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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 2004

Tabled in the House of Assembly and ordered to be published, 11 October 2004

Fourth Session, Fiftieth Parliament

PART A

Audit Overview

By Authority: J. D. Ferguson, Government Printer, South Australia

2004

Government
of South Australia

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30 September 2004

The Hon R R Roberts, MLC
President
Legislative Council
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The Hon I P Lewis, MP
Speaker
House of Assembly
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Gentlemen,

AUDITOR-GENERAL'S REPORT 2003-04

Pursuant to the provisions of the *Public Finance and Audit Act 1987*, I herewith provide to each of you a copy of my 2004 Annual Report. This Report includes the Honourable the Treasurer's Statements for the financial year ended 30 June 2004.

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 2004;

(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 and the inter-relation of procedures, policies, 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
- Primary Industries and Resources — Department of
- 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

Financial Operations of Government

The Government's financial operations in the pursuit of it's fiscal and policy targets in 2003-04 can, in my opinion, be characterised as 'cautious but purposeful'. The Government's fiscal targets and the reported progress in the achievement of these targets is stated in the 2004-05 Budget Papers.[1]

There has been a continued improvement in the amount and the quality of the financial information that has been provided for the information of the Parliament in the Budget Papers. Some of this information is being provided for the first time[2] and in other matters there has been an expansion on the information that has been made available in previous years.[3]

As the commentary on Public Finances in Part A of this Audit Report indicates, the revenue stream to the Government in the 2003-04 financial year has been strong. This has allowed for a degree of flexibility in policy choice and policy initiatives.

Controls Over Financial Transactions

One matter that is of constant moment is that of the need to maintain adequate controls over the financial transactions of government so that there can be assurance that governmental processes are undertaken lawfully and properly. For reasons stated in this Report, there have been instances identified when controls have not operated as required by law.[4] Another matter of importance is that of the maintenance of the integrity of the appropriation processes of the Parliament and the transparency associated with public expenditure. Comment on both of these matters is included hereunder in this Memorandum.

Some major public sector agency administrative changes are taking place[5] and certain projects that will result in major financial commitments[6] will come to fruition in the 2004-05 financial year. Audit is conscious of the need to monitor the arrangements associated with these matters and to bring to notice issues that may raise questions as to the legality and/or propriety of government processes. The view that has long been taken by Audit is that structural and procedural integrity are fundamental to the maintenance of public confidence in government and its processes.

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1 See Budget Paper No 3 at p 1.4.

2 eg See Budget Paper No 3 at p B.3.

3 eg See Budget Paper No 3 at p A.7.

4 The 'law' is a reference to the *Public Finance and Audit Act 1987* and Treasurer's Instructions. Two examples are stated hereunder in this Memorandum.

5 ie Department of Health; Department for Families and Communities; the establishment of new health service entities and structures.

6 ie Information Communications Technology contracts.

Assessment of Audit Risk

Audit processes must necessarily adjust to developments that have a consequence for the assessment of 'audit risk'. Developments that can have an impact on audit risk arise from adverse and/or unfavourable occurrences, not only within this State, but also in other Australian jurisdictions and overseas. Audit risk can and does arise across a broad spectrum.

Public/Corporate Governance

The continued development of the law with respect to liability necessitates a constant focus on risk management within government. Public/corporate governance and risk management have emerged as matters of significance in the audit and accountability of government.

Part B of This Report

Part B of this Report, contains detailed audit commentary on those government agencies that have been included herein. There are several agencies with respect to which financial statements have historically been included in this Report that, for various reasons, the financial statements are not included in this Report but will be included in a Supplementary Report.

In my opinion, the several matters that are discussed in this Memorandum should be brought to the attention of the Parliament and the Government.

OBSERVATIONS REGARDING ACCOUNTING AND CONTROL MATTERS

Delivery of Financial Statements to the Auditor-General

It has become apparent over the past few years that there are certain agencies that are not able to produce financial statements in auditable form within the period required by the *Public Finance and Audit Act 1987*.[7]

In my opinion, this inability to meet the statutory deadline is, in part, attributable to the fact that the system and skill resource in some agencies is inadequate to discharge the accounting requirements involved. The implications for agency management and audit risk in these circumstances is obvious. Further, the Audit experience is that the operation of the control environment within certain agencies is inadequate. Part B of the Audit Report details the position with respect to individual agencies. In my opinion, matters associated with accounting processes and control compliance should be reviewed as a priority.

Proposed Accounting Changes

There are further significant changes proposed regarding the recording and reporting of the financial affects of transactions by government entities in this, and indeed, other States and the Commonwealth. Having regard to their importance for financial reporting for government in this State, and the need to understand the context in which they will operate, these matters are discussed in the Attachment to this Memorandum.

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7 *Public Finance and Audit Act 1987*, section 23(1). The relevant period to deliver the financial statements to the Auditor-General is within 42 days after the end of the financial year of the public authority (agency).

MAINTAINING THE INTEGRITY OF THE PARLIAMENTARY APPROPRIATION PROCESSES

General Principles

It has long been settled that 'No money can be taken out of the Consolidated Fund into which the revenues of the State have been paid excepting under a distinct authorisation from Parliament itself'. (*Auckland Harbour Board v The King* [1924] AC 318, 326)

The *Public Finance and Audit Act 1987* is one of the primary legislative instruments that regulates the arrangements that apply in this jurisdiction regarding the expenditure of public monies. One of the important principles associated with good public administration is that of openness and transparency regarding administrative decisions and financial transactions.

An important aspect of the annual auditorial function includes consideration not only of whether governmental expenditure has been authorised by Parliament, but also, whether at the agency level, there are proper controls associated with the payment of monies that have been appropriated.

In accordance with his/her responsibilities under the *Public Finance and Audit Act 1987*, where there is a matter that is not in conformity with the law, propriety, and the established conventions that apply in matters associated with the public finances, it is the duty of the Auditor-General to draw these matters to the attention of the Parliament.[8]

Parliament votes the annual appropriation to agencies on the basis of the Executive Government's (ie the Crown's) requirements for the public services of the State as set out in the Budget papers.[9]

The Annual Appropriation Act provides the base funding (excluding standing authority under various Acts of Parliament) that Parliament has approved for the general purposes of government as set out in the annual budget papers.

Parliament has authorised a degree of flexibility in the appropriation balances for any year through:

- the ability to transfer appropriation balances between agencies pursuant to section 5 of the Appropriation Act and section 13 of the *Public Finance and Audit Act 1987*.
- the Governor's appropriation fund facility pursuant to section 12 of the *Public Finance and Audit Act 1987*.

[8] See *New South Wales v Bardolph* (1934) 52 CLR 455.

[9] The Parliament, in determining the amount of the grant by way of annual appropriation, would be mindful of the other sources of funds that are made available for the public services of the State. By way of example, the grants, general/specific purpose, received from the Commonwealth would be taken into account, eg Department of Health. In short, the annual appropriation by the Parliament is based on an understanding of the total resources needed for the public services for the financial year.

- the contingency balances for employee entitlements, supplies and services, and the purchase of plant and equipment included under the purpose 'Treasury and Finance — administered items for the Department of Treasury and Finance' in the Appropriation Act.

A Recommendation for Further Disclosure in the Treasurer's Statements

It is to be noted that the Treasurer's Statements do not disclose additions to agency appropriations arising from allocations from the contingency balances. Consistent with the principle of openness in public administrative matters and the enhanced disclosures that are now being made, it is respectfully suggested that these disclosures be made. This particular matter stands out as an inconsistency when compared to disclosures made in statements A and K in relation to adjustments to appropriations arising from section 5 of the Appropriation Act, section 13 of the *Public Finance and Audit Act 1987*, and the Governor's appropriation fund pursuant to section 12 of the *Public Finance and Audit Act 1987*.

THE MATTER OF THE OPERATION OF THE CROWN SOLICITOR'S TRUST ACCOUNT

The operation of the Crown Solicitor's Trust Account is a matter that has been drawn to Audit attention following a review of this account by the Chief Executive of the Attorney-General's Department. The operation of this particular account has raised issues concerning the matter of transparency in public administrative processes and the integrity of the published financial statements of that Department.

The Audit position with respect to this matter has been fully detailed in Part B of this Report in the commentary associated with the Attorney-General's Department.

In essence, in my opinion, there was non-compliance with the requirements of the relevant Treasurer's Instructions issued in accordance with the *Public Finance and Audit Act 1987*. This non-compliance circumvented the controls mandated by the Treasurer regarding public financial administration in this State. For the reasons discussed in Part B, the financial statements were misstated as a result of the proper control processes not being applied. A further consequence is that the departmental bi-laterals and Parliamentary estimate processes were compromised as a result of the Department of Treasury and Finance and the Parliamentary Estimates Committee, for the relevant year, being unaware of the fact of retained cash balances being held and available to the Attorney-General's Department.

In the course of the review of this matter there were representations to the effect that the amounts involved did not result in the financial statements being 'materially' misstated. With respect to those who suggest otherwise, the question of materiality is irrelevant in circumstances where it is known that the financial statements are incorrect, but nonetheless, are signed off with no indication of that fact being drawn to the attention of potential users.

For the purpose of completeness in terms of Executive Government accountability, I have taken the step of confirming that the Attorney-General, as the responsible Minister, did not have any knowledge of the arrangements relating to the operation of the Crown Solicitor's Trust Account, and that the Attorney-General did not know at the time of his appearance at the Parliamentary Estimates Committee, and in his discussions with the

Treasurer in the course of the departmental bi-laterals, that the cash position of the Attorney-General's Department had not been fully disclosed in the published financial statements.

The consequence for the audit as a result of this development is that the inherent risks associated with the Attorney-General's Department were reassessed and further substantive audit procedures will be undertaken. The presentation of the Department's financial statements will be included in a Supplementary Report.

TRANSFER OF FUNDS BY ONE GOVERNMENT DEPARTMENT TO ANOTHER GOVERNMENT DEPARTMENT

In the course of the audit of the Department of Administrative and Information Services (DAIS), it was noted, that on 1 July 2003 a payment of $5 million was made by DAIS to the Department of Water, Land and Biodiversity Conservation (DWLBC). This transaction, described as an 'interagency loan' was contrary to law and raised serious concerns regarding the adequacy of the internal control processes within both DAIS and DWLBC.

In fairness, it must be emphasised that neither the responsible Ministers, nor the Chief Executives of both DAIS and DWLBC were aware that this transaction had taken place. It was only following Audit requesting advice regarding the reason for this transaction that it was drawn to the notice of the senior management of the two departments involved.

Clearly, such a transaction undermines not only the Parliamentary appropriation and estimates processes, but on being identified, substantially changed the nature of the audit risk associated with the controls within both these agencies for the 2003-04 financial year. Further details on this matter can be found in the respective commentary on DAIS and DWLBC in Part B of this Report.

The Treasurer's Instructions provide for the procedures that are to apply in circumstances where the cash resources available to an agency are inadequate to meet its financial obligations.

THE DISCLOSURE AND ACCOUNTABILITY FOR A MAJOR FINANCIAL COMMITMENT UNDERTAKEN BY GOVERNMENT AFTER THE PASSING OF THE ANNUAL APPROPRIATION ACT

In April 2004, the Under Treasurer advised me of the Government's intention to make an ex-gratia payment to gas industry participants to offset costs that might otherwise be passed onto gas consumers. The payment was one of a range of spending decisions made after the 2003-04 Budget.[10]

This was a substantial transaction, and, in my opinion, it is important that the Parliament be advised of the nature and extent of the audit assurance that is being provided regarding the amount that is required to be paid to achieve the Government's policy objective.

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[10] The commentary under this heading is also related to the matter of the integrity of the appropriation process.

As a result of consideration of this matter I wrote to the Under Treasurer advising my view of the appropriation principles that should apply in the circumstances of this case. These principles arise from the application of the laws and processes applying to public finances in this State and are discussed above.[11]

In my opinion, the Governor's Appropriation Fund should be used for funding new and unexpected purposes, ie those not previously set out for consideration and approval by Parliament as part of the appropriation (Budget) process.

The disclosure requirements in relation to use of the Governor's Appropriation Fund (Statement K of the Treasurer's Statements) provides accountability for the use of the Fund.

In my opinion, other facilities, that have been identified above, ie:[12]

- section 5 of the Appropriation Act;
- section 13 of the *Public Finance and Audit Act 1987*;
- the contingency balances for employee entitlements, supplies and services, etc;

should be used where expenditure is essentially an extension or addition to original appropriations approved by Parliament.

The Government's proposed contribution to gas industry participants stood out as an item that was clearly in the category of new expenditure not previously set out for consideration and approval by Parliament.

A payment of $54.6 million (exclusive of GST), funded from the Governor's Appropriation Fund, was made on 28 June 2004 to Envestra Limited (Envestra) and is disclosed in Statement K of the Treasurer's Statements (see the Appendix to Part B of this Report).

Given the amount and nature of the payment, further particulars of the processes applied in making the payment are set out below for the information of Parliament.

Payment to Envestra Limited

In March 2004, the Government announced that it had set aside up to $64 million to ensure that the households in South Australia that have gas supplied to them would not have to pay certain costs incurred by industry participants to introduce full retail competition (FRC) in the South Australian gas retail market from 28 July 2004.

To facilitate FRC among gas retailers, the sole gas distributor in South Australia, Envestra Limited, has obligations that it must adhere to in operating in the competitive gas market. The gas retail market rules are developed by the REMCo. REMCo is the gas retail market administrator.

[11] See section above 'Maintaining the Integrity of the Parliamentary Appropriation Processes'.

[12] ibid.

A range of matters were identified for risk management to ensure the integrity of the proposed ex-gratia payment and the achievement of the Government's objectives. An implementation plan was prepared to ensure all risks were appropriately managed.

The plan identified that the arrangement must prevent gas entities from:

- ***double-dipping*** — ie recovering the same costs from both the Government and the customers;

- ***over-recovering*** — ie recovering an amount from the Government greater than what a prudent operator would have required including non FRC costs.

Three entities were initially considered, ie REMCo, Envestra and Origin Energy Retail. Ultimately only Envestra received a payment.

Ensuring that Envestra do not double-dip or over-recover is being achieved through the Essential Services Commission (Commission), given its expertise, and its price determination methodology and powers.

Double-Dipping

Section 33(1) of the *Gas Act 1997* provides the power to the Commission to determine prices for Envestra and REMCo under Part 3 of the *Essential Services Commission Act 2002* (the ESC Act). If a gas entity fails to comply with a price determination, under section 27 of the ESC Act, a maximum penalty of up to $1 million applies. Further, under section 48, the court convicting a person of an offence against the ESC Act, can order the payment of profit to be delivered up (ie a penalty) as a result of the commission of the offence.

Pursuant to subsection 33 (2) (a) of the *Gas Act 1997*, the Minister for Energy may, by notice published in the Gazette, direct the Commission about factors to be taken into account by the Commission in making a determination in addition to those that the Commission is required by the ESC Act to take into account.

The Minister for Energy issued two notices to the Commission under the *Gas Act 1997*, giving directions to the Commission in undertaking this price determination.

The first notice, issued by the Minister for Energy on 11 May 2004, specified additional factors that the Government required the Commission to take into account in respect of certain costs that are applicable to the introduction of FRC in South Australia.

The second notice, issued by the Minister for Energy on 16 June 2004, detailed that the quantum of the Government's ex-gratia payment to Envestra was $54 609 367.

The Commission took into account the matters set out in both notices in making the price determination, setting prices of zero in respect of the prudent FRC costs for the two year term of the price determination (which applies up until the date of commencement of revisions to Envestra's Access Arrangement in South Australia).

The Commission noted that the Government ex-gratia payment will not be entirely consumed within the first two years of FRC.

The Commission has reported that it will ensure that the benefit of the remaining ex-gratia payment that is not required in the first two years of FRC is allocated to consumers in future years in a manner that is consistent with any Ministerial notice or direction issued.

Over-Recovering

Over-recovering is prevented with the assistance of the price determination methodology. As part of preparing a price determination, the Commission undertook an assessment of costs submitted by gas entities. Given the requirements of the *Gas Act 1997* and Part 3 of the ESC Act, the Commission determined the costs that would be prudently incurred by a gas distributor undertaking the responsibilities that Envestra has under the Retail Market Rules, taking into consideration industry circumstances. These prudent costs are the basis for setting the maximum prices that Envestra can charge.

Prudent costs considered included:

- capital costs such as project scoping;
- system design;
- system development; conversion;
- internal testing and industry testing and operating costs such as FRC system management;
- meter and site data management;
- multi-retailer billing;
- customer transfer.

In determining the prudent costs the Commission engaged the assistance of two experts recognised as having expertise in the relevant fields.

Summary

Full details of the Commission's deliberations and the terms of the price determination, are set out in the Commission's publicly available Price Determination Report of June 2004.

In essence, to achieve the objective of protecting households from the costs of the FRC, the Government relied on the Commission, given its expertise, to determine a present value of the identified prudent costs and to determine prices for Envestra having regard to the payment made by the Government to Envestra.

In my view, the approach and methodology applied by the Government and the Commission in assessing the value of the ex-gratia payment made of $54.6 million was sound. I emphasise that my review has been restricted to the methodology applied in this matter. The detail of establishing the prudent costs and discounting those costs to a present value ex-gratia payment has not been the subject of independent audit assurance by my Department.

ACCOUNTABILITY ARRANGEMENTS UNDER SHARED SERVICES AGREEMENTS

At this point in time the South Australian Government has not mandated a requirement for the establishment of shared services in the South Australian public sector although this matter is under active consideration. There are, however, several cases where shared services have been implemented with respect to certain functions by governmental agencies in this State.[13]

The logic of shared services in effecting savings within government cannot be denied. Shared service arrangements have been successfully implemented in both the Government and the private sector. In some States, shared services arrangements are mandated on a whole-of-government basis.

Claims regarding 'savings' need to be vigorously analysed to ensure that 'hidden costs' are properly and fully disclosed. It is important that any claim of savings is not misleading in the sense that the hidden costs may not be fully recognised.

The theoretical model for the adoption of shared services indicates that there is the potential for substantial savings over a range of common functions within government. These functions include finance, human resource management, procurement, and document and records management. This list is not intended to be exhaustive of the possibilities for the application of the shared services model.

Nonetheless, within government there is the expectation that there will be proper controls and that the accountability arrangements will be such as to provide assurance regarding the financial and other processes involved. Audit experience has shown that under the existing shared service arrangements the assurance levels have not, in some matters, been satisfied to the standard that is necessary for government operations.

In any shared services proposal it is important that the functions to be the basis of a shared service arrangement be structured on a soundly based business plan and that the allocated responsibilities are adequately documented.[14]

UPDATE AUDIT COMMENTS ON MATTERS ASSOCIATED WITH THE IT GOVERNANCE REPORT PRESENTED TO PARLIAMENT IN DECEMBER 2003 INCLUDING UPDATE AUDIT COMMENT ON ICT ARRANGEMENTS FOR GOVERNMENT

Background

In December 2003, I tabled a Supplementary Report to Parliament entitled "Information and Communications Technology – Future Directions: Management and Control". That Report made certain observations regarding inadequacies that needed attention in important governance and management arrangements both at a whole-of-government and agency level.

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13 It is noted that with the establishment of a separate Department for Families and Communities, being formerly a responsibility of the now Department of Health (formerly the Department of Human Services) that these departments have been requested by the Executive Government to explore opportunities for shared services.

14 Some of the issues that arise in relation to shared services are discussed in Part B — Department of Administrative and Information Services.

Some of the issues identified at that time included:

- The absence of a consolidated whole-of-government IT strategic plan;
- The need for monitoring and reporting to Executive Government of overall progress of major IT project developments against Cabinet approved expectations;
- The need for agencies to give greater attention to strategic planning and management for IT related matters;
- The need for the maintenance of effective risk management practices.

DAIS is the lead agency for IT developments. Audit considered that the role/responsibilities of DAIS should be enhanced to include responsibility for the development of a government IT Strategic Plan and for monitoring and reporting to Cabinet on matters concerning the implementation of approved IT projects. Specifically, it was suggested that the role could be undertaken by DAIS in the context of the creation of a position of whole-of-government Chief Information Officer.[15]

Action Proposed

In response, DAIS advised of planned initiatives to address these matters and indicated that this would require considerable engagement and consultation with agencies and other key stakeholders. This was necessary to develop and agree a formal program of work in respect to the initiatives under consideration.

Further, DAIS advised that this consultation and the resultant proposed initiatives would require that a submission be made to Cabinet by the Minister for Administrative and Information Services. DAIS anticipated that the matters of consultation and development of the Cabinet submission would be completed by early 2004.

