public non-financial corporations and public financial corporations held by the general government sector. Changes in net worth arise from transactions, the operating result and from revaluations of assets and liabilities.

The following chart plots the Budget data for all States.

Chart 11.1 — GFS - General Government Sector Net Worth per Capita



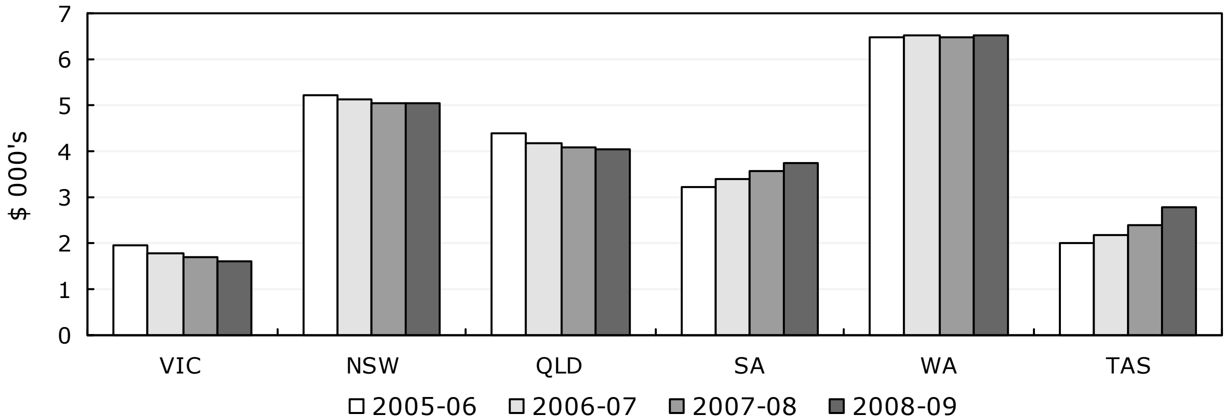
The chart shows the increase in net worth in this State through to 2008-09 based on current budget settings. This is consistent with the projections for other states.

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

11.5 NET FINANCIAL WORTH PER CAPITA

Net financial worth is total financial liabilities less financial assets. The following chart plots Budget data for all States.

Chart 11.2 — GFS - General Government Sector Net Financial Worth per Capita



The chart shows the increase in net financial worth in this State through to 2008-09 based on current budget settings and its anticipated improvement relative to most states over the period. This difference compared to the trend of net worth shows the influence of non-financial assets.

12 NET DEBT

12.1 INTRODUCTION

Since the collapse of the State Bank, management of net debt has been a major focus of fiscal strategy. The achievements over a number of years of restructuring the State's finances have reduced net debt to historically low levels and in the 2005-06 Budget, the Government has revised its fiscal targets and now focuses on total liability data.

The following commentary discusses trends in net debt and debt management.

12.1.1 Definition of Net Debt

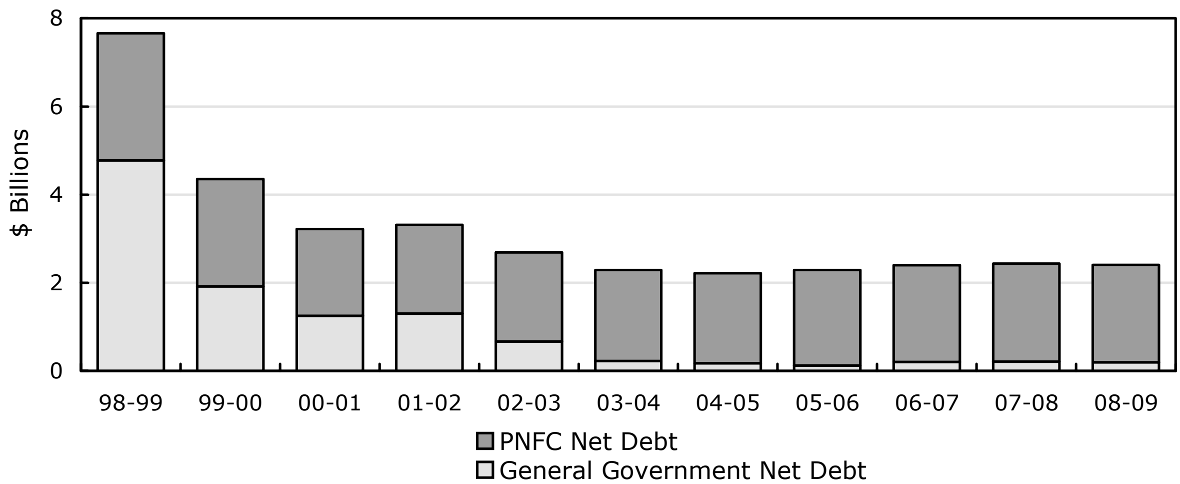
Net debt[129] equals certain financial liabilities (the sum of deposits held, advances received and borrowing) minus financial assets (the sum of cash and deposits, advances paid, and investments, loans and placements) as defined in the GFS framework.