A program of consultation was undertaken by DAIS in late 2003 and 2004 with individual agencies on proposals with respect to the abovementioned matters, including consideration of the creation of a position of whole-of-government Chief Information Officer as earlier suggested by Audit. I have been advised that the matter of the creation of such a position is being actively progressed at the date of this Report.

An Update Status

More recently, Audit has communicated with DAIS on these matters and in response the DAIS Chief Executive advised an intention to consult with Chief Executives with a view to presenting a submission to Cabinet.

As stated in my December 2003 Report, clear responsibility and accountability as to outcomes in information technology service provision and developments at a whole-of-government and agency level is necessary. Proper administrative arrangements for DAIS and individual agencies will enable the Government to have an adequate level of assurance regarding the ability of public sector agencies to deliver in accordance with realistically agreed expectations, now, and into the future.

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15 It is noted that the Victorian Government has created a Chief Information Officer (CIO) position to enable whole-of-government IT management to be effectively managed.

The DAIS Chief Executive has advised that each of the matters raised by Audit is being actively considered with a view to a submission to Cabinet in early 2005.

HUMAN RESOURCE MANAGEMENT SYSTEMS: AUDIT COMMENTARY

Background

Over the past three years a common human resource management system has been implemented in the majority of government agencies and health units. This system, ie CHRIS HRMS, is supplied and operated by an external service bureau. The system includes:

- payroll;
- leave management;
- recruitment selection;
- training and development.

This strategically important system involves the management of payroll and personnel functions for approximately 50 000 government employees in over 70 government agencies and health units.

The Department of Health (DoH) is responsible for managing the contract and implementation of the CHRIS HRMS for the DoH Central Office and all health units. DAIS is responsible for managing the contract and implementation of the CHRIS HRMS for a number of participating agencies of government outside the Health and Education sectors.

The Department of Education and Children's Services is in the process of implementing a replacement HRMS system, ie Valeo system. Previous reports to Parliament have included comment on development and implementation delays experienced with this system, and associated funding issues.

Security and Control Issues

Both DoH and DAIS, in their respective roles as lead agencies, have commissioned IT security consultancy firms to undertake a number of security reviews over the operations of the external bureau. Those reviews took place during 2002 and 2003. The contracted security reviews revealed inadequate control exercised over the operations of the bureau.[16]

A review of the CHRIS system implementation in the Health sector by Audit during 2003 found that, amongst other matters: [17]

- The system supplier had not provided a completely effective working system to DoH (in particular the leave management component) as contracted;

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16 The detailed commentary on these inadequacies were set out in the December 2003 Auditor-General's Supplementary Report to Parliament: 'Information and Communications Technology — Future Directions : Management and Control'.

17 ibid.

- Problems with the leave management component had prevented official acceptance by DoH;

- DoH and the health units were incurring additional costs while the system was not fully implemented. It was noted by Audit that some contract payments were being withheld until a number of matters with the bureau provider were resolved.

The 2004 Update

A follow up review undertaken by Audit during 2004, indicated that the matters identified with the CHRIS HRMS as implemented in the Health Sector have not been satisfactorily resolved. Review by Audit of the CHRIS HRMS implementation in the DAIS agency sector has not revealed similar concerns. Nonetheless, as mentioned above, certain security issues associated with the operation of the external bureau in relation to both the Health Sector and DAIS agencies remain to be satisfactorily addressed.

Where government, through its agencies, is involved in contractual arrangements with external IT service providers for the provision of major IT systems and services that are of importance for the continuity of governmental operations, agencies need to be particularly vigilant to ensure systems and services acquired for a particular purpose effectively meet that purpose. The implementation of the CHRIS HRMS and the Valeo systems demonstrates the need for close management of these arrangements.

STATE AGENCY AND AUDITOR-GENERAL ACCESS IN OUTSOURCING/PUBLIC PRIVATE CONTRACTUAL ARRANGEMENTS

Background

In my opinion, private sector IT service providers contracting with the Government need to be aware of the requirement for the State, through its contracting agency, and the statutory right of the Auditor-General, to separately and independently access and review their controls and operations. This is particularly important when the external IT service provider is responsible for processing, transmitting, or storing government information.

The need for appropriate access clauses to be included within IT contracts with external IT service providers has been the subject of comment by Audit for some years.[18] In some cases Audit has found that contract access clauses had not been included for State agencies. In these circumstances a government agency is not in a position to manage its obligations of ensuring the adequacy of the control environment.

The State

The State, through its agencies has a responsibility for managing and controlling contracts with the private sector for the provision of IT systems and services. This responsibility includes the review and monitoring of security controls over government systems and the information under the control of the private sector providers. It also includes ensuring the effective delivery of the contracted services.

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[18] See Auditor-General's Annual Report for year ended 30 June 2001, Part A Overview, at p 125.

The rights of the State, exercised through its agencies, is generally speaking not founded on a statutory basis. These are contractual rights. Accordingly, it is essential that the contractual terms are unambiguous and that there are the necessary rights of access to protect the public interest.

Auditor-General Access

The Auditor-General also has responsibility to form opinions on the controls exercised over government systems and information security. The Auditor-General's right of access to systems, facilities, and information to discharge that responsibility is to be found in the *Public Finance and Audit Act, 1987*.

Notwithstanding that the Act provides for access by the Auditor-General, it is appropriate that notice of this right by the Auditor-General is brought to the attention of private sector IT service providers. The most effective way to achieve this is by inclusion of a contract clause advising of, and facilitating, such access rights at the time of contracting.

Current Status

In the context of ensuring that this matter is addressed, I have recently communicated with DAIS as the lead IT agency of government. DAIS, in response, advised that proposed clauses pertaining to the Auditor-General had been forwarded to Crown Law for consideration for inclusion in future contracts.

The importance of this matter is highlighted by the recent developments with respect to future Information and Communications Technology (ICT) arrangements for government. These arrangements will see the completion of new large contracts being entered into by the Government with external IT service providers.

CONCLUDING COMMENTS ON MATTERS RAISED IN THIS MEMORANDUM

As mentioned above, there is, in my opinion, the need for a review of the accounting processes and the resources to support the accounting and control compliance requirements in several government agencies. There is also, for the reasons mentioned in this Memorandum, a need to emphasise the importance of compliance with the mandated legislative requirements in government agencies.

K I MacPherson
AUDITOR-GENERAL

ATTACHMENT

PROPOSED CHANGES FOR REPORTING OF GOVERNMENT FINANCIAL TRANSACTIONS: HARMONISATION; CONVERGENCE; AND GOVERNMENT FINANCIAL STATISTICS

In recent years, there have been far reaching changes in the recording and reporting of the financial effects of transactions by government entities in this State. The process of change is not yet complete. There are four matters that are associated with these changes that warrant comment.

Four Important Matters

The first and most important was the move from traditional fund accounting to accrual accounting. This change, now complete, was to allow meaningful comparisons of the financial performance and financial position of private and public sector entities.

The second change, now virtually complete, was 'harmonisation'. Harmonisation was intended to make Australian accounting standards compatible with (but not identical to) international accounting standards developed by the International Accounting Standards Committee in London. The objective of harmonisation was to facilitate international comparisons of financial performance and financial position and to make easier cross border listing on stock exchanges. Harmonisation involved the staged replacement of nearly all Australian accounting standards.

The third agent of change is 'convergence'. This is a process that is currently under way in Australia. Convergence means making Australian accounting standards the same as international accounting standards. Convergence was required by directive of the Financial Reporting Council (FRC). It has the same objectives as harmonisation but takes the process further. The incorporation of Australian International Financial Reporting Standards (AIFRS) in financial reports will occur in reporting periods beginning on of after the 1st January 2005. This process is discussed in more detail later in this Attachment.

The fourth change applies only to the public sector and has not yet begun. In November 2002, the FRC announced that public sector financial accounting and reporting should be compatible with Government Financial Statistics (GFS). GFS is an accounting and reporting system devised by the International Monetary Fund for the presentation of the national accounts and the financial reports of the whole-of-government. At present, the financial reports of government agencies are based upon generally accepted accounting principles (GAAP) as represented by Authorised Australian Accounting Standards. GAAP are different from GFS. The financial reports of agencies must now be restated to GFS before consolidation in the national accounts and the financial statements of the whole-of-government. The move to GFS in the public sector should remove the need to translate the financial reports of agencies. One effect of the change will be to reduce the comparability of the financial reports of public and private sector entities. It will be recalled that the move to accrual accounting was supposed to increase comparability.

Convergence

Convergence is, however, the current issue facing accounting and reporting by government agencies. The issue of AIFRS has been preceded by a series of exposure drafts and the preparation of 'pending standards'. Before the pending standards become AIFRS and are legally enforceable as part of the Corporations Act, they must be approved by the Federal Parliament. At the time of writing, no such approval has been given. When AIFRS are approved by Federal Parliament they become Approved Australian Accounting Standards (AAAS) compliance with which is mandatory for corporations. Under the provisions of the *Public Finance and Audit Act 1987*, South Australian public sector agencies must also comply with the new AAAS. Some agencies were created by specific legislation that usually also requires compliance with AAAS.

At present, public sector compliance with AAAS is modified by specific standards dealing with accounting and reporting by government departments, local government and whole-of-government. These public sector standards have not yet been replaced by AIFRS. They are, however, in need of revision. In general, these standards require compliance with other AAAS. In a few cases, however, the requirements of the public sector standards differ from the requirements of other standards. They also deal with matters that are unique to the public sector such as infrastructure assets and administered items. Some AIFRS have inclusions that apply only to 'not-for-profit entities. At this stage it is not clear what will happen to the public sector specific standards. However, they have not been withdrawn and are probably still applicable.

The Treasurer issues Accounting Policy Statements (APS) that provide guidance to agencies in applying the AAAS. In most cases the APS reinforce the need to comply with AAAS. In some cases, however, the APS limit choices of policies or require accounting policies that differ from the requirements of AAAS.

Harmonisation

The harmonisation process that preceded convergence means that differences between AIFRS and current AAAS have been minimised. Nevertheless, there are still differences that must be accommodated in the recording and reporting processes of South Australian government agencies.

In some cases, these differences are changes in terminology. For example, 'asset revaluation reserves' become 'revaluation reserves'; the 'statement of financial performance' becomes the 'income statement'; and the 'statement of financial position' becomes the 'balance sheet'.

In other cases the changes are more significant. For example, the presentation of 'extraordinary items' on the face of the income statement or in notes to the accounts will no longer be permitted. Corrections of errors will be recognised retrospectively (adjusted to the beginning balance of retained profits) instead of being recognised as expense or revenue in the income statement of the period in which the correction is made. Changes in accounting policy will also be recognised retrospectively as if the new policy had always applied. An impairment test will be required for all non-current assets. In the 'old' standards, the impairment test applied to non-current assets carried at cost. There is also a change to the definition of recoverable amount. There is a change to the definition of 'joint control' in joint ventures. The new definition has the potential to cause reclassification of some existing joint ventures as other forms of investment.

One change of significance to the private sector is that 'goodwill' need not be amortised as its useful life is 'uncertain'. On the other hand, self-generated intangibles cannot be capitalised. This means that previously capitalised self-generated intangibles will have to be written off. This should not be an issue for government agencies.

Some Implications for Government in Adopting the Proposed Changes

Incorporating the cumulative effect of these and other changes in accounting and reporting policies has the potential to be a significant burden on accounting, audit and finance staff in government agencies. Staff will have to be re-trained to implement the required changes. Changes to accounting systems and staff training will not be cost free. The Department of Treasury and Finance will have to modify and reissue Accounting Policy Statements to make them applicable to and consistent with AIFRS. DTF may also have to revise Treasury Instructions that apply to accounting and reporting matters.

The AIFRS must be applied for reporting periods beginning on or after 1 January 2005. There is, however, an additional requirement that comparative figures for reporting periods beginning on of after 1 January 2004 must also be based on AIFRS. For agencies with financial years ending on 30 June, this means that AIFRS must be applied from 1 July 2005. However, in the financial statements for the year ended 30 June 2006, the agency must present comparative figures based on AIFRS for the year ended 30 June 2005 (beginning 1 July 2004).

It appears that agencies have two alternatives in implementing the move to AIFRS. The first choice is to keep two sets of accounting records during the year beginning 1 July 2004. The first set of accounts would be based on the current AAAS and would be the basis of the formal financial statements for the year ended 30 June 2005. The second set of accounts would be based on AIFRS and would provide the comparative figures for inclusion in the financial statements for the year ended 30 June 2006. It would also provide the opening balance sheet for the year beginning 1 July 2005.

The second choice is to use the current AAAS during the year ended 30 June 2005. This record would be the basis of the formal financial statements for the year ended 30 June 2005. On 1 July 2005, these financial statements would then be restated to AIFRS to provide a starting balance sheet for the year ended 30 June 2006 and comparative AIFRS figures for the year ended 30 June 2005 for inclusion in the financial statements for the year ended 30 June 2006.

There is a particular problem for agencies whose financial year ends on 31 December. These agencies must apply AIFRS from 1 January 2005 and provide AIFRS comparative figures from 1 January 2004.

Concluding Commentary

It is apparent, therefore, that the recording and reporting of financial information will be an issue for South Australian government agencies during the financial year beginning on or after 1 January 2005. It should not be supposed that the issue would be resolved by 30 June 2006. It is certain that new and revised AIFRS will be issued after that date. Each new standard will require changes to accounting and reporting policies. In addition, the cloud of the prospective move to GFS hangs over financial accounting in the government sector.

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 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 mainly includes looking at 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 2 to 13 in this Part of my Report.

2.1.1 Public Sector Reform

For a number of years the State public sector has been going through substantial restructuring and reform reflecting changing priorities and policies of what businesses should be operated by Government, what services should be provided by Government, and how services should be provided within the limited financial resources of the State. Although individual jurisdictions have different issues, similar paths are being followed in reform plans across all Australian public sectors. An important aspect of reform and public sector resourcing has been a uniform policy by all Australian Government's to carry low, indeed, if any, debt in their General Government Sector.

Key aspects of the restructuring process in this State have been a very large and sustained targeted voluntary separation program to reduce employee numbers (more than 17 000 separations in the ten years to 2003-04) and asset sales, most importantly the State's electricity assets, but also other significant assets including ports, pipelines, race betting, government general insurance and public transport. Outsourcing arrangements have also been a feature, including water and waste water operations, information technology, and correctional services.

There have also been changes in the financial relationship with the Commonwealth, most notably, with the introduction of GST funding to replace a range of state taxes.

There has also been change in financial planning and reporting. In the 2002-03 Budget, the Government introduced a new fiscal responsibility framework, including accrual fiscal targets which is regarded as superior to previous cash based frameworks.

Financial reporting has gone through staged evolution and in 2002-03, the accrual-based Government Financial Statistics (GFS) framework became the basis for consistent financial reporting of the budget, supported by Australian Accounting Standard based agency reporting.

2.1.2 Balanced Budgets

In the four years up to 2002-03, substantial budget deficits (on the GFS-General Government Sector accrual basis) had been incurred ranging from $124 million in 2001-02 to $471 million in 1999-2000.

In the 2002-03 Budget, the Government set out its fiscal targets including to achieve, on average, balanced budgets 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 has fortunately coincided with what one economic analyst[19] describes as a 'once in a decade lucky break' in terms of favourable economic conditions that have generated significant unbudgeted revenues.

Since setting this target, it has been, or is estimated to be, exceeded (ie achieved budget surpluses) and it is forecast to be exceeded throughout the four years, 2004-05 to 2007-08, of the 2004-05 Budget.

This is a major improvement in the state of the public finances compared to the four years leading up to 2003-04.

In the last two years to 2003-04, the Government has benefited from substantial windfall property taxation revenue (up $316 million over two years) and in the last year, from higher than budgeted Commonwealth GST revenues. These and other revenue increases have exceeded increases in expenditures generating surpluses.

The results have also been assisted by a shift in approach from previous years so that it is now practice to make distributions from the Public Financial Corporations (PFC) Sector as budgeted. I noted last year that I considered the new practice to be an improvement in financial reporting and management control. Up to 2002-03 it had generally been practice to defer budgeted distributions to match timing changes with expenditures. The effect was to manage the bottom line.

Large distributions have been budgeted and received from PFCs in the past two years notwithstanding other revenue gains, and large distributions from PFCs have been budgeted for the next two years. These are important to the reported budget result. Indeed, if not for the PFC distributions, the result for 2004-05 would be a net borrowing (deficit) and the 2005-06 result a net lending of $13 million rather than the projected net lending of $126 million. From 2006-07, distributions from PFCs reduce to be in line with the expected annual profits of the PFCs.

2.1.3 AAA Credit Rating

Another of the Government's fiscal targets is to ensure risks to the State finances are prudently managed, while maintaining at least a double-A plus credit rating. The Government currently has a target of achieving a triple-A credit rating within the next three years.

The AAA 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 conduct its affairs accordingly.

2.1.4 Ageing Population

It is well known that South Australia, like other jurisdictions, has an ageing population. In response to an Audit inquiry on strategic thinking being undertaken on the impact of that issue on the State's finances, the Department of Treasury and Finance (DTF) have advised that since July 2003 the DTF had collaborated with a private sector forecaster to develop modelling capacity to project South Australian Government finances to 2041-42.

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19 South Australian Centre for Economic Studies - Economic Issues No.13 'The 2004-05 South Australian Budget' - July 2004.

A report on this work was being finalised. The results suggested South Australia's long term fiscal pressures will be similar to pressures projected for the Commonwealth Government and that accordingly, there is about a 15 year time horizon for forward planning to address this issue.

2.1.5 Infrastructure Planning

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

I note that Ministers and portfolios are responsible for strategic infrastructure planning and priority setting within their respective policy areas. The DTF have advised that a whole-of -government strategic infrastructure planning "framework" was not used to establish the priorities for the 2004-05 Budget. This is consistent with past practice. Cabinet, rightly, take responsibility for whole-of-government strategic infrastructure planning when deciding which projects are approved in the budget.

DTF have also advised that in line with recommendations of the Economic Development Board (EDB 18 and 69), the Office for Infrastructure Development will take a significant role in strategic infrastructure planning for the State in the future, including setting priorities between competing infrastructure needs in line with the State Strategic Plan.

2.1.6 State Strategic Plan

In past Reports I have discussed the timely communication of Government outcomes and key priority areas and initiatives and indicated the view that strategic planning documents should be released as part of the budget process to communicate the foundations on which the Budget was based[20].

In March 2004, the Government announced its State Strategic Plan to guide South Australia's development over the next decade. The 2004-05 Budget indicates that it delivers new initiatives to address all six key objectives of the State Strategic Plan.

It will be important that the linkages of the State Strategic Plan and the Budget be evident as an element of assessing financial performance in the future.

2.2 OPERATING STATEMENT

2.2.1 Estimated Result for 2003-04

The 2004-05 Budget reports a large increase in revenues resulting in a significantly improved estimated net lending (surplus) result of $264 million for 2003-04 compared to the $20 million net borrowing (deficit) set out in last year's Budget.

Total revenue is estimated to exceed budget by $632 million or seven percent and total expenses to exceed budget by $425 million.

[20] Report of the Auditor-General for the year ended 30 June 2001, Part A p96.