12.2 NET DEBT

12.2.1 Longer Term Trends in the Level of Debt

The following chart shows data on a long-term basis to the end of the forward estimates. The impact of the use of proceeds from the electricity disposal process is clearly visible on general government debt in 1999-2000. Public sector net debt has reduced by $5.4 billion to $2.2 billion (3.9 percent of South Australia's Estimated Gross State Product) in the period 1998-99 to 2004-05. Forward estimates show that net debt is projected to rise to $2.4 billion in 2008-09 (3.4 percent of South Australia's Estimated Gross State Product).

Chart 12.1 — GFS - South Australian Public Sector Net Indebtedness 1999 to 2009



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

In real terms, total net debt is projected to increase in the first two years of the forward estimate period and then reduce thereafter.

General government sector net debt is estimated to be $174 million for 2004-05. Over the forward estimates net debt increases in this sector by $22 million to $196 million due to projected net lending deficits.

Net debt of the public non-financial corporations increases by $165 million over the same period to $2.2 billion.

Chart 12.1 highlights that most debt resides with the public non-financial corporations sector. The main holders of debt in that sector are the South Australian Water Corporation, South Australian Housing Trust and TransAdelaide. Of these the South Australian Water Corporation is a commercial business servicing its debt from business revenues.

12.2.2 Debt Affordability and Servicing

Chart 12.1 clearly highlights the affordability of general government net debt and why the Government was able to revise its fiscal targets.

At the end of 2004-05 total public sector net debt is estimated to represent 3.9 percent of gross state product compared to 19.3 percent in 1998-99.

12.3 DEBT MANAGEMENT

The South Australian Government Financing Authority (SAFA) has been delegated the responsibility for managing the debt of the South Australian Treasurer.

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

12.3.1 Debt Management Policy

In 2000-01 the Treasurer changed the policy benchmark duration from 2.8 years to in between 1 to 1.5 years. This policy has been retained and applied during the 2004-05 financial year.

What this means in practice is that the average maturity of the debt portfolio will be lower than it previously was. The lower duration benchmarks offer lower average interest costs over the long-term but with possible higher short-term budget volatility.

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

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

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

Due to the timing of the preparation of the whole-of-government statements, the last completed statements relate to the year ended 30 June 2004, and the following commentary has therefore been kept purposely brief.

The following summarises the financial position for the six financial years 1998-99 to 2003-04.

Table 13.1 — AAS 31 (Whole-of-Government Financial Statements) Financial Position Data (Nominal Terms)

	1999 $'million	2000 $'million	2001 $'million	2002 $'million	2003 $'million	2004 $'million
Assets						
Cash and investments	6 008	7 577	4 987	4 658	6 423	6 761
Superannuation assets	3 996	4 916	5 175	5 057	5 277	6 517
Physical assets	22 825	20 817	21 934	22 621	24 234	25 261
Other	4 255	3 587	2 199	2 460	2 063	1 869
TOTAL ASSETS	37 084	36 897	34 295	34 796	37 997	40 408
Liabilities						
Unfunded superannuation	3 909	3 544	3 262	3 987	4 445	5 668
Borrowings	13 243	11 173	6 992	6 754	7 468	6 781
Employee entitlements	1 028	1 024	1 108	1 208	1 440	1 595
Superannuation liabilities	3 945	5 117	5 300	5 183	5 411	6 635
Other	4 476	4 110	3 347	3 736	4 729	4 674
TOTAL LIABILITIES	26 601	24 968	20 009	20 868	23 493	25 353
NET ASSETS	10 483	11 929	14 286	13 928	14 504	15 055

The $551 million increase in net assets for 2003-04 was due mainly to an increase in Superannuation assets ($1240 million) and physical assets ($1027 million), offset by increases in Superannuation liabilities ($1224 million) and Unfunded superannuation liabilities ($1223 million).

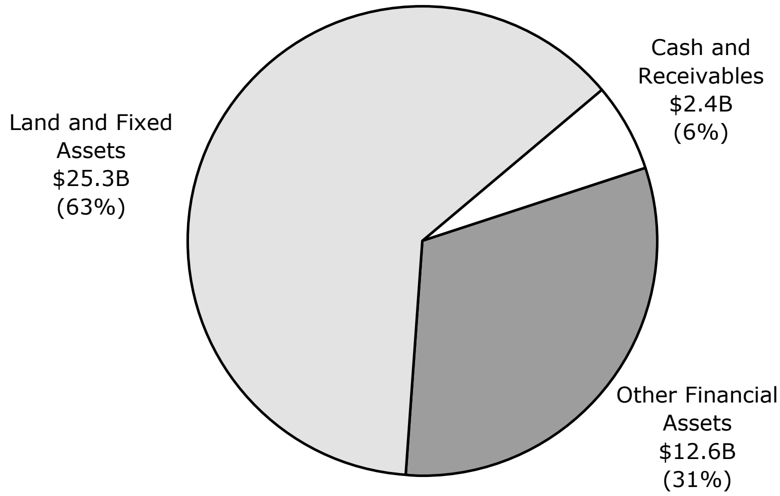
These movements mirror changes reported under the GFS methodology earlier in the Report.

13.1 WHOLE-OF-GOVERNMENT ASSETS

The most significant assets held by the State Government are land, buildings and improvements; water and transport infrastructure; and financial assets such as investments. This position is similar to interstate jurisdictions.

The following chart shows the composition of assets under the control of the State.

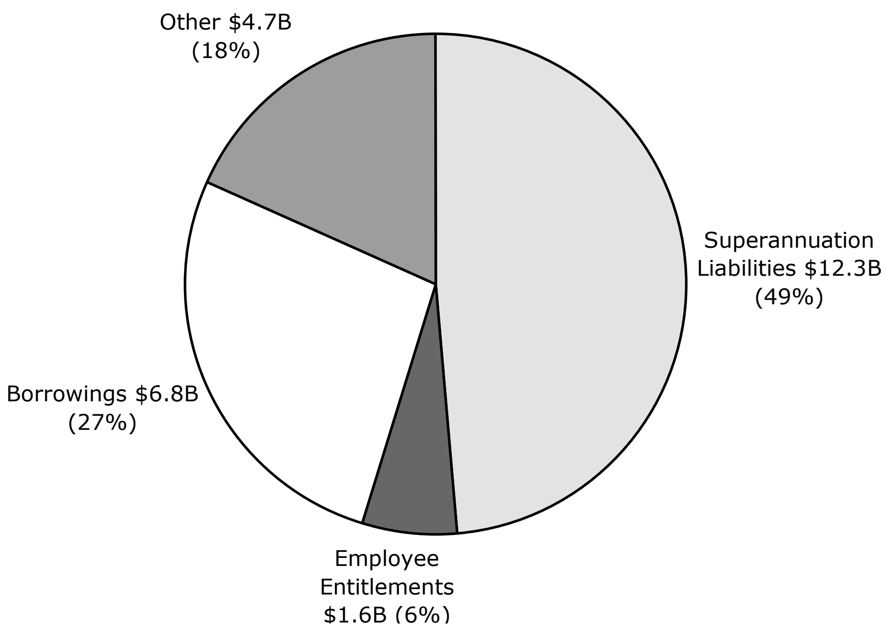
Chart 13.1 — Composition of Total Assets as at 30 June 2004 ($'billion)



13.2 WHOLE-OF-GOVERNMENT LIABILITIES

The following chart shows the Government's reported liabilities as at 30 June 2004. The chart shows that borrowings and superannuation liabilities are the most significant liabilities. These make up 76 percent of the total liabilities as shown below.

Chart 13.2 — Composition of Total Liabilities as at 30 June 2004 ($'billion)



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