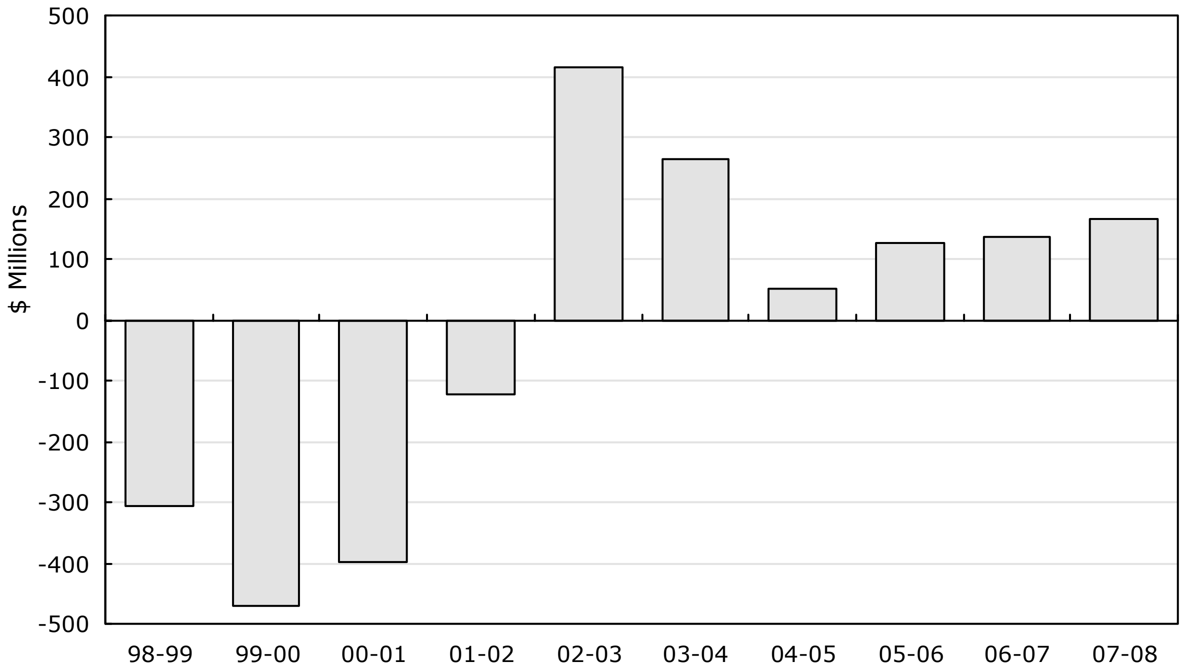
Net underspending on capital (net acquisition of non-financial assets) has contributed $78 million to the improved result. This, however, tends to simply reflect delayed timing of expenditure rather than an improved financial performance.

2.2.2 Budget Forecasts

The four years to 2007-08 are in line with last year's Budget, with net lending estimated to improve each year over the term of the Budget reaching $165 million by 2007-08.

The following chart shows the achieved and expected outcomes for the ten years to 2007-08.

GFS - General Government Sector Net Lending (Borrowing) Result



Some matters of significance to the 2004-05 Budget estimates years are:

- new expenditure initiatives totalling $1 150 million over the next four years;
- taxation measures designed to bring in $181 million less over four years;
- targeted savings totalling $235 million over four years;
- minimal expected growth in expenses in the 2005-06 and 2006-07 years;
- reliance on distributions from two financial corporations amounting to $255 million over four years, of which $225 million is in the first two budget years;
- reliance on distributions from the Non-Financial Corporations Sector of government amounting to $1.2 billion over four years.

While forecasting similar outcomes to the previous budget, the underlying level of activity, total revenues and expenses, is markedly higher than was budgeted in 2003-04.

The estimated higher revenue base, now $650 million or 7 percent more than was estimated for 2004-05 in the 2003-04 Budget, means that the Government was in a position to increase expenditure in the 2004-05 Budget to meet parameter and policy spending increases, while continuing to exceed the fiscal objective of balanced budgets for the General Government Sector.

The surpluses have also been achieved, or planned to be achieved, while also forecasting an affordable capital program that ranges from a low of $560 million in 2005-06 to a high of $655 million in 2007-08.

2.2.3 Distributions from Reserves

The use of large distributions from the reserves of Government businesses and particularly the South Australian Asset Management Corporation (SAAMC) and the South Australian Financing Authority (SAFA) have been projected in most Budgets. There can be no argument that the use of reserves would be expected to occur periodically.

These distributions are discretionary and simply transfer between sectors of government. They ultimately allow governments considerable flexibility in budget setting, being limited only by access to funds. In this regard I have previously indicated that I am of the view that such distributions from SAAMC and SAFA are unsustainable. These entities do not have the capacity to replace amounts of the magnitude of the distributions over the four years 2002-03 to 2005-06 going forward. It is notable that the forward estimates for 2006-07 and 2007-08 anticipate the lowest distributions from these entities for a number of years. As the Budget also estimates increasing net lending results over the forward estimates, it is apparent the need for these distributions is diminishing.

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

2.3 BALANCE SHEET[21]

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 2004-05 Budget despite an increasing unfunded superannuation liability.

2.3.1 Estimated Position for 2003-04

Notwithstanding past asset sales, the State has a substantial asset base. Assets are estimated to increase by over $1 billion for 2003-04 to $28.5 billion due mainly to revaluations.

Liabilities are estimated to increase $1.3 billion to $13.2 billion also due mainly to revaluations.

The major increase in liabilities in 2003-04 is due to unfunded superannuation liabilities that are estimated to increase by $1.3 billion to $5.8 billion as at 30 June 2004. The increase was due principally to a revised discount rate arising from the early adoption of a new accounting standard by the Government. Improved investment performance from equity markets in 2003-04 were estimated to result in a $230 million higher than expected reduction in the liability.

[21] Balance sheet data is for the Non-financial Public Sector unless otherwise stated.

Net debt was estimated to fall $174 million to $2.5 billion of which the General Government Sector is $382 million.

Net worth, comprising total assets less total liabilities, is estimated to be stable at $15.2 billion.

2.3.2 Budget Forecasts

Assets are estimated to increase to $29.9 billion in 2007-08.

Liabilities are forecast to decrease to $13.1 billion in 2007-08.

Although unfunded superannuation liabilities are forecast to increase to $6 billion by 2007-08, the Government's target to fully fund superannuation liabilities by 2034 is on track based on the estimates set out in the 2004-05 Budget.

Net debt is estimated to improve in the forward estimates period, reducing to $1.6 billion by 2007-08.

General Government Sector net debt is estimated to decrease and then be eliminated by 2006-07 such that this sector will have net financial assets of $429 million by 2007-08.

Net worth is forecast to rise in the four years to 2007-08, with a total increase over the forward estimates period of $1.6 billion.

2.4 RISKS AND MANAGEMENT TASKS FOR THE 2004-05 BUDGET

Having set out projections that show positive changes to the State's finances over the four year period of the 2004-05 Budget, the challenge for the Government will be to deliver these outcomes.

2.4.1 Managing Performance

The characteristics of the 2004-05 Budget are in line with the previous year, particularly in respect to the projection of restraint in relation to expenses in the 2005-06 and 2006-07 years. This is, in my opinion, a risk to be managed when compared to the recent history for outlays and emphasises the need for managing the actual performance against budget and for control of spending.

There is a natural tension between the fiscal aims of restraint and balanced budgets and the complex and often mounting service demands in agencies. Evidence of this arose during 2003-04 with identified problems with agency budgeting and with actions taken to avoid carryover restrictions. Managing the relationships with agencies and ensuring they have the necessary systems and skills will be fundamental to the achievement of fiscal targets. The application of a new cash alignment policy in 2004-05, whereby agencies will be required to return surplus cash to the Consolidated Account, may magnify risk in this respect. Notwithstanding, agencies must operate within the framework established for financial management.

It is notable that outlay increases experienced in recent years have been covered by better than budgeted performance by taxation receipts and Commonwealth general-purpose grants. It is of course possible that this will or will not occur in any particular year given that revenue performance is subject to the influence of economic conditions.

Importantly, the Budget has been prepared anticipating a weakening in the property market. To the extent that revenue estimates are conservative, there is perhaps, some flexibility in the management task. This again, is a matter to be monitored and managed.

The projected net lending outcomes, estimated to total $480 million over the four years to 2007-08, also provide a buffer assisting the likelihood that the fiscal target of, on average, balanced budgets will be achieved.

The commentary that follows in sections 5 to 7 provides further analysis of the 2004-05 Budget and related control issues that the Government has identified in response to the Budget position and its fiscal targets.

2.5 CONCLUDING OBSERVATIONS

Notwithstanding reforms to the public sector over the past decade and more, it is only in the past two years that operating surpluses (GFS accrual based) have been or are estimated to be achieved.

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 desirable lift.

Importantly, it is projected that a net lending (surplus) will be achieved each year to the end of the Budget forward estimates, 2007-08.

Virtually all financial indicators are expected to improve. The most significant liability, unfunded superannuation liabilities, while forecast to increase, is being managed in accordance with now long established policy to be funded by 2034. The last two years of the forward estimates forecast a low reliance on contributions from PFCs.

If the budgeted results are achieved over the forward estimate years, the Government will have exceeded a key fiscal target, which is to achieve, on average, balanced budgets in the General Government Sector. This will, in turn, consolidate an improved position for addressing challenges to the State’s financial position in the longer term.

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.*

These reporting frameworks, may, for persons not already familiar with their application, appear complex and difficult to understand and apply. This is particularly the case with respect to the application to the State finances of the UPF. The following commentary has been prepared with the intent of assisting the understanding of these matters.

Although the AAS framework remains 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.

As a result of the focus on the UPF for the Budget, the major proportion of the discussion and analysis in this Part of the Report is directed at reviewing information that is reported on that basis. 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[22] 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.

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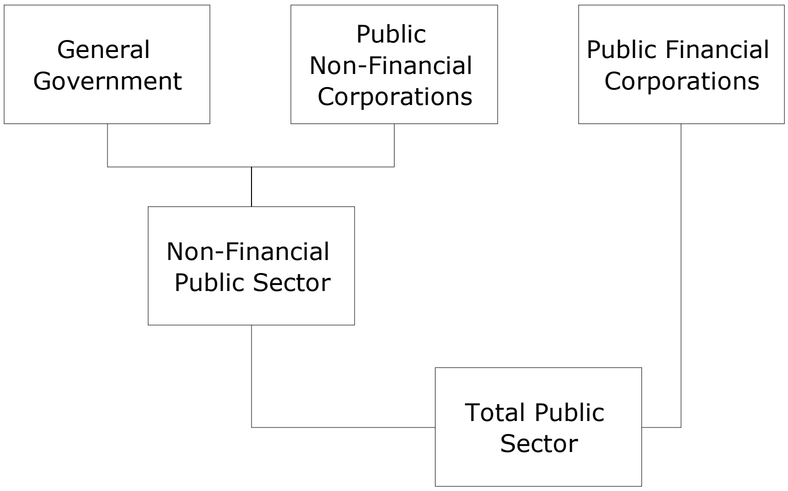
22 To avoid confusion and ensure consistency, Audit has used the term GFS throughout this Report to refer to the accrual-based Government Financial Statistics (GFS) framework adopted under the Uniform Presentation Framework (UPF).

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

Another key aspect of the GFS framework is that of the identification of different sectors, recognising that state government activities 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:



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 matter 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 budget process has concluded. As a result, the Budget Papers do not provide any details of the total public sector.

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

As previously mentioned, Audit's discussion on the State's financial performance and position have mainly focused around the use of the General Government Sector consistent with the Budget presentation. The focus on the General Government Sector is because of its dependence upon taxation revenue and Commonwealth government grants to support their 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.

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*** — is the net operating balance less net acquisition of non-financial assets. It indicates the extent to which accruing expenses and net investment expenditure is funded by revenues.
- ***Net Worth*** — a financial position measure that comprises total assets (financial and non-financial) less total liabilities less any contributed capital. This measure includes non-current physical assets (land and fixed assets) and employee entitlements such as unfunded superannuation and employee leave balances.
- ***Net Financial Worth*** — a similar measure to net debt, which is calculated from the balance sheet as total financial assets less total liabilities.
- ***Net Debt*** — comprises certain financial liabilities less financial assets. The items included in this measure are discussed in depth in the Budget Papers.[23]

These measures have been the subject of Audit focus throughout this commentary on the State's financial performance, financial position and overall financial strength.

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 2004-05 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.

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

3.3 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 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 that explains how the entity is managing the transition to IFRS and gives a narrative of the expected key differences in accounting policies as a result of the adoption of IFRS. All financial reports in Part B of this Report disclose this information.

Further information regarding the introduction of IFRS is to be found in the Attachment to the Memorandum to Parliament

3.3.3 AAS Whole-of-Government Financial Statements

In 1998-99 Accounting Standard AAS 31 'Financial Reporting by Governments' became operative. Whole-of-government financial reports for South Australia have been prepared by the Department of Treasury and Finance (DTF) since that time.

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

Previously, I have reported that 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 2002-03, a management letter was forwarded to the DTF in March 2004 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.[24]

The matters raised included:

- timeliness issues with the preparation of whole-of-government financial statements. In particular, it was noted that a number of other States had been able to finalise and publish their whole-of-government financial statements many months before South Australia, which did so in March 2004;
- inadequate audit trail available to support some amounts disclosed in the notes to the financial statements and some material accounting journals processed;
- the inclusion of a number of material account balances from government entities that received qualifications;
- recommendations for disclosure and presentation improvements when preparing future whole-of-government financial statements.

[24] Government of South Australia, Consolidated Financial Statements for the year ended 30 June 2003.

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 consolidated whole-of-government reporting.

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 proposes to finalise an Exposure Draft for a new standard in March 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 lapse 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.[25]

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 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 will apply in 2004-05. Pursuant to the cash alignment policy, payments will be required to be made to return surplus cash to the Consolidated Account. The implication of this policy is that agencies have an incentive to spend the cash allocated to them to avoid having surplus cash.

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 these are unbudgeted expenses;

- 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;

[25] *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.

- 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 areas where improvements could be made. These included:

- preparation of reconciliations to ensure data transferred from the DTF's corporate ledger to the central general ledger is complete and accurate;
- the need to delete over 100 inactive accounts from the central general ledger; and
- documenting procedures for the preparation of the Treasurer's Statements.

Departmental Response

In response, the DTF indicated that each of the matters raised had either been resolved, or that action had been taken to implement the Audit recommendations.

Accrual Appropriation Excess Fund Account

In addition, to these matters Audit commented on observations made in respect of the operation of the Accrual Appropriation Excess Fund Account. This is 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

The 2004-05 Budget Papers[26] indicate that the Government is committed to the following fiscal principles:

Fiscal target	to achieve, on average, balanced budgets in the General Government Sector.
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 as they arise and progressively fund past service superannuation liabilities.
Risk	to ensure risks to State finances are prudently managed, while maintaining at least a double-A plus credit 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).

These fiscal principles reflect a commitment by the Government to containing the public sector's level of liabilities by ensuring no growth in net debt from ongoing operations of the General Government Sector, by eliminating unfunded superannuation liabilities, and by requiring all PNFC borrowing to be fully funded from resultant cash flows.

This rationale is supported by the risk principle that aims to ensure that public sector liabilities and contingent liabilities are carefully managed.

These principles are consistent with those proposed for a Charter of Budget Honesty. The Charter requires the Government's fiscal objectives to take into account a range of issues including tax policy and burden, risk, and service delivery. Further, these principles ensure that both short term and long term objectives are taken into account to ensure equity between present and future generations.

The Government's long-term objective is for general government operating expenses and investing expenditure to be met entirely by revenues. The fiscal targets do not distinguish general government investing expenditure from operating expenditure. The Government's view is that general government investing expenditure is not undertaken to generate future revenue streams and therefore it will generally be met from current revenue streams or operating surpluses. This target ensures no growth in general government net debt from operating or investing expenditure.

As a result of the Government's decision to pursue these particular targets, the focus of Audit's commentary is directed to those and associated measures.

[26] Budget Statement 2004-05, Budget Paper 3, p1.4.

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	Achieve a sustainable fiscal surplus in the General Government Sector.
Victoria	Short Term: Target Operating Surplus of $100 million for the General Government Sector (measured on AAS 31 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 accrual 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 2002-03 to 2005-06) (measured on a AAS 31 basis).
NT	To achieve an underlying cash surplus by 2004-05.
	To achieve a positive GFS operating balance within 10 years in the General Government Sector.

(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.

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.

4.3 SOME AUDIT OBSERVATIONS ON THE FISCAL MEASURES

Given the availability of common data from all jurisdictions and that it is a framework constructed for the specific issues of the public sector, the GFS financial statements and associated measures/indicators are, in Audit's opinion, appropriate for the development of the primary fiscal strategy.

However, notwithstanding that the focus on the General Government Sector within that framework is common among almost all jurisdictions, to focus on a smaller sector such as the General Government Sector introduces some issues. One of particular importance, that I have reported in past years, is the following.

The General Government Sector is only part of the overall public sector as it does not include Public Non-Financial or Public Financial Corporations. While transactions with the other sectors will be included in the General Government Sector results, I have previously reported that I believe it important that relevant information also be available for the PNFC sector in particular.

Budget papers in the past have picked up four year forward estimates for the General Government Sector. By comparison, the PNFC published data was only for the immediate budget year with some financial position data (eg. net worth) through the forward estimated period. I had stated that I believe it important that comparative period information be available for users so as not to lose sight of the broader public sector activity.

This matter has now been resolved. The 2004-05 Budget Papers include four year forward estimates for the Public Non-Financial Corporations sector and the Non-Financial Public sector. Other long term trend data is now also presented in the Budget Papers.[27]

I consider these to be improvements in the information available for the public sector that resolve the reporting matters I have previously raised.

[27] Budget Statement 2004-05, Budget Paper 3, particularly Appendix A Tables A.2, A.5, Appendix B B.3 and B.8.

5 STATEMENT OF FINANCIAL PERFORMANCE

5.1 OVERVIEW

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

- the estimated result for 2003-04, and how it compares both to the prior year numbers and the budgeted amounts;
- the Budget for 2004-05 having regard to the estimated result for 2003-04;
- a longer term view of the forecast results going forward to 2007-08.

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 2004-05 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.

- When considering the estimated result for 2003-04 it must be emphasised that these results are only estimates. Past experience has been that actual results have varied substantially from the estimated result (eg the 2002-03 General Government Sector estimated result was net lending $312 million, actual result was $414 million). While such variations have been small relative to the level of activity of the State (eg estimated expenses for 2003-04 for the General Government Sector exceed $9 billion), when the budget result target is small for a particular year, variations can be significant. This is a matter relevant to monitoring budget performance discussed later.
- 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 2003-04 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 2004-05 Budget are regarded as being of a high standard in their presentation and disclosures. Improvements in the detail of disclosure in the 2004-05 Budget Papers, such as inclusion of forward estimates data for the public non-financial corporations sector and trend data for the general government and non-financial public sector,[28] is consistent with a history of continuous improvement in financial information.

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28 Budget Statement 2004-05, Budget Paper 3, particularly Appendix A Tables A.2, A.5, Appendix B B.3 and B.8.

- 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 financial performance of the State's finances, both in terms of results over time, and against other states. These limitations are not so great as to invalidate the overall trend analysis from the Budget data, ie it is generally within reasonable limits.

5.2 INFLUENCE OF THE FISCAL STRATEGY FOR 2004-05

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

5.2.1 Balanced Budgets

The Government's primary fiscal target is 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).

This target was adopted in the 2002-03 Budget and continues in the 2004-05 Budget.

5.2.2 AAA Credit Rating Target

As noted in Section 4 of this Part of the Report, another of the Government's fiscal targets is to ensure risks to State finances are prudently managed, while maintaining at least a AA plus credit rating. Further to this, in the 2004-05 Budget the Government stated:

> *In its State Strategic Plan, the Government has announced a target of achieving a triple-A credit rating within the next three years, in line with other mainland States.*[29]

The AAA rating is the highest credit rating that applies. To achieve this, the State will have 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 AAA rating is a specific target for Government.

The considerations of rating agencies include:

- Balance sheet strength - manageable liabilities and financial risks.

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[29] Budget Statement 2004-05, Budget Paper 3, Table 1.2.

- Financial results that are sustainable and improving - certainly recurring or consecutive deficits (net borrowings) would not be acceptable especially if due to operating activities (wage and service 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.

It is apparent that these matters are consistent with the Government's fiscal targets as set out in Section 4 and that they represent what is now generally accepted by all Australian governments as good, if not expected, public sector financial management practices.

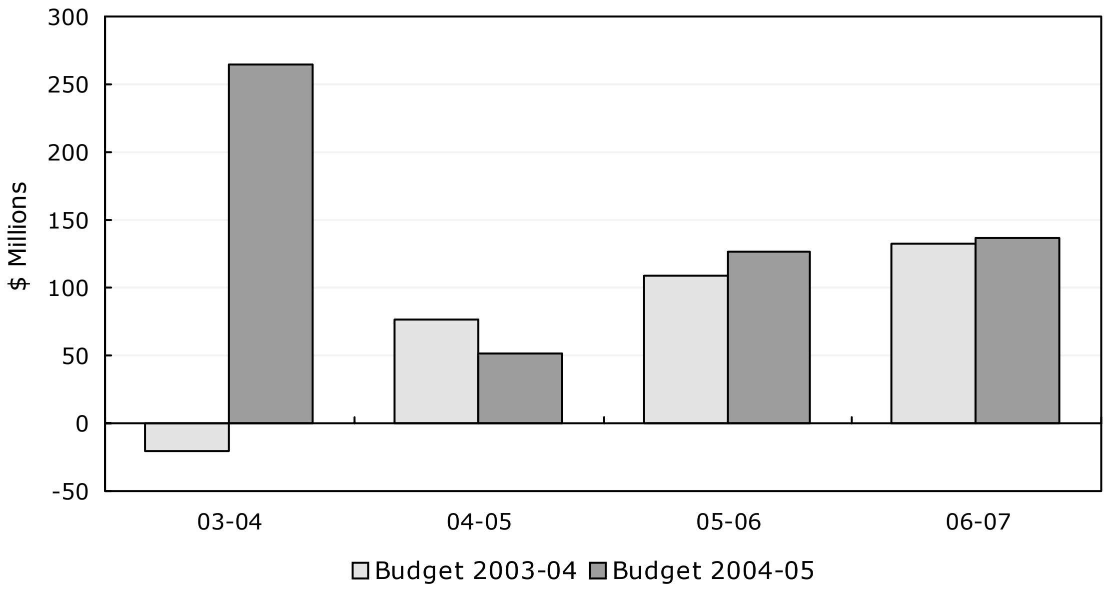
Notwithstanding, achievement of the AAA credit rating demands more than reference to these criteria. To achieve the highest rating, there can be no significant exceptions to the rating agencies' criteria. It can be expected that the Government will conduct its affairs accordingly.

5.2.3 Net Lending (Borrowing) - Comparison of 2003-04 and 2004-05 Budgets

The 2004-05 Budget identifies an estimated surplus of $264 million for 2003-04 compared to a deficit of $20 million estimated in the 2003-04 Budget. The Government has 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 2003-04 Budget Papers and the 2004-05 Budget Papers.

Net Lending (Borrowing) Budget 2003-04 to Budget 2004-05



The chart highlights the substantial change in the estimated result for 2003-04 from budget. The Government estimates for surpluses for the three years to 2006-07 are consistent with the estimates made for the 2002-03 Budget.

5.3 ESTIMATED RESULT FOR 2003-04

5.3.1 General Government Sector

The estimated result for the year was a GFS net lending result of $264 million, which is an improvement of $284 million from the budget for the year. The estimated result was $150 million lower than the previous year's result.

The following table shows the estimated result for 2003-04 in comparison to the original budget estimate, and the actual result for the 2002-03 financial year, and identifies the differences to the 2003-04 Budget.

Table 5.1 — General Government Budget Comparisons 2002-03 to 2003-04

	2002-03 Actual $'million	**2003-04 Budget $'million**	**2003-04 Estimated Result $'million**	Difference to Budget $'million	Difference to Budget Percent
GFS Revenue					
Taxation revenue	2 431	2 463	2 783	320	13
Current grants	4 638	4 729	4 916	187	4
Capital grants	209	166	165	(1)	(1)
Sales of goods and services	997	952	1 049	97	10
Interest income	146	123	159	36	29
Distributions from PFCs	332	96	96	-	-
Distributions from PNFCs	300	351	362	11	3
Other	293	282	264	(18)	(6)
Total Revenue	9 346	9 161	9 793	632	7
Less: **GFS Expenses**					
Gross operating expenses					
Employee expenses	3 997	4 087	4 271	184	5
Depreciation	401	410	427	17	4
Other operating expenses*	2 126	2 220	2 310	90	4
Nominal superannuation interest expense	299	337	354	17	5
Other interest expense	297	249	269	20	8
Current transfers*	1 724	1 777	1 868	91	5
Capital transfers	54	23	29	6	26
Total Expenses	8 898	9 103	9 528	425	5
GFS Net Operating Balance	448	58	264	206	355
Less: **Net Acquisition of Non-Financial Assets**					
Purchases of non-financial assets	474	535	563	28	5
Less: Sales of non-financial assets	41	49	138	89	182
Less: Depreciation	401	410	427	17	4
Add: Change in inventories	2	2	2	-	-
Total net acquisition of non-financial assets	34	78	-	(78)	(100)
GFS Net Lending (Borrowing)	414	(20)	264	284	-

Note: Totals may not add due to rounding.

* 2003-04 Budget data is adjusted for $261 million grants reclassified from Other Operating expenses to Current transfers.

As shown above, events have occurred during the 2003-04 financial year resulting in significant changes to the original budget estimates. In total, the variances have resulted in a better than budgeted estimated GFS net lending (borrowing) result, reversing the result to an estimated net lending position.

The primary reasons for the change in the original budget result are as follows:

- ***Taxation Revenue*** — stamp duties on conveyances were estimated to exceed expectations by $224 million due mainly to a stronger than budgeted for property market. In addition, most other taxes also were above the original Budget amounts.

- ***Current Grants*** — the increase relates primarily to better than expected receipts of GST revenue grants (up $99 million) and specific purpose payments (up $61 million) from the Commonwealth.

- ***Sales of Goods and Services*** — the increase reflects higher land transfer fees reflecting the buoyancy in the property market, additional Commonwealth funding relating to energy-efficiency programs and the recognition of ambulance fees following the reclassification of the South Australian Ambulance Service into the General Government Sector.

- ***Expenses*** — increases in employee expenses including settlement of awards, operating expenses including an unbudgeted payment of $54.6 million for implementation of gas full retail contestability.

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

The nature of the movement in net lending (borrowing) is generally consistent with the previous year. Limiting the extent of over-run of total operating expenses has resulted in revenue gains flowing through to the 'bottom line'.

5.3.1.1 Net Acquisition of Non-Financial Assets

In past years, capital underspending against budget has been substantial. The 2002-03 result for gross fixed capital formation was $132 million under budget.[30]

It is notable that the 2003-04 estimated result for purchases of non-financial assets is expected to exceed the budget. The 2003-04 budget for purchases of non-financial assets of $535 million, included a slippage allowance[31] 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.

The estimated result does not include the slippage allowance but does include purchases and sales of motor vehicles due to changed reporting arrangements for motor vehicle sales since the 2003-04 Budget.

When sales of non-financial assets (which exceed budget by $89 million) are taken into account, purchases net of sales total $425 million, $61 million under budget.

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30 Final Budget Outcome 2002-03 p9.

31 Budget Statement 2004-05, Budget Paper 3, Table 2.22.

Underspending has been carried forward into the forward estimates consistent with past practice.

Total net acquisition of non-financial assets for 2003-04 is estimated to be $78 million under budget, thereby contributing significantly to the improvement in the net lending (borrowing) result but essentially only due to the delayed timing of expenditure.

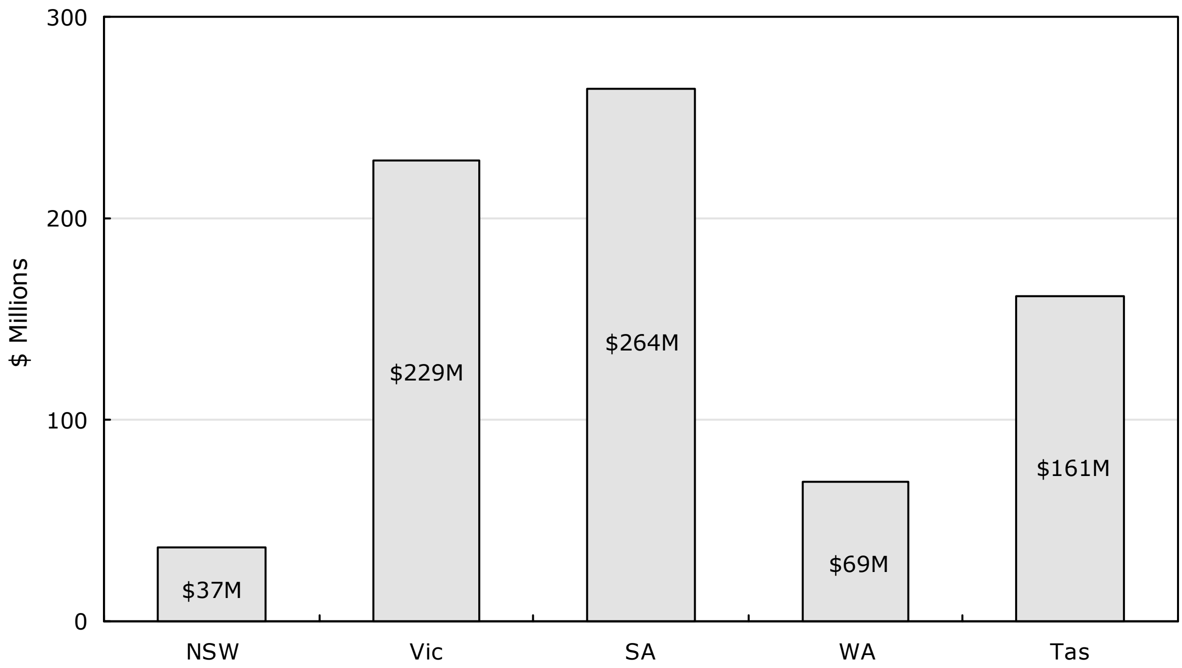
5.3.1.2 Application of the Result

The result for 2003-04 is essentially reflected in the change in net debt, which at 30 June 2004 is estimated to be $382 million for the General Government Sector, down $284 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 2004. 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.

GFS - General Government Sector Estimated Net Lending (Borrowing) Result for 2003-04



Source: NSW, Vic, WA and Tas data have been sourced from the jurisdictions' 2004-05 Budget Papers.

Queensland, which is not shown on the chart, estimates net lending for 2003-04 of $1.7 billion, benefiting from funded superannuation liabilities and strong investment income. The chart shows that the estimated result for South Australia for 2003-04 is the highest of the other States shown on the chart, notwithstanding that South Australia is the second smallest by financial activity.

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 $142 million, which is an improvement of $268 million from the budget for the year.

The result was $263 million lower than the previous year's result due to significantly higher estimated total expenses in 2003-04 compared to 2002-03.

The following table shows the estimated result for 2003-04 in comparison to the original budget estimate, and the actual result for the 2002-03 financial year, and identifies the differences to the 2003-04 Budget.

Table 5.2 — NFPS Budget Comparisons 2002-03 to 2003-04

	2002-03 Actual $'million	**2003-04 Budget $'million**	**2003-04 Estimated Result $'million**	Difference to Budget $'million	Difference to Budget Percent
GFS Revenue					
Taxation revenue	2 272	2 287	2 609	322	14
Current grants	4 641	4 729	4 917	188	4
Capital grants	237	166	182	16	10
Sales of goods and services	2 272	2 108	2 224	116	6
Interest income	103	89	117	28	31
Other	648	465	430	(35)	(8)
Total Revenue	10 172	9 845	10 478	633	6
Less: **GFS Expenses**					
Gross operating expenses					
Employee expenses	4 167	4 243	4 432	189	4
Depreciation	603	614	635	21	3
Other operating expenses*	2 919	2 951	3 079	128	4
Nominal superannuation interest expense	299	337	354	17	5
Other interest expense	374	342	353	11	3
Other property expense	3	5	6	1	20
Current transfers*	1 276	1 314	1 355	41	3
Capital transfers	54	29	35	6	21
Total Expenses	9 696	9 834	10 248	414	4
GFS Net Operating Balance	476	11	230	219	1991
Less: **Net Acquisition of Non-Financial Assets**					
Purchases of non-financial assets	783	909	952	43	5
Less: Sales of non-financial assets	117	160	231	71	44
Less: Depreciation	603	614	635	21	3
Add: Change in inventories	9	2	2	-	-
Total Net Acquisition of Non-Financial Assets	72	137	88	(49)	(36)
GFS Net Lending (Borrowing)	405	(126)	142	268	(213)

Note: Totals may not add due to rounding.

* 2003-04 Budget data is adjusted for $261 million grants reclassified from Other Operating expenses to Current transfers.

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 in line with the 2003-04 Budget with net borrowing estimated to be $123 million[32] (budget $106 million).

5.3.3 The Consolidated Account Outcome

As discussed, 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 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 appropriation authorised under various acts.

Total appropriation authority for 2003-04 was $6.5 billion, including the Governor's Appropriation Fund, but excluding specific appropriations authorised in various acts. Actual payments were $6.3 billion, excluding specific appropriations authorised in various acts, well within appropriation authority.

The result on the Consolidated Account for 2003-04 was a surplus of $329 million ($444 million in 2002-03). This surplus was determined after total receipts of $6.7 billion and payments of $6.4 billion.

The surplus of $329 million exceeded the budgeted amount by $364 million.

This surplus was used to repay borrowings from SAFA. This is reflected in the reduction in net debt as at 30 June 2004 as previously discussed.

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

- Large increases in stamp duties receipts of $287 million due to higher than expected activity in the property sector.

- Commonwealth General Purpose Grants exceeding budget by $83 million, mainly through GST revenue grants increasing by $91 million after adjusting for movements in GST transitional grants.

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'.[33]

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32 Budget Statement 2004-05, Budget Paper 3, Appendix A Table A.2.

33 Report of the Auditor-General for the year ended 30 June 2004, Part B, Volume V, Appendix.

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 2003-04 Budget included contingency funds[34] totalling $119 million ($98 million), which when added to the $182 million ($184 million) available from the GAF provided flexibility within the Budget of $301 million ($282 million) or 4.9 percent (4.7 percent) of the total of the *Appropriation Act 2003* less the total of budgeted contingency funds.

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 2003-04.

Table 5.3 — Appropriation Flexibility

	Authority/ Budget $'million	**Actual Payments $'million**
Governor's Appropriation Fund	182	134
Total contingency provisions	119	128
Total Flexibility	301	262

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 Statements.[35] The main items were for a payment of $55 million for implementation of gas full retail contestability, additional funding of $29 million to Department of Human Services, (including $16 million for additional nurses) and $25 million to Transport Services relating to transfer of fines to the Community Road Safety Fund.

Contingency Provisions

Details of payments from the contingency funds are not disclosed in the Treasurer's Financial Statements. Payments are transfers of additional funding to agencies. These payments are included within the total payments amounting to $1 billion from the line 'Administered Items for Department of Treasury and Finance' in Statement A of the Treasurer's Statements.[36]

[34] Note that some contingency funds are committed to identified purposes subject to further consideration and approval.

[35] Report of the Auditor-General for the year ended 30 June 2004, Part B, Volume V, Appendix.

[36] Report of the Auditor-General for the year ended 30 June 2004, Part B, Volume V, Appendix.

The following table shows where contingency funds were applied in 2003-04.

Table 5.4 Application of Contingency Funds

Purpose	**Amount Issued $'million**
Department for Human Services (DHS)	113
Further Education, Employment, Science and Technology	5
Premier and Cabinet	4
Other	6
Total Contingency Payments	128

The major reasons for the transfers to DHS were the settlement of enterprise bargaining arrangements for salaried and visiting medical officers during 2003-04.

The original amounts set aside for contingency provisions are within the appropriation line 'Administered Items for the Department of Treasury and Finance,[37]. 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 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 Statements.

Spending decisions in 2003-04 resulted in section 13 transfers amounting to $96 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 Statements.[38]

The main items were a $96 million transfer from the Department of Administrative and Information Services, a transfer of $41 million to the Department of Human Services and a transfer of $25 million to Administered Items for the Department of Treasury and Finance for various items.

As can be seen from the preceding discussion and table, the flexibility arrangements within the 2003-04 Budget were sufficient to meet additional costs.

5.4 AAS 31 RESULTS

The following briefly discusses the financial result of the AAS 31 statements as at 30 June 2003. As previously discussed, there are some limitations in analysing AAS 31 data particularly due to the timing of its preparation each year. They do, however, provide the opportunity to observe the financial result of the Government using a full

[37] 2003-04 Portfolio Statements, Budget Paper 4 p3.23 and 3.25.

[38] Report of the Auditor-General for the year ended 30 June 2004, Part B, Volume V, Appendix.

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 2003, with comparative amounts for the preceding four years.

Table 5.5 — AAS 31 Financial performance (1999-2003)

	1999 $'million	2000 $'million	2001 $'million	2002 $'million	2003 $'million
Revenues					
Taxation	1 729	2 081	2 024	2 037	2 272
Grants	3 697	3 925	4 361	4 807	5 010
Sale of goods and services	4 163	3 975	3 321	2 571	2 898
Investment revenues	1 048	1 552	871	811	878
Net revenues from asset disposals [(a)]	64	1 137	268	63	28
Other	327	388	525	1 010	906
Total Operating Revenues	11 028	13 058	11 370	11 299	11 992
Expenses					
Employee expenses	3 660	3 298	3 526	4 942	5 032
Supplies and services	2 814	3 149	3 008	2 665	2 713
Grants and subsidies	1 387	1 497	1 356	1 380	1 395
Borrowing cost expenses	1 554	2 119	921	757	761
Other	1 953	1 908	1 734	2 581	3 000
Total Operating Expenses	11 368	11 971	10 545	12 325	12 901
Net Surplus (Deficit)	(340)	1 087	825	(1 026)	(909)
Increase in asset revaluation reserve	215	353	1 184	666	1 495
Increase (Decrease) in adoption of new standard	(178)	6	348	2	(10)
Total Changes in Equity	(303)	1 446	2 357	(358)	576

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

The following briefly explains the large movements in 2003 revenue and expense amounts.

Revenue

Total operating revenue for the 2002-03 financial year was $12 billion; an increase of $693 million on the revenues earned in the 2001-02 financial year. The increase was due mainly to the following:

- ***Taxation*** — increased by $235 million due mainly to increase in property related taxes, gambling revenue and stamp duty on insurance.
- ***Grants*** — Commonwealth Government grants increased by $120 million, including an increase in general purpose grants of $107 million.
- ***Sales of Goods and Services*** — increased by $327 million due mainly to the inclusion in 2002-03 of WorkCover Corporation in the AAS31 Statements for the first time.

Expenses

Total expenses increased by $576 million during the financial year. The increase was due mainly to:

- ***Other Expenses*** — increased by $419 million due mainly to the inclusion in 2002-03 of WorkCover Corporation in the AAS31 Statements for the first time.

5.5 2004-05 BUDGET

The following focuses on the trends arising from the 2004-05 Budget tabled in Parliament in May 2004. It provides an overview of the expected result for 2004-05 and provides the context for discussion on individual lines of the Budget hereunder in this Part. Given that the fiscal targets are now focused on the accrual-based GFS framework, the analysis deals only with that framework.

5.5.1 Matters of Significance to the 2004-05 Budget

It is projected that the key fiscal target to achieve, on average, balanced budgets in the General Government Sector will be exceeded over the Budget forward estimates to 2007-08.

Some matters of significance to the 2004-05 Budget estimates years, are:

- New expenditure initiatives totalling $1150 million over the next four years;[39]
- targeted savings totalling $235 million over four years;[40]
- taxation measures designed to bring in $181 million less over four years;[41]
- reliance on distributions from the Public Financial Corporations Sector of government amounting to $280 million over four years,[42] of which $255 million is from two entities;
- reliance on distributions from the Non-financial Corporations Sector of government amounting to $1.2 billion over four years.[43]

5.5.2 General Government Sector - Operating Statement

The Budget presented to Parliament in May 2004 details a budget GFS net lending result for 2004-05 of $52 million, a decrease of $212 million on the estimated 2003-04 result.

39 Budget Statement 2004-05, Budget Paper 3, Table 2.1.

40 Budget Statement 2004-05, Budget Paper 3, Table 2.2.

41 Budget Statement 2004-05, Budget Paper 3, Table 3.1.

42 Budget Statement 2004-05, Budget Paper 3, Table 3.15.

43 Ibid

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

Table 5.6 — General Government Budget Comparison 2003-04 and 2004-05

	2003-04 Estimated Result $'million	2004-05 Budget $'million	Difference $'million	Difference Percent
GFS Revenue				
Taxation revenue	2 783	2 780	(3)	(0.1)
Current grants	4 916	5 051	135	2.7
Capital grants	165	177	12	7.3
Sales of goods and services	1 049	1 101	52	5.0
Interest income	159	161	2	1.3
Distributions from PFCs	96	124	28	29.2
Distributions from PNFCs	362	299	(63)	(17.4)
Other	264	304	40	6.8
Total Revenue	9 793	9 997	204	2.1
Less: **GFS Expenses**				
Gross operating expenses				
Employee expenses	4 271	4 406	135	3.2
Depreciation	427	452	25	5.9
Other operating expenses	2 310	2 491	181	7.8
Nominal superannuation interest expense	354	338	(16)	(4.5)
Other interest expense	269	263	(6)	(2.2)
Current transfers	1 868	1 914	46	2.5
Capital transfers	29	17	(12)	(41.4)
Total Expenses	9 528	9 881	353	3.7
GFS Net Operating Balance	264	116	(148)	(56.1)
Less: **Net Acquisition of Non-Financial Assets**				
Purchases of non-financial assets	563	627	64	11.4
Less: Sales of non-financial assets	138	111	(27)	(19.6)
Less: Depreciation	427	452	25	5.9
Add: Change in inventories	2	-	(2)	100.0
Total Net Acquisition of Non-Financial Assets	-	64	64	-
GFS Net Lending (Borrowing)	264	52	(212)	(80.3)

Note: Totals may not add due to rounding.

It can be seen from the above table that the difference for the 2004-05 year is due mainly to:

- total revenue rising in line with inflation (CPI is forecast to be 2 percent for South Australia in 2004-05)[44] due to a forecast drop in taxation revenue (reflecting expected softening of property markets in 2004-05) and a reduction in distributions from PNFCs (2003-04 included a one-off $50 million special dividend from the Land Management Corporation) offsetting increases in other revenue items;
- 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 2004-05;
- an increase in total net acquisition of non-financial assets of $64 million.

[44] Budget Statement 2004-05, Budget Paper 3, Table 8.1.

An important feature of the 2004-05 budget is the allowance for a downturn in property activity compared to the high level of growth which was sustained for the previous two 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 2004-05 of $2.8 billion, is $587 million or 27 percent more than the 2001-02 actual total of $2.2 billion.

A further notable feature is that given that budget operating results are relatively minor for 2004-05 (ie a positive net operating result of $116 million representing 1.2 percent of total revenue of $10 billion), the discretionary distributions totalling $124 million, from the PFCs enable the achievement of the net lending of $52 million.

More detail of the factors influencing the 2004-05 Budget are considered in the context of the longer-term trends discussed later in this Report.

5.5.3 Changes in 2004-05 General Government Sector Budgeted Results

Another view of the 2004-05 budget is provided when comparing it to the previous estimate for the 2004-05 year as provided in the 2003-04 Budget Papers. Differences between the estimate and the 2003-04 budget are set out in the following table.

Table 5.7 — General Government Comparison of Estimate and Budget for 2004-05

	2004-05 (2003-04 Budget) Estimated $'million	2004-05 (2004-05 Budget) Budget $'million	Difference $'million	Difference Percent
GFS Revenue				
Taxation revenue	2 559	2 780	221	8.6
Current grants	4 802	5 051	249	5.2
Capital grants	158	177	19	12.0
Sales of goods and services	981	1 101	120	12.2
Interest income	129	161	32	24.8
Distributions from PFCs	124	124	-	-
Distributions from PNFCs	294	299	5	1.7
Other	300	304	4	1.3
Total Revenue	9 347	9 997	650	7.0
Less: **GFS Expenses**				
Gross operating expenses				
Employee expenses	4 156	4 406	250	6.0
Depreciation	413	452	39	9.4
Other operating expenses*	2 271	2 491	220	9.7
Nominal superannuation interest expense	345	338	(7)	(2.0)
Other interest expense	255	263	8	3.1
Current transfers*	1 782	1 914	132	7.4
Capital transfers	17	17	-	-
Total Expenses	9 239	9 881	642	6.9
GFS Net Operating Balance	108	116	8	7.4
Less: **Net Acquisition of Non-Financial Assets**				
Purchases of non-financial assets	468	627	159	34.0
Less: Sales of non-financial assets	24	111	87	-
Less: Depreciation	413	452	39	9.4
Total Net Acquisition of Non-Financial Assets	31	64	33	106.5
GFS Net Lending (Borrowing)	77	52	(25)	(32.5)

Note: Totals may not add due to rounding.
* 2003-04 Budget data is adjusted by $201 million grants reclassified from Other Operating expenses to Current transfers.

This presentation confirms that the budget for 2004-05 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 $650 million or 7 percent higher than was estimated in the 2003-04 Budget, the budgeted net lending for the 2004-05 year is a $25 million deterioration over the earlier estimate due mainly to:

- a real increase in total operating expenses that absorb virtually all of the revenue increase such that there is an improvement in the GFS Net Operating Balance of only $8 million over the earlier estimate;
- an increase in the net acquisition of non-financial assets of $33 million. This includes the effect of carry-over expenditure from the previous year. 2004-05 Budget data for purchases and sales is also grossed up for motor vehicle transactions, a revised approach from the previous year.

5.5.4 Reconciliation of General Government 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 2003-04 Budget.[45]

Table 5.8 Reconciliation of General Government Net Lending

	2003-04 Budget $'million	2004-05 Budget $'million	2005-06 Estimate $'million	2006-07 Estimate $'million
2003-04 Budget	**(20)**	**77**	**109**	**133**
Parameter and other variations				
Revenue - taxation	320	261	234	251
Revenue - other	312	414	382	370
Operating expenses	(271)	(472)	(404)	(479)
Net capital investment expenditure	52	(23)	(26)	5
Net Effect of Parameter and Other Variations	**413**	**180**	**186**	**147**

[45] Budget Statement 2004-05, Budget Paper 3, Table 1.7.

Table 5.8 Reconciliation of General Government Net Lending *(continued)*

	2003-04 Budget $'million	2004-05 Budget $'million	2005-06 Estimate $'million	2006-07 Estimate $'million
Policy measures				
Revenue - other	-	16	20	22
Revenue - taxation	-	(40)	(45)	(47)
Operating expenses	(183)	(239)	(257)	(269)
Net capital investment expenditure	26	(60)	(6)	(68)
Net Effect of Policy Measures	**(157)**	**(323)**	**(288)**	**(362)**
Use of Provisions Set Aside in the 2003-04 Budget and the 2003-04 MYBR				
Operating expenses	29	70	70	41
Capital investment expenditure	-	50	50	179
Net Effect of Use of Provisions Set Aside	**29**	**120**	**120**	**220**
2004-05 Budget	**264**	**52**	**126**	**137**

Revenues

The table shows that revenue changes since the 2003-04 Budget are virtually all due to parameter changes. The following table shows the major components of revenue changes.

Table 5.9 Revenue Parameter Changes

	2003-04 Budget $'million	2004-05 Budget $'million	2005-06 Estimate $'million	2006-07 Estimate $'million
Property related taxes	263	198	162	174
GST revenue grants	84	27	(2)	(3)
Specific purpose grants	55	111	85	71
General purpose grants	15	92	93	144
Total	**417**	**428**	**338**	**386**

Operating Expenses

Table 5.8 shows that parameter effects are estimated to add operating expenses of $1.6 billion over the four years to 2006-07. These include corrections totalling $288 million (over four years) for Department of Human Services estimates identified at the mid year budget review, inclusion of SA Ambulance Service in the General Government Sector (expenses in the order of $50 million per annum essentially offset by equivalent revenue parameter effect).

Policy spending decisions have added $948 million to operating expenses over the four year period.

5.5.5 Public Non-Financial Corporation Sector - Operating Statement

The GFS net borrowing result for the Public Non-Financial Corporation (public trading enterprises) Sector is budgeted to be a surplus of $37 million, a $160 million improvement on the estimated result for 2003-04 ($123 million deficit). The differences between the two years are set out in the following table.

Table 5.10 — PNFC Budget Comparison 2003-04 and 2004-05

	2003-04 Estimated Result $'million	2004-05 Budget $'million	Difference $'million	Difference Percent
GFS Revenue				
Current grants	541	572	31	5.7
Capital grants	17	31	14	82.4
Sales of goods and services	1 314	1 310	(4)	(0.3)
Interest income	16	17	1	6.3
Other	70	91	21	30.0
Total Revenue	1 959	2 020	61	3.1
Less: **GFS Expenses**				
Gross operating expenses				
Employee expenses	199	211	12	6.0
Depreciation	208	217	9	4.3
Other operating expenses	1 051	1 027	(24)	(2.3)
Other interest expense	143	144	1	0.7
Other property expense	361	298	(63)	(17.5)
Current transfers	27	43	16	59.3
Capital transfers	6	6	-	-
Total Expenses	1 994	1 946	(48)	(2.4)
GFS Net Operating Balance	(35)	75	110	-
Less: **Net Acquisition of Non-Financial Assets**				
Purchases of non-financial assets	399	358	(41)	(10.3)
Less: Sales of non-financial assets	104	103	(1)	(1.0)
Less: Depreciation	208	217	9	4.3
Total Net Acquisition of Non-Financial Assets	88	38	(50)	(56.8)
GFS Net Lending (Borrowing)	(123)	37	160	(130.1)

Note: Totals may not add due to rounding.

The improvement in the 2004-05 budget results from expected growth in revenues and reductions in budgeted expenses.

This is further improved by reduced purchases of non-financial assets.

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 Corporation sectors. The budgeted result for the Non-Financial Public Sector is net lending of $89 million, that is a deterioration of $53 million from the 2003-04 estimated result. Explanations for the change are consistent with those described for the two sectors above. Detail supporting this result is provided in the 2004-05 Budget Papers.[46]

5.6 A LONGER TERM PERSPECTIVE OF FINANCIAL PERFORMANCE

The Budget presented by the Government also includes forward projections extending to the 2007-08 year in addition to the detailed information relating to the 2004-05 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 for the first time in the Appendices to the Budget Statement 2004-05, Budget Paper 3.

5.6.1 General Government Sector Operating Statement Time Series

The table on the following page provides a 10 year time series for those individual elements that contribute to the budget result.

The table highlights that although the net lending result is budgeted to decrease by $212 million to $52 million in 2004-05, the net lending result is expected to increase in the following three years.

If the forecast result is achieved over the four years of the 2004-05 Budget, the Government will have exceeded a key fiscal target, which is to achieve, on average, balanced budgets in the General Government Sector.

[46] Budget Statement 2004-05, Budget Paper 3, Appendix A, Table A.3.

Table 5.11 - GFS - General Government Sector Operating Statement
Time Series Note - Totals may not add due to rounding

	1998-1999	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08
GFS Revenue	**Actual $'million**	**Actual $'million**	**Actual $'million**	**Actual $'million**	**Actual $'million**	**Estimated Result $'million**	**Budget $'million**	**Estimate $'million**	**Estimate $'million**	**Estimate $'million**
Taxation revenue	2 433	2 748	2 197	2 193	2 431	2 783	2 780	2 798	2 917	3 009
Current grants	2 875	3 098	3 992	4 485	4 638	4 916	5 051	5 222	5 439	5 685
Capital grants [(a)]	-	-	-	-	209	165	177	137	131	151
Sales of goods and services	733	696	982	902	997	1 049	1 101	1 120	1 131	1 163
Interest income	143	215	169	131	146	159	161	162	171	186
Distributions from PFCs	n.a.	33	44	50	332	96	124	113	22	22
Distributions from PNFCs	n.a.	458	278	241	300	362	299	297	296	302
Other	1 034	399	446	536	293	264	304	320	334	333
Total Revenue	7 218	7 644	8 108	8 538	9 346	9 793	9 997	10 169	10 441	10 851
***Less:* GFS Expenses**										
Gross operating expenses	4 973									
Employee expenses	n.a.	3 281	3 517	3 828	3 997	4 271	4 406	4 528	4 652	4 800
Depreciation	323	337	322	390	401	427	452	448	457	465
Other operating expenses	n.a.	2 076	2 376	2 270	2 126	2 310	2491	2 508	2 541	2 675
Nominal superannuation interest expense	277	274	248	244	299	354	338	343	347	351
Other interest expense	643	601	353	272	297	269	263	249	226	213
Current transfers	1 213	1 345	1 545	1 663	1 724	1 868	1 914	1 962	2 023	2 076
Capital transfers	76	59	43	44	54	29	17	15	19	17
Total Expenses	7 505	7 974	8 406	8 713	8 898	9 528	9 881	10 051	10 265	10 596
GFS Net Operating Balance	(287)	(330)	(297)	(174)	448	264	116	118	176	255
Less: **Net Acquisition of Non-Financial Assets**										
Purchases of non-financial assets[(b)]	364	478	457	508	474	563	627	560	599	655
Less: Sales of non-financial assets	n.a.	n.a.	30	171	41	138	111	120	103	100
Less: Depreciation	323	337	322	390	401	427	452	448	457	465
Add: Change in inventories	(2)	-	(3)	3	2	2	-	-	-	-
Add: Other movements in non-financial assets	(21)	-	-	-	-	-	-	-	-	-
Total net acquisition of non-financial assets	19	140	102	(50)	34	-	64	(8)	39	90
GFS Net Lending/(Borrowing)	(306)	(471)	(399)	(124)	414	264	52	126	137	165

(a) Prior to 2002-03, capital grants were not reported separately but were included in 'other' revenue.
(b) 1998-99 and 1999-2000 net of sales of non-financial assets.

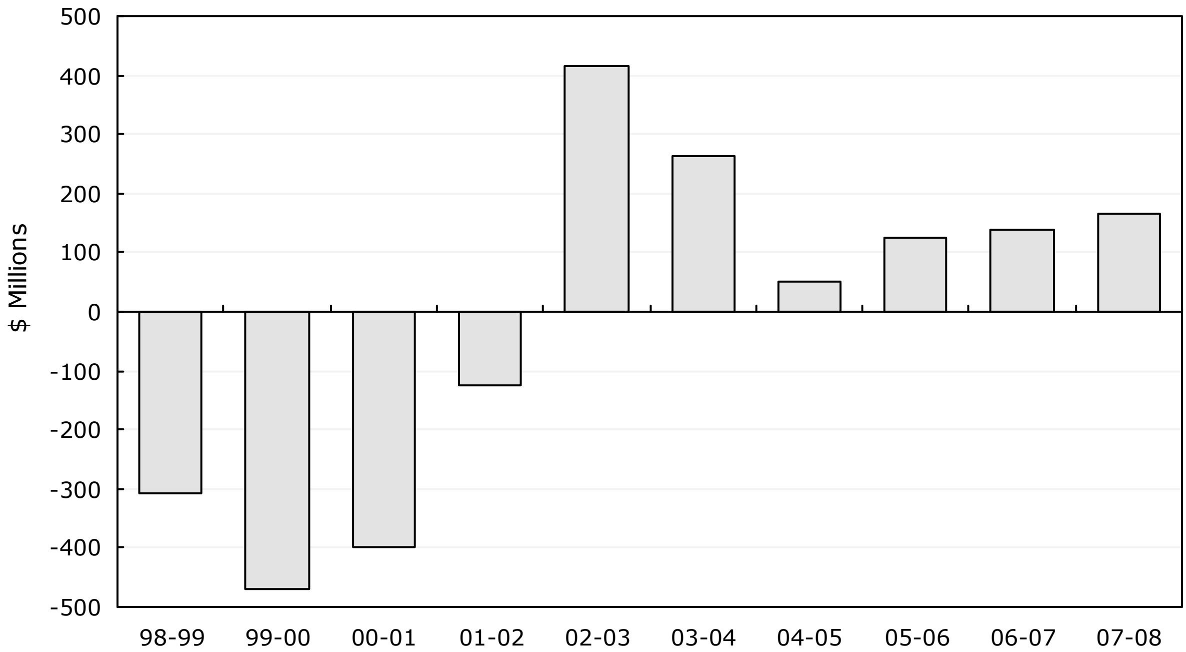
The following discussion explores some of the key indicators arising from the historic and forecast data.

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 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.

GFS - General Government Sector Net Lending (Borrowing) Result



The chart shows that the movement in the State's net lending (borrowing) result is forecast to improve each year from 2004-05 following a significant reduction from 2002-03. The projected net lending outcomes are estimated to total $480 million over the four years to 2007-08.

The fiscal target to achieve, on average, balanced budgets in the General Government Sector was adopted in the 2002-03 Budget. Results prior to 2002-03 are not directly comparable on a policy basis, as other fiscal targets were in place. Since the current policy was adopted, it has been, or is estimated to be, exceeded in both completed financial years since that Budget.

It is now forecast that the fiscal target will be exceeded through the period covered by the 2004-05 Budget which if achieved, will have consolidated a marked change in results compared to the first four years shown in the chart.

It is important to note that before 2002-03 it had been practice to defer transferring budgeted discretionary distributions from the PFCs if the distributions were not required. Table 5.7 shows that up to 2001-02 distributions from PFCs never exceeded $50 million in a year notwithstanding much larger budgeted amounts.

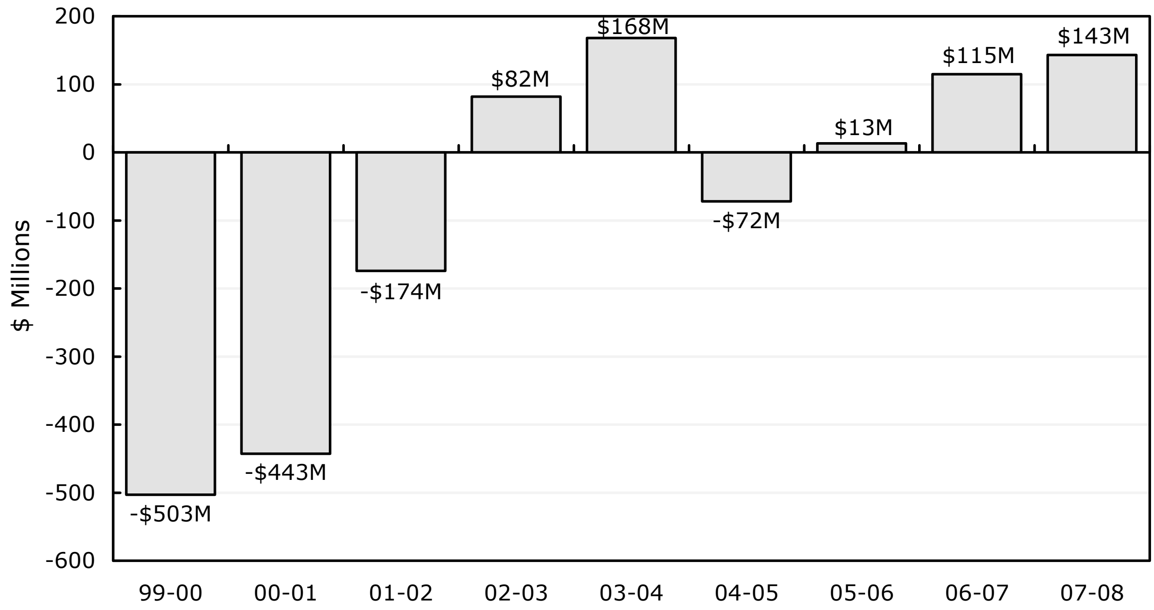
As an example in 2001-02, $296 million was budgeted to be distributed by the South Australian Asset Management Corporation and South Australian Government Financing Authority but $277 million of this was deferred. Had the budgeted distribution occurred, the result for 2001-02 would have been a surplus of $153 million. In turn, the result for 2002-03 would have been markedly lower, as the estimated revenues from PFCs for 2002-03 in the 2001-02 Budget, was $116 million, but the amount received in 2002-03 was $327 million.

This highlights the significance of discretionary distributions to the reported result.

5.6.3 Net Lending (Borrowing) before PFC Distributions

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.

Net Lending (Borrowing) before PFC Distributions



The chart shows the importance of PFC distributions as the adjusted results are significantly reduced. The 2003-04 result is also assisted by a special dividend of $50 million from the Land Management Corporation, part of the PNFC sector. It is not until 2006-07 that the surpluses are not heavily influenced by PFC distributions. Nonetheless, the fiscal target of on average balanced budgets is still achieved over the four years of the 2004-05 Budget and is rising to 2007-08.

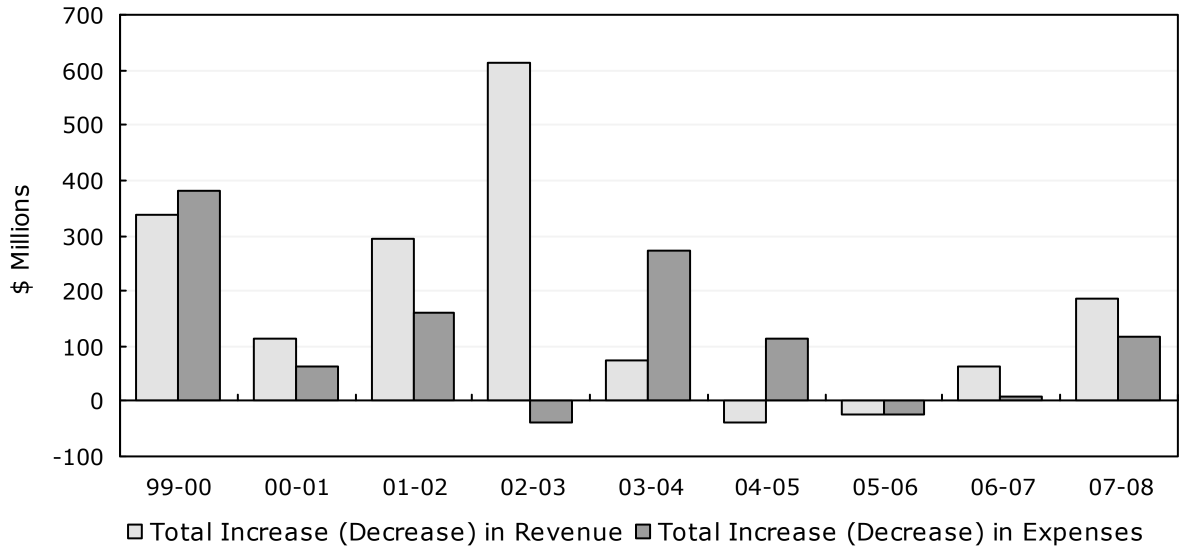
It is important to note that it is appropriate to expect distributions to the General Government Sector from PFCs. These distributions are discretionary and simply transfers between sectors of government. It is the variance between the years that is important when considering trends over the years.

5.6.4 Net Operating Balance Influences

Having established that notwithstanding PFC distributions, the net lending result improves over the period of the 2004-05 Budget, it is useful to consider how the current operating surplus, determined by GFS revenues less GFS expenses, is in turn proposed to improve.

The following chart shows the increase or decrease, in real terms, of total revenue and total expenses to the previous year for the nine years to 2007-08.

Increase/Decrease of Total Revenue and Total Expenses to Previous Year (a)



(a) Estimated June 2004 values.

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 five years to 2003-04. Total revenues are then estimated to reduce in the two years to 2005-06 and again grow in the last two years to 2007-08. As previously noted, the decrease in 2004-05 is due to an expected slow down in property based revenues. This is also the case for 2005-06.

Total Expenditure

For total expenditure, it is notable that in the six years to 2004-05, only in 2002-03 is there a decrease in real terms. The 2004-05 budget proposes real increases in expenses of $112 million over 2003-04.

It is then forecast that total expenses will reduce by $24 million in 2005-06 and increase marginally by $10 million in 2006-07 before increasing by $117 million in 2007-08.

The projected current operating surplus for two of the four years of the 2004-05 Budget is subject to highly constrained expenditure. This has been the case in past budgets.

The chart, however, shows that experience to 2003-04 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 2008.

The following table shows 2004-05 budgeted GFS total revenue for each state.

Table 5.12 2004-05 Budgeted GFS Total Revenue by State

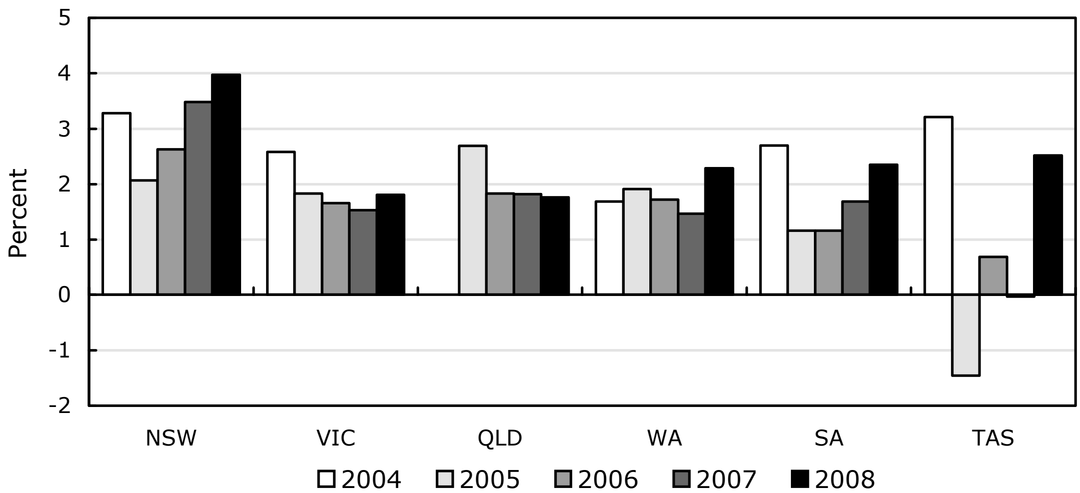
State	NSW $'million	Victoria $'million	Queensland $'million	WA $'million	SA $'million	Tasmania $'million
GFS Total Revenue	40 361	28 965	24 009	12 719	9 997	3 090

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

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 2004-05 with projected increases over the budget period. Given the relative size of the different states, the trend in South Australia's result is in line with the other states. Note that Queensland's net operating balance was $2.4 billion, benefiting from funded superannuation liabilities and strong investment income in 2003-04. Due to the size of this result it is omitted from the chart to assist legibility.

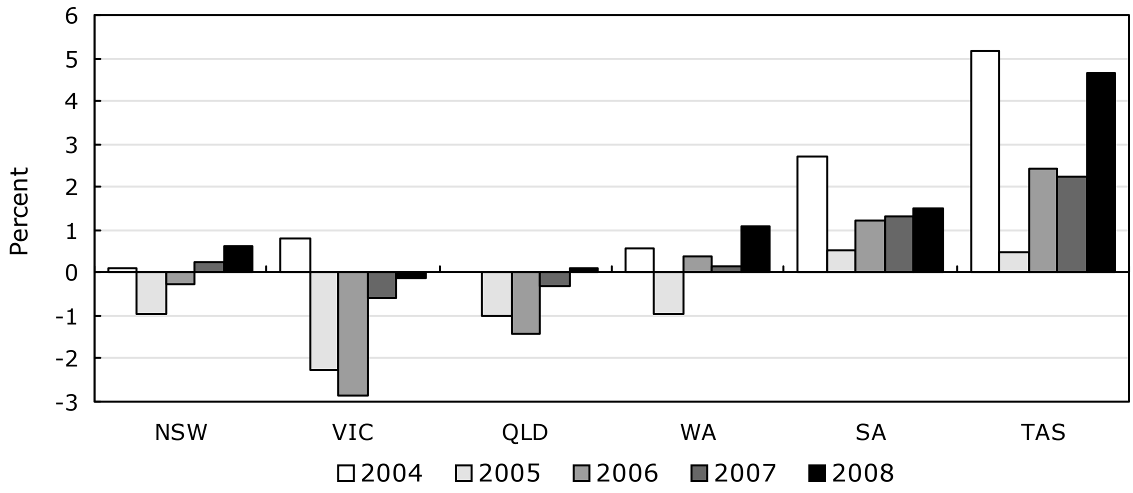
The chart also shows that South Australia's net operating balance as a proportion of GFS total revenue, compares favourably with the estimates of the majority of other states in 2007 and 2008.

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.

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



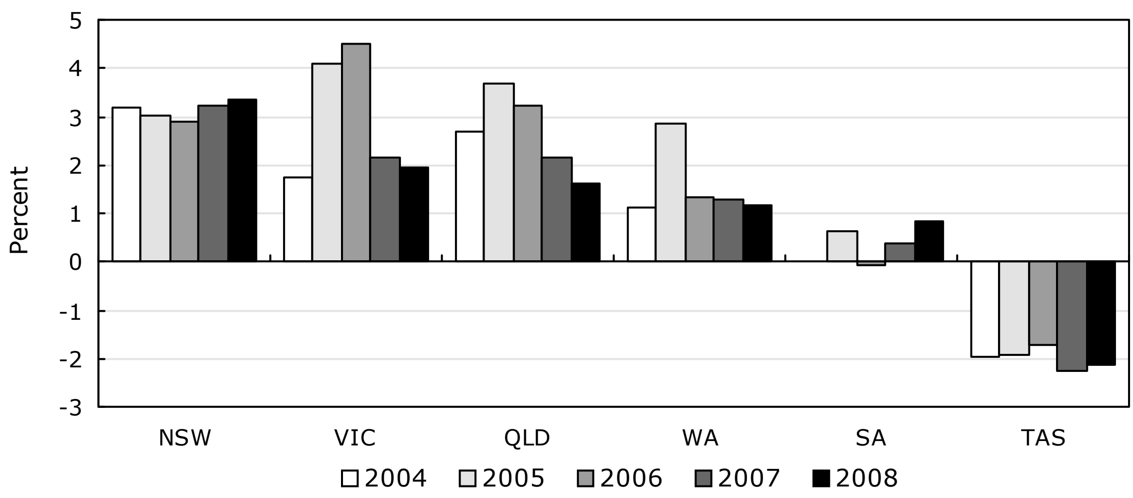
As detailed in the chart, only South Australia and Tasmania are estimating to achieve net lending (surplus) results in 2005. All states are projecting improvements in this indicator and by the end of the forecast period, only Victoria is forecasting a net borrowing result in 2008. Queensland's net lending of $1.7 billion in 2003-04 is again excluded.

The chart shows that South Australia's net lending as a proportion of GFS total revenues is better than most states. As mentioned, the difference between net operating balance and net lending (borrowing) is the net acquisition of non-financial assets.

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.

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 all 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.

It is evident that notwithstanding the fiscal targets set out for all jurisdictions in Section 2 of this Part of the Report, other states are willing to accept net borrowing outcomes to satisfy capital spending policies.

6 REVENUE

This section provides comment on the State's revenue projections as detailed in the 2004-05 Budget.

6.1 OVERVIEW

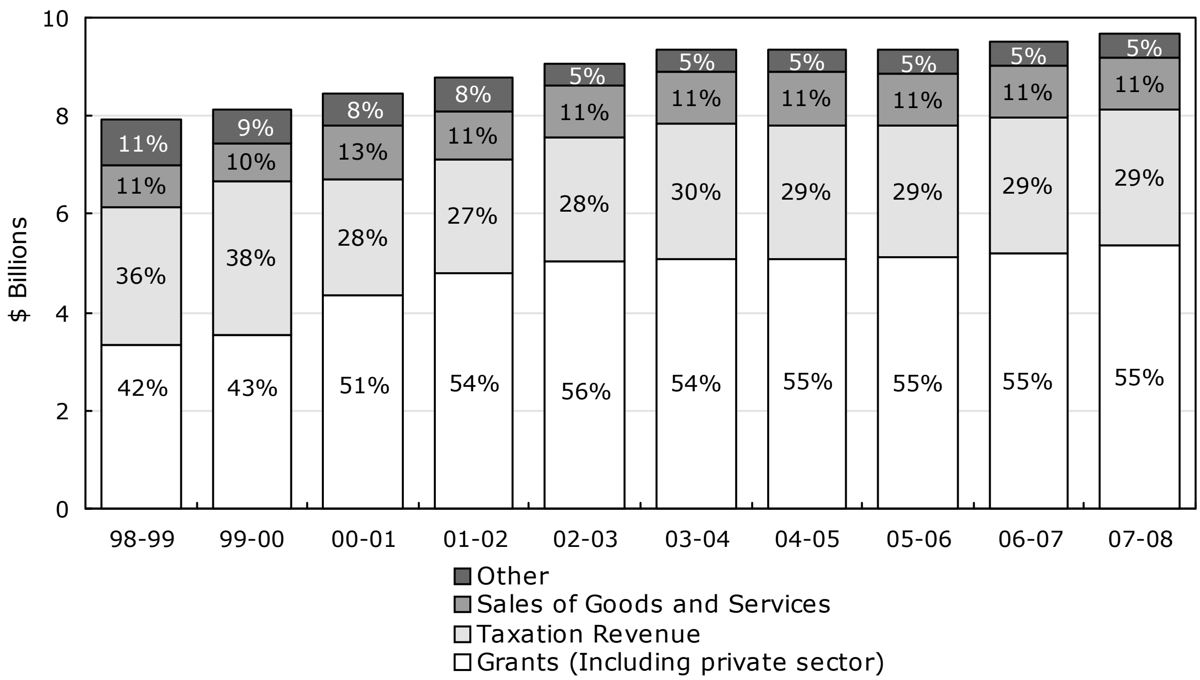
Under the National Tax Reforms, as from 1 July 2000, there have been very significant changes to the composition of the revenue side of the Budget. Foremost in the changes are the effects of the national tax reform and revised Commonwealth-State funding arrangements. Under these arrangements some State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

While the State is reliant on Commonwealth grants, it continues to derive about 48 percent of its revenue from its own sources, mainly state taxation revenue. Most of the components show steady growth over the forward estimates notwithstanding ups and downs in individual elements. As with recent past budgets, the main item that varies significantly from year to year is distributions from public financial institutions SAAMC and SAFA.

Total GFS revenues are estimated to be $9.8 billion in 2003-04, an increase of $447 million (4.8 percent) over the previous year. Budgeted GFS revenues for 2003-04 were $9.2 billion, an increase of $343 million (3.9 percent) over the previous year.

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

General Government Sector GFS Revenues (Real)[(a)]



(a) Estimated June 2004 values. Excludes distributions from PNFCs and PFCs.

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 2001-02. As from 2001-02 to the end of the forward estimate period in 2007-08 the level of GFS revenue remains fairly stable in real terms.

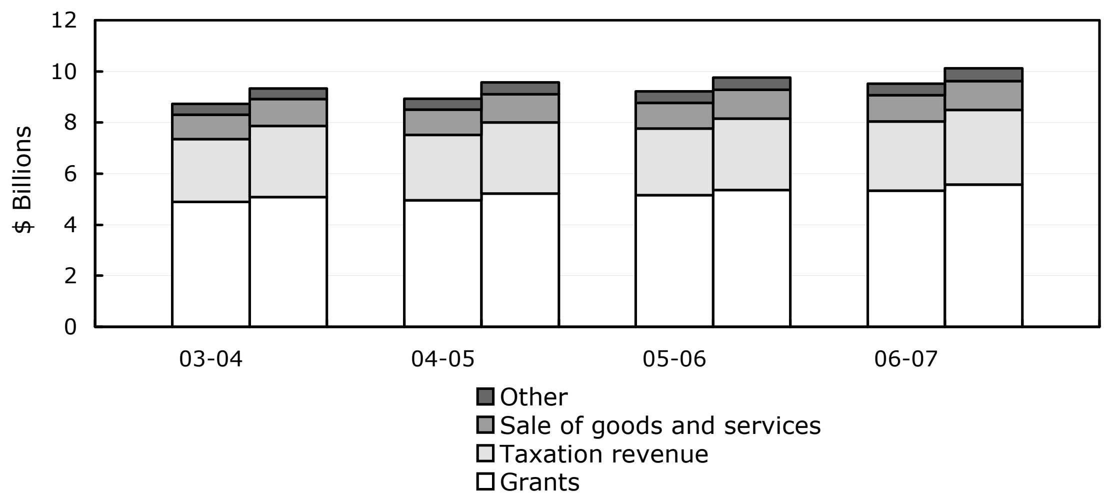
- The effect of the changes from national tax reform. The rapid increase in Commonwealth general-purpose grants and the offsetting reduction in State taxation revenue in 2000-01 and 2001-02 are readily apparent. This is essentially an exchange of State based revenue to Commonwealth based revenue.

- As from 2003-04, the proportion of revenue in the form of grant funding remains quite stable, representing approximately 55 percent of GFS revenues.

The following chart shows the main revenue components as budgeted in the 2003-04 Budget and 2004-05 Budget for the years 2003-04 to 2006-07.

It is evident that significant revisions have taken place in the 2004-05 Budget, estimating growth not previously budgeted.

Comparison of 2003-04 Budget and 2004-05 Budget [(a)]



(a) Left column represents data from the 2003-04 Budget Papers and right column represents data from the 2004-05 Budget Papers. Excludes distributions from PNFCs and PFCs.

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

6.2 GRANTS

Grants from the Commonwealth Government represent over 98 percent of total estimated grants received in 2003-04, 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 2003-04. Commonwealth funding includes general purpose payments, 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 2003-04 is $5 billion, an increase of $252 million (5.3 percent) over the previous year. Estimated funding for 2004-05 is $5.1 billion. Funding in 2007-08 is expected to grow to $5.8 billion, a real increase of $0.3 billion over 2003-04.

Under the National Tax Reforms, as from 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.[47]

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 or national competition payments is as yet unknown. Commonwealth revenues are estimated to increase over the forward estimate period from 51 percent of GFS revenues in 2003-04 to 53 percent of GFS revenues in 2007-08. While Commonwealth funding is the foundation of State finances, it is not controllable by the State.

6.2.1.1 General Purpose Payments

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

Over the forward estimates, GPPs are expected to grow from $3.2 billion in 2003-04 to $3.8 billion in 2007-08, a real increase of $0.3 billion.

6.2.1.2 Specific Purpose Payments

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

Both the Australian Health Care Agreement (AHCA) and the Commonwealth-State Housing Agreement (CSHA) expired on 30 June 2003. The State has now entered into new agreements covering the next five years to 2007-08.

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

In 2003-04, total estimated specific purpose payments to the State are $1.8 billion, and are estimated to be $1.8 billion (real) in 2007-08.

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 2003-04. Taxation revenue comprises collections from a diverse range of activities, including payroll, property, motor vehicles and gambling activities.

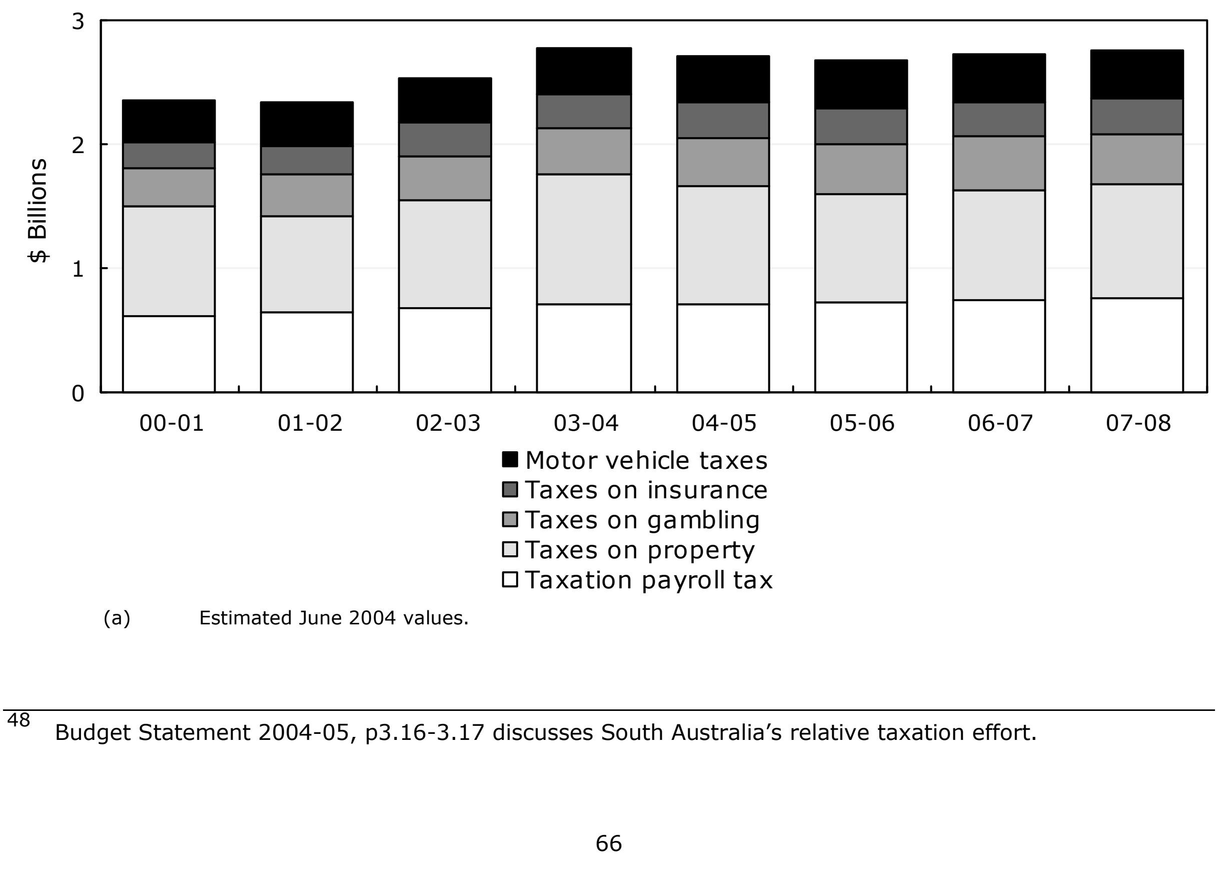
The Government has a fiscal strategy to ensure the State has an effective tax regime having regard to the Government's social and economic objectives. Considerations in relation to the State's capacity to raise taxation revenue include the capacity of taxpayers to pay and the State's relative tax effort compared to other states and territories.[48]

Total taxation receipts for 2003-04 are estimated to be $2.8 billion, an increase of $352 million (14 percent) over the previous year, and $320 million (13 percent) above budget. This improvement on budget was due mainly to increased stamp duty and land tax reflecting sustained buoyancy in property market conditions.

Taxation receipts for 2004-05 are estimated to be $2.8 billion, the same as 2003-04. Revenue from property taxes is expected to decrease in 2004-05 reflecting taxation relief measures introduced in the Budget as well as a projected weakening in property market conditions. Growth in other taxation revenues largely offsets the projected fall in property tax revenues.

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.

Taxation Revenue (Real) [(a)]



(a) Estimated June 2004 values.

48 Budget Statement 2004-05, p3.16-3.17 discusses South Australia's relative taxation effort.

The chart demonstrates that the overall increase in revenue from taxation is in the period to 2003-04, but then remains steady in the forward estimates period.

Taxation revenue in 2007-08 is expected to fall to $2.77 billion, a real decrease of $16 million compared to $2.78 billion in 2003-04.

The following discussion provides a brief overview of the main components of taxation revenue.

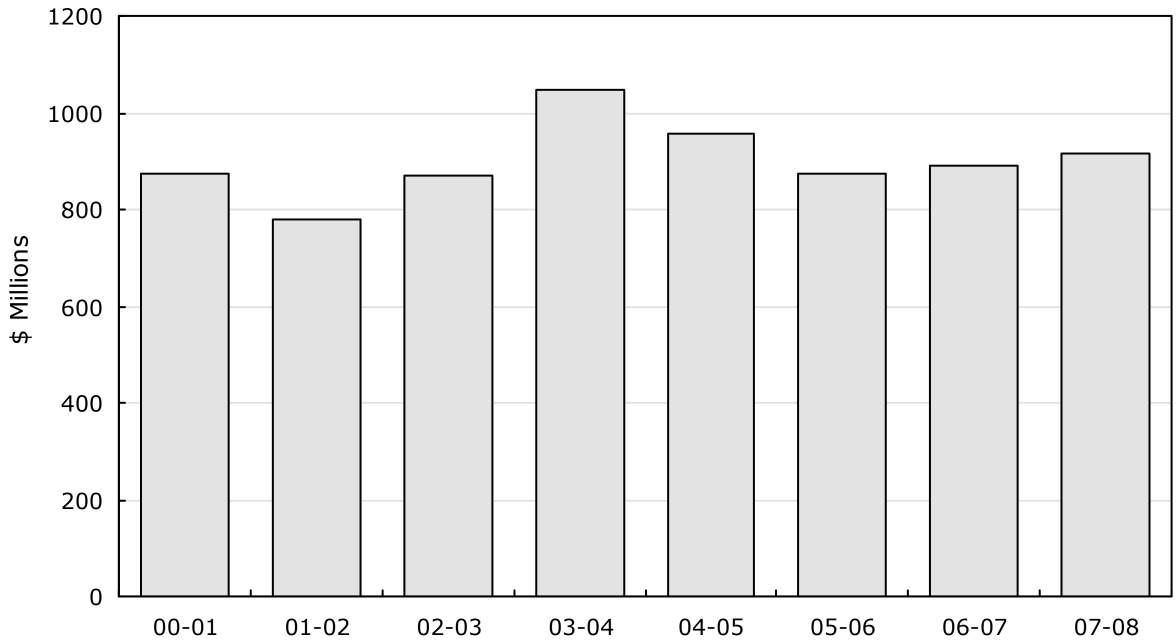
6.3.1 Property Taxes

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 2003-04 are estimated to be $1046 million, an increase of $208 million (25 percent) over the previous year, and $263 million (34 percent) above budget. This improvement on budget was due mainly to increased stamp duty and land tax reflecting sustained buoyancy in property market conditions.

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

Taxes on Property (Real) [(a)]



(a) Estimated June 2004 values

The trend in the forward estimates period reflects:

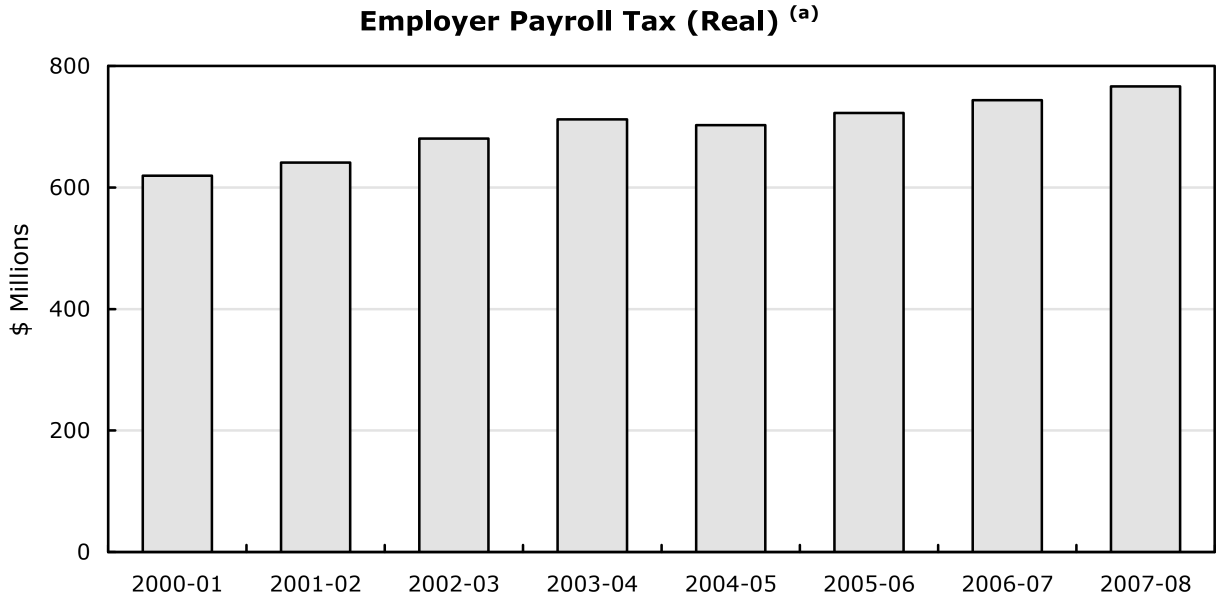
- an expectation that the property prices will stabilise before resuming growth in line with inflation in the latter years of the forward estimates period;
- an assumption that property turnover is projected to fall in both 2004-05 and 2005-06 before resuming moderate growth;

- fewer large commercial property sales are expected to occur in 2004-05;
- the abolition of debits tax from 1 July 2005.

6.3.2 Payroll Tax

Payroll Tax continues to be a principal source of taxation revenue. In 2003-04, employer payroll taxes are estimated to be $712 million representing 26 percent of total taxation revenues, and budgeted to be $720 million in 2004-05.[49]

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



(a) Estimated June 2004 values

The decrease in payroll tax receipts in 2004-05 mainly reflects the impact of the payroll tax reduction from 5.67 percent to 5.5 percent and lower earnings and employment growth assumptions. The growth in payroll tax receipts after 2004-05 reflects estimated employment and earnings growth.

6.3.3 Gambling Taxes

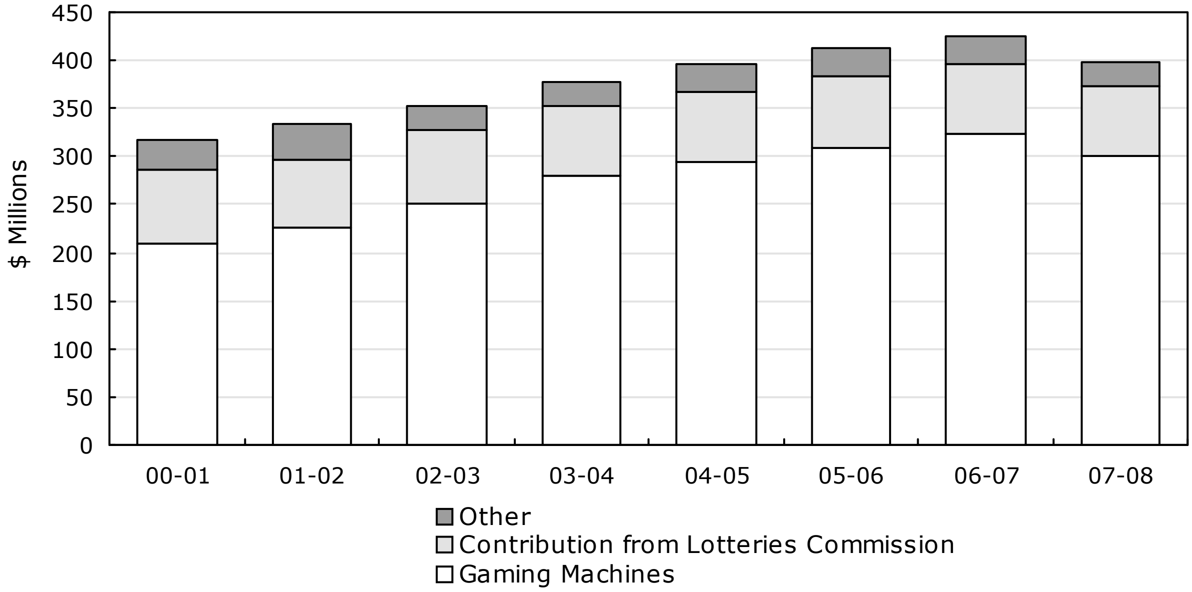
During 2003-04, the estimated taxation revenues from gambling activities amounted to $377 million, $38 million (11 percent) over the previous year and $5 million (1.4 percent) over the 2003-04 budget.

The following chart shows the trend in gambling taxes (in real terms) and highlights the increasing contribution that gaming machines tax will make to the State's Budget until

[49] Budget Statement 2004-05, Budget Paper 3, Table 3.8.

31 October 2007 when 100 percent smoking bans in gaming venues will impact on gaming machine activity in clubs, hotels and the Casino.

Gambling Taxes (Real) [(a)]



(a) Estimated June 2004 values

In the six years 2000-01 to 2006-07, gambling taxes increase $107.5 million in real terms. This is all due to gaming machines which are estimated to contribute $114 million offset by small reductions in real terms, in other gambling revenues.

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 11 percent of GFS revenues in 2003-04. 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 2003-04 is estimated to be $1049 million, an increase of $52 million (5.2 percent) over the previous year, and $97 million (10 percent) above budget.

The increase against budget reflects higher than budgeted land transfer fees reflecting the buoyancy in the property market, additional Commonwealth funding relating to energy-efficiency programs and the recognition of ambulance fees following the reclassification of the South Australian Ambulance Services into the General Government Sector.

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 grow from $1.05 billion in 2003-04 to $1.07 billion (real) in 2007-08.

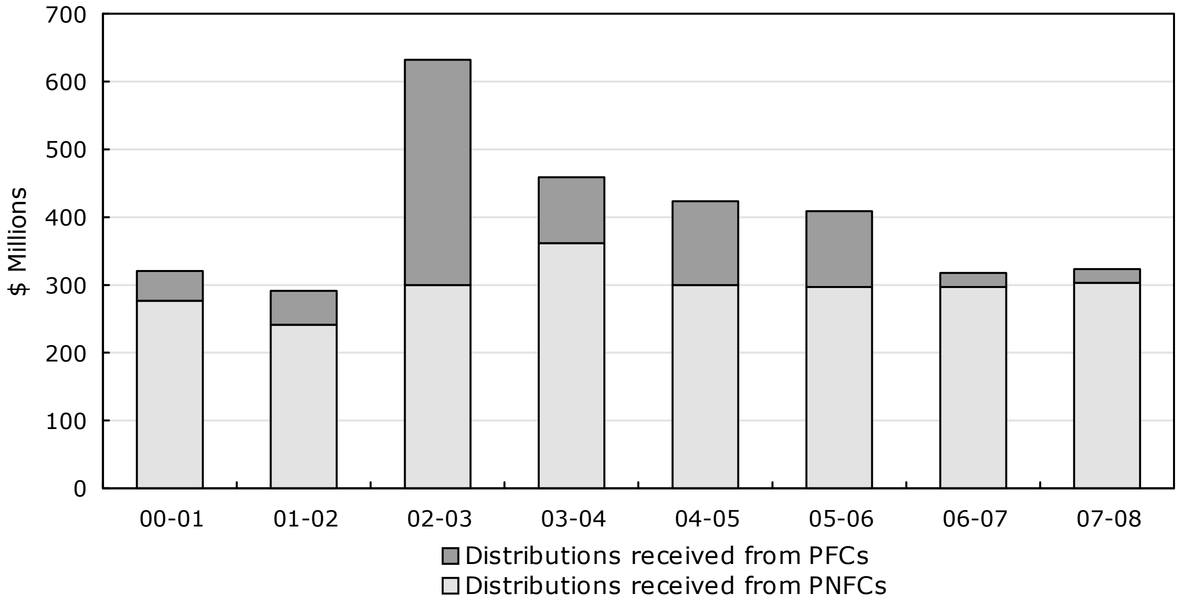
6.5 OTHER REVENUE

The more significant components of Other revenue are the distributions received from Public Non-Financial Corporations (PNFCs) and the Public Financial Corporation (PFCs), which comprise essentially tax equivalent payments and dividends. Distributions from PNFCs and 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.

The distributions come from two other GFS sectors, namely the Public Non-Financial Corporations (PNFCs) and the Public Financial Corporation (PFCs). On a consolidated financial reporting basis, these distributions are internal transfers and would 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 following chart shows the trend in distributions received from PNFCs and PFCs for the eight years to 2007-08.

Distributions Received by the General Government Sector



The chart highlights that distributions are large but reducing over the forward estimates period due to reductions in distributions from PFCs. As the net lending result is estimated to improve over that period, budget reliance on PFC distributions may diminish in the future.

6.5.1 Public Non-Financial Corporations

In 2003-04, distributions received from PNFCs amounted to $362 million, an increase of $62 million (21 percent) over the previous year and $11 million (3 percent) above budget. Notwithstanding the increase in 2003-04, these distributions are relatively steady from year to year reflecting the management of ongoing stable businesses.

Increases in distributions from PNFCs in 2003-04 mainly reflect a once-off special dividend from the Land Management Corporation of $50 million.

Forestry SA is estimated to have an above budget result in 2003-04 arising from continued strong demand for timber products for housing.

Land Management Corporation is expected to have an above budget result in 2003-04 due to continuing strong demand in the building sector driving land sales significantly above budget estimates.

SA Water Corporation is also estimated to have an above budget profit in 2003-04 reflecting increases in connections/extensions as a result of high levels of property development activity, offset by a reduction in revenue from water sales caused by the introduction of water conservation measures and weather conditions.

Distributions from PNFCs are expected to be lower over the forward estimates period mainly on account of the once-off special dividend from the Land Management Corporation in 2003-04.

6.5.2 Public Financial Corporations

The main source of revenue projected from the PFCs category is income from the South Australian Assets Management Corporation (SAAMC) and South Australian Government Financing Authority (SAFA) and these fluctuate over the forward estimates period due to the way distributions are managed to achieve the budgeted result.

In recent years up to 2002-03, distributions from these entities included in Budgets have virtually entirely been deferred to later periods. In 2003-04, budgeted distributions from SAAMC and SAFA, amounting to $58.5 million and $25.8 million were taken up and received. Distributions from PFCs are budgeted to be $124 million in 2004-05.[50]

Projected distributions from SAAMC and SAFA for the period of the 2004-05 Budget are as follows:

Table 6.1 - Projected Distributions from SAFA and SAAMC

	2004-05 $'million	2005-06 $'million	2006-07 $'million	2007-08 $'million	Total $'million
SAFA	44.3	103.0	10.9	10.9	169.1
SAAMC	73.2	4.0	4.2	4.2	85.6
	117.5	107.0	15.1	15.1	254.7

As at 30 June 2004 SAFA and SAAMC had accumulated reserves totalling $195 million and $121 million respectively.

The distributions projected to 2007-08 are estimated to reduce the total accumulated reserves of SAFA to around $102 million, and SAAMC to around $64 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 early part of the current Budget forward estimates. As noted previously and detailed in Table 6.1, the distributions are decreasing over the period of the estimates.

[50] Budget Statement 2004-05, Budget Paper 3, Table 3.15.

6.6 RISKS TO REVENUE

The Budget Statement 2004-05 provides quite detailed consideration of various risks to the revenue budget. Included in the risk analysis is:

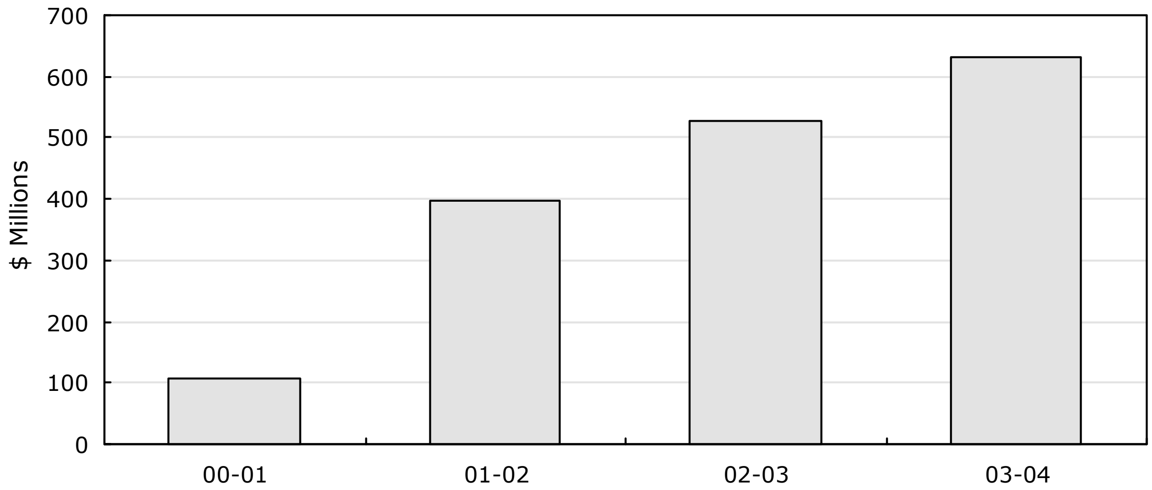
- Taxation and Royalties:
  - A variance of 1 percent in taxation and royalty revenue equates to about $28 million per annum.
  - Gaming machines numbers in clubs and hotels are proposed to be reduced by 3000. A variance of 1 percent in hotel and club gaming machine expenditure equates to about $4 million in gambling tax revenue per annum.
  - Provision has been made in the forward estimates for a 15 percent fall in gaming machine expenditure in licensed clubs, hotels and the Casino commencing in 2007-08 when the smoking ban takes full effect. The assumed tax revenue loss is $41 million in 2007-08.
  - A variance of one cent in the exchange rate has a direct revenue impact of about $0.9 million on royalty revenue, while a 1 percent change in international prices for copper, uranium, gold, oil and petroleum liquids has a direct revenue impact of $0.6 million.
- Commonwealth Grants:
  - General Purpose Payments (GPPs)
    - ❖ A variance of 1 percent in GST revenue growth has a revenue impact of $25-$30 million.
    - ❖ The possibility of future National Competition Council penalties means a significant part of future National Competition Policy (NCP) payments to the State is at risk. In addition, the Commonwealth Government did not commit to a specific level of NCP payments beyond 2005-06. The Budget includes $56 million in 2006-07 for NCP grants.
    - ❖ 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.
  - Specific Purpose Payments (SPPs)
    - ❖ Funding levels of SPPs 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 2004-05, Paper 3, Chapter 7 for the full details.

6.6.1 Past Revenue Outcomes

To provide a recent historic context, the following chart shows the difference between budgeted and actual GFS revenue for the past four years.

Difference Between Budget and Actual GFS Revenues



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, changes in the relativities determined by the Commonwealth Grants Commission 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 2003-04 estimated GFS expenses total $9.5 billion and are estimated to exceed budget by $425 million or 5 percent. A summary of major expenses for the General Government Sector against budget is as follows:

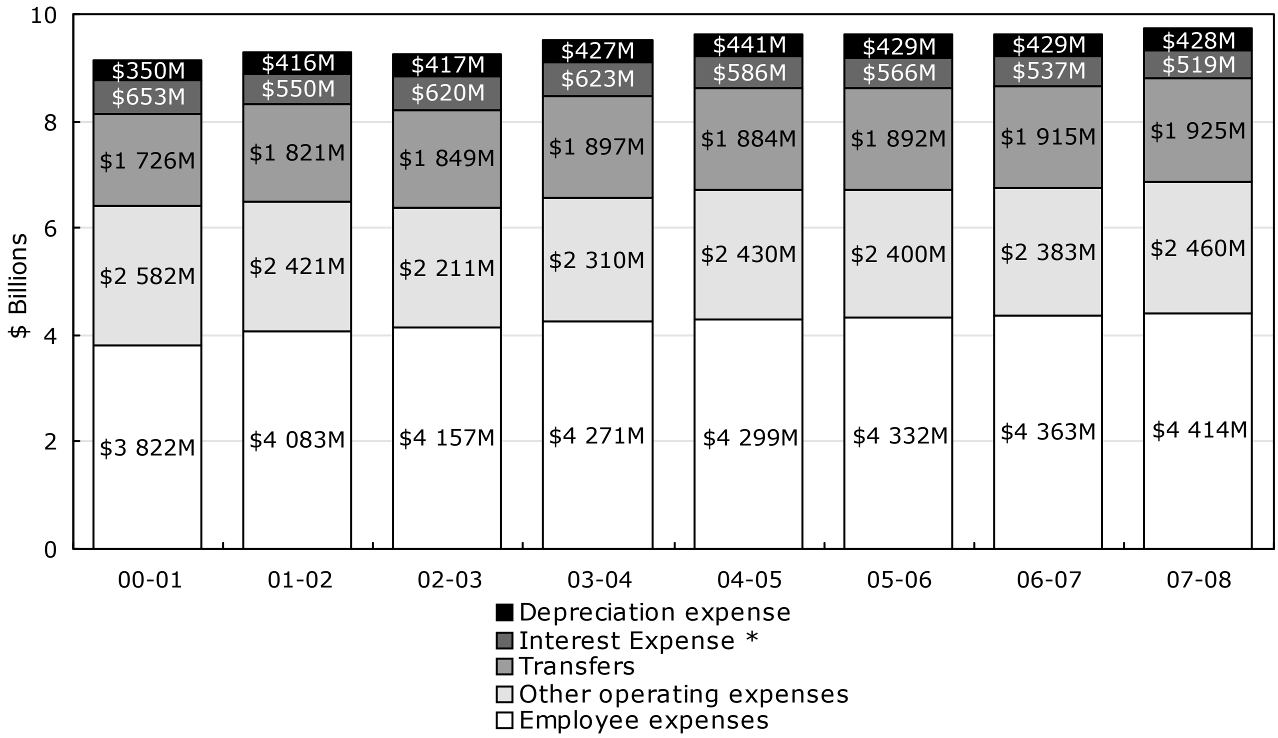
Table 7.1 — GFS - General Government Sector Expenses

	2003-04 Budget $'million	2003-04 Estimated Result $'million	Difference $'million	Difference Percent
Employee Expenses:				
Salaries and wages	3 562	3 680	118	3
Other employee entitlements	525	591	66	13
Operating Expenses:				
Depreciation expense	410	427	17	4
Transfers [a]	1 799	1 898	99	6
Interest expense	249	269	20	8
Nominal superannuation interest expense	337	354	17	5
Other operating expenses [a]	2 220	2 310	90	4
	9 103	9 528	425	5

(a) 2003-04 Budget adjusted for reclassification of $261 million DECS grants to other operating expenses.

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.

General Government Sector GFS Expenses (Real) [a]



(a) Estimated June 2004 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 $4.3 billion in 2003-04) represent a very high proportion (45 percent) of GFS expenses. They are estimated to increase by 3.2 percent in 2004-05 and about three percent per year to 2007-08.

The 2004-05 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 DTF administered lines 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, which are due for renegotiation in the following timeframes:

Police — 1 July 2004
Wages parity — 1 October 2004
Nurses — 1 October 2004
Salaried Medical Officers — 14 April 2005
Teachers — 1 October 2005

Notwithstanding amounts provided in the Budget, the Government estimates that if wages and salaries for public sector employees increased by 1 percent per annum more than is currently factored into the Budget, then wage and salary expenditure would increase by over $152 million in 2007-08.[51]

7.2.2 Other Operating Expenses

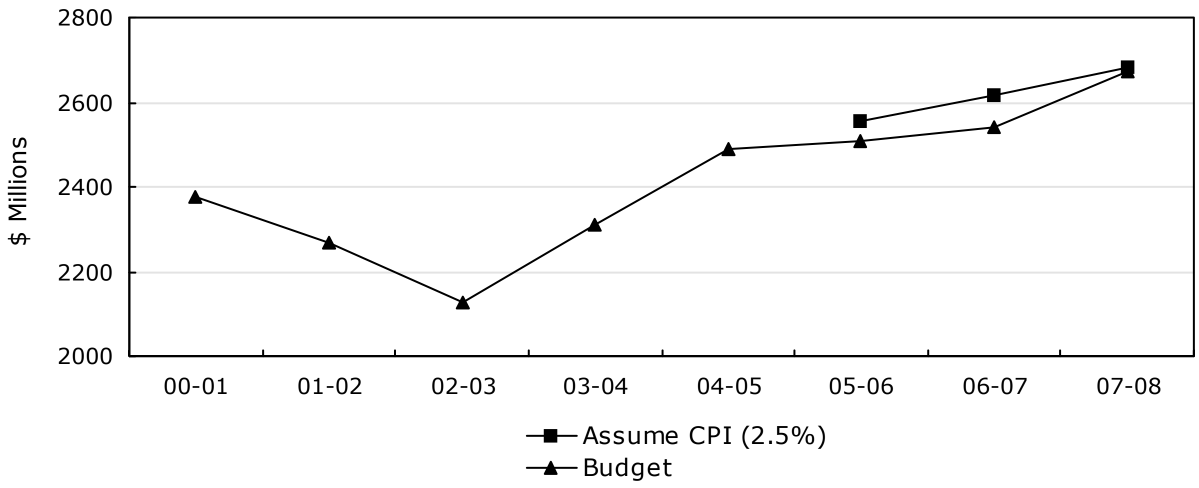
Other operating expenses include general purchases of goods and services.

These expenses are estimated to be $2.3 billion for 2003-04 that is, $90 million or 4 percent over budget. These expenses are budgeted to increase by $181 million or 7.8 percent in nominal terms in 2004-05.

Although it is difficult to establish with accuracy the 'natural' cost pressures within this expenditure line, the following chart compares the budgeted expenditure for the GFS General Government Sector other operating expenses with an increase from the 2004-05 year in line with the long term Consumer Price Index (CPI) assumptions of the 2004-05 Budget.

[51] Budget Statement 2004-05, Budget Paper 3, Page7.6.

GFS - General Government Sector Other Operating Expenses



The chart highlights that other operating expenses are estimated to fall in real terms from 2005-06 to the end of the forward estimates.

Based on this analysis the potential shortfall in the Budget in the event of CPI growth in this item would be:

	Based on CPI (2.5%) $'million
2005-06	45
2006-07	76
2007-08	8

In making that analysis it is recognised that the preparation of the Budget should be based on an approach that takes account of anticipated expenditure rather than simply drawing on past expenditure as a base. However, although the use of the CPI index to predict future expenses may be problematical, it is useful in highlighting a potential risk to the Budget and forward estimates if expenditure targets (which incorporate a significant savings component in the 2004-05 Budget) are not achieved.

Audit has been advised that the Government is well aware of this risk and has put in place a framework to monitor closely the progress of the savings strategies factored into 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 2004-05 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;
- grants to local government;

- grants to industry;
- appropriations for the South Australian Housing Trust and TransAdelaide; and
- community service obligation payments to the South Australian Water Corporation and Forestry SA.

Transfer payments are estimated to be $1.9 billion for 2003-04, that is, $99 million or 6 percent above budget.

Minor increases in these expenses are budgeted over the forward estimates. These increases are consistent with the long term CPI assumptions of the 2004-05 Budget

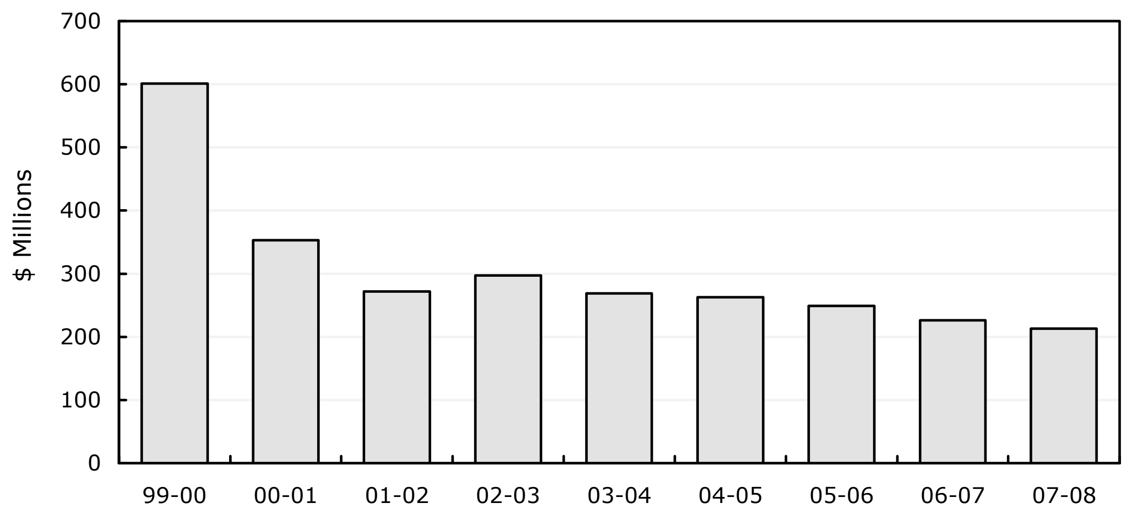
7.2.4 Interest Expense

The impact of the interest expense on the State's finances has diminished greatly over the last few years as the full impact of assets sales has taken place, decreasing from $601 million in 1999-2000 to an estimated interest expense of $269 million in 2003-04.

To put the reductions since 1999-2000 in perspective, it must be remembered that a major portion of the reduction in interest expense has come at the cost of distributions to GFS revenues from the assets sold to reduce public sector debt.

The trend in GFS General Government Sector interest expense is highlighted in the following chart.

GFS - General Government Sector Interest Expense (Nominal)



Interest expense is projected to decrease over the forward estimate period and has reduced by an average of $16 million per year for the forward years compared to the 2003-04 Budget. This improvement is due to lower interest expenses as a result of cash surpluses, and resultant lower levels of net debt.

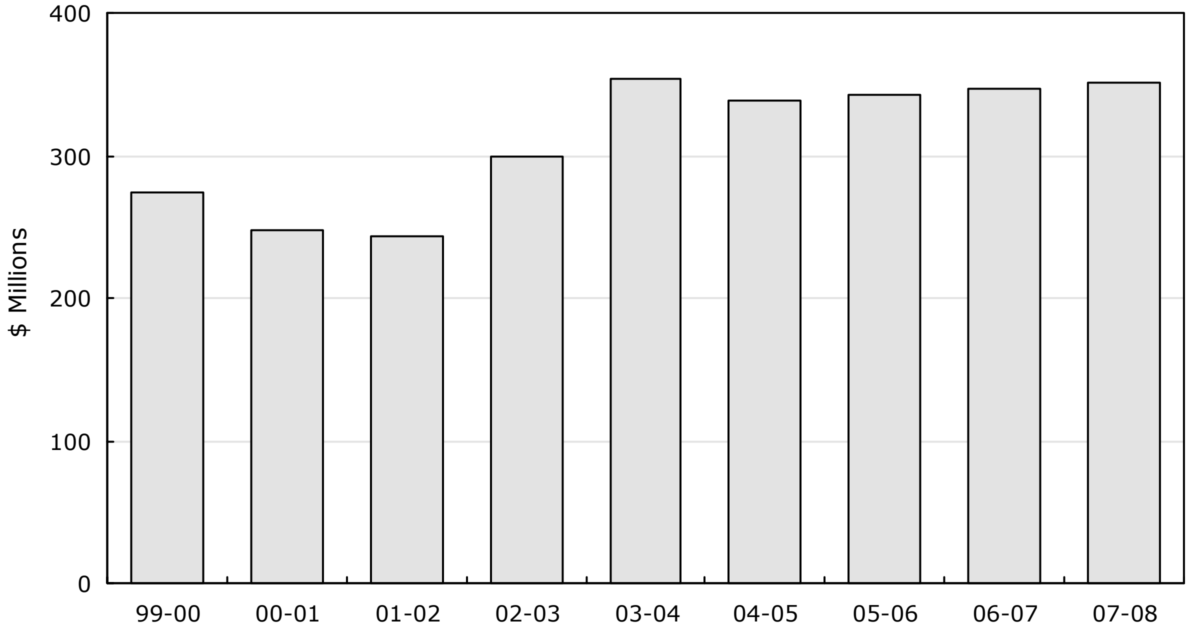
Further discussion in relation to debt movements is provided in the section under the heading '12 - Net Debt'.

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.

The following chart shows the GFS General Government Sector nominal superannuation interest expense for the past five years, and the forward estimates in the Budget Papers.

GFS - General Government Sector Nominal Superannuation Expense (Nominal)



The decrease in nominal superannuation interest expense in 2004-05 is due to:

- higher than expected investment earnings expected to be achieved by Funds SA in 2003-04; offset by
- the effect of changes in accounting assumptions as the Government has adopted a revised discount rate (from 7.5 percent to 6.0 percent) in anticipation of a new Australian Accounting Standard for employee benefits.

Due to revisions of the unfunded liability, the budget expenses over the forward years are almost $10 million per annum lower than was estimated in the 2003-04 Budget. The decreases over the forward years from 2004-05 reflect the effect of higher than expected earnings for 2003-04 partly offset by the change in accounting assumptions mentioned above.

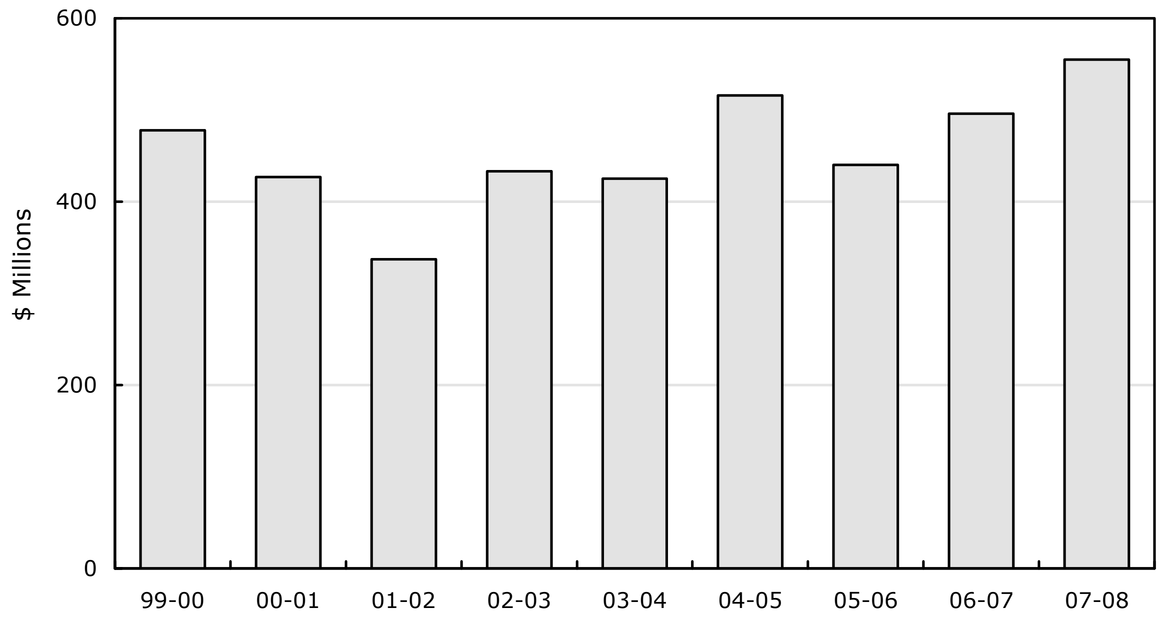
Further details of the unfunded superannuation liability are included later under the heading '10.3 - Unfunded Superannuation'.

7.2.6 Capital Payments

Gross fixed capital formation in the GFS - General Government Sector Operating Statement represents the value of acquisitions less disposals of new or existing fixed assets.

The following chart shows net capital expenditure over the period presented in the 'GFS - General Government Sector Operating Statement Time Series' table presented earlier in this Report.

GFS - General Government Sector Net Capital Payments (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.

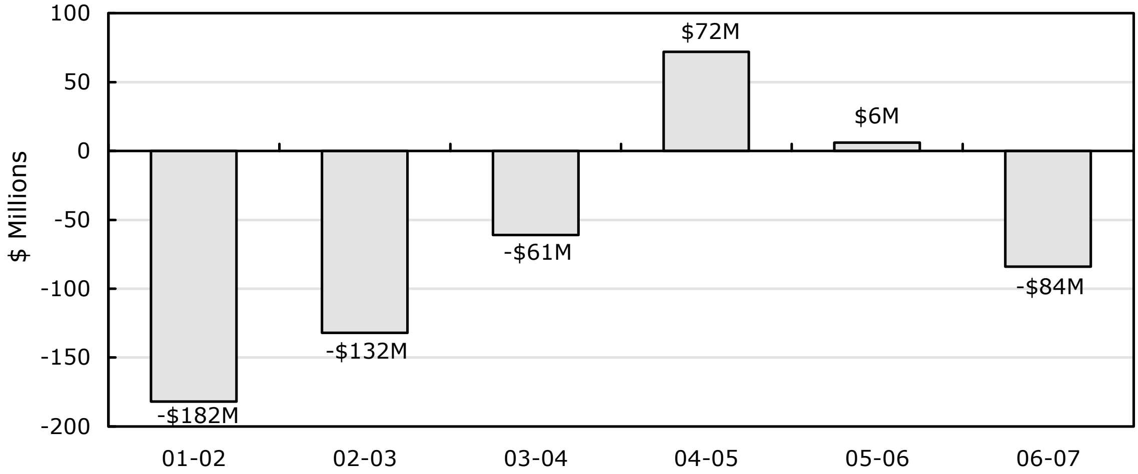
Although there will be components of future expenditure that have effectively been committed, the forward years contain funds contingent on future approvals of between $1.2 million (in 2004-05) and $316.2 million (in 2007-08).

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 Since the 2003-04 Budget

The 2004-05 Budget is different from the 2003-04 Budget in regards to budgeted capital expenditure. The following chart highlights variances between the budgeted and actual or estimated result up to 2003-04 and data presented in the 2003-04 Budget Papers and the 2004-05 Budget Papers for the three years to 2006-07.

Variations in Gross Fixed Capital Formation (a)



(a) Gross fixed capital formation equals purchases of non-financial assets less sales of non-financial assets.

The chart highlights underspending against budget in 2001-02 to 2003-04 and the variances between the 2003-04 Budget Papers and the 2004-05 Budget Papers for the three years to 2006-07. The variances from the 2003-04 Budget have been a contributor to the presentation of projected net lending outcomes in 2006-07 in the General Government Sector operating statement, reducing gross capital formation expenses by $84 million.

7.2.6.2 Strategic Planning and Capital Spending

In response to an Audit inquiry on the current basis for strategic infrastructure planning and its link with the Capital Investment Statement, the Department of Treasury and Finance advised that:

> *Ministers and portfolios are responsible for strategic infrastructure planning and priority setting within their respective policy areas.*
>
> *While a whole of government strategic infrastructure planning "framework" was not used to establish the priorities for the 2004-05 Budget, the 2004-05 budget process provided the opportunity for Cabinet to consider relative priorities early in the process (December) and identify those projects which were to be further developed for consideration during the remainder of the budget process.*
>
> *In summary, ERBCC[52] and Cabinet take responsibility for whole of government strategic infrastructure planning when deciding which projects are approved in the budget. In doing this they take account of the*

52 Expenditure Review and Budget Cabinet Committee (ERBCC).

priorities identified in each of the Ministerial portfolios and decide which of them are priorities at the whole of government level.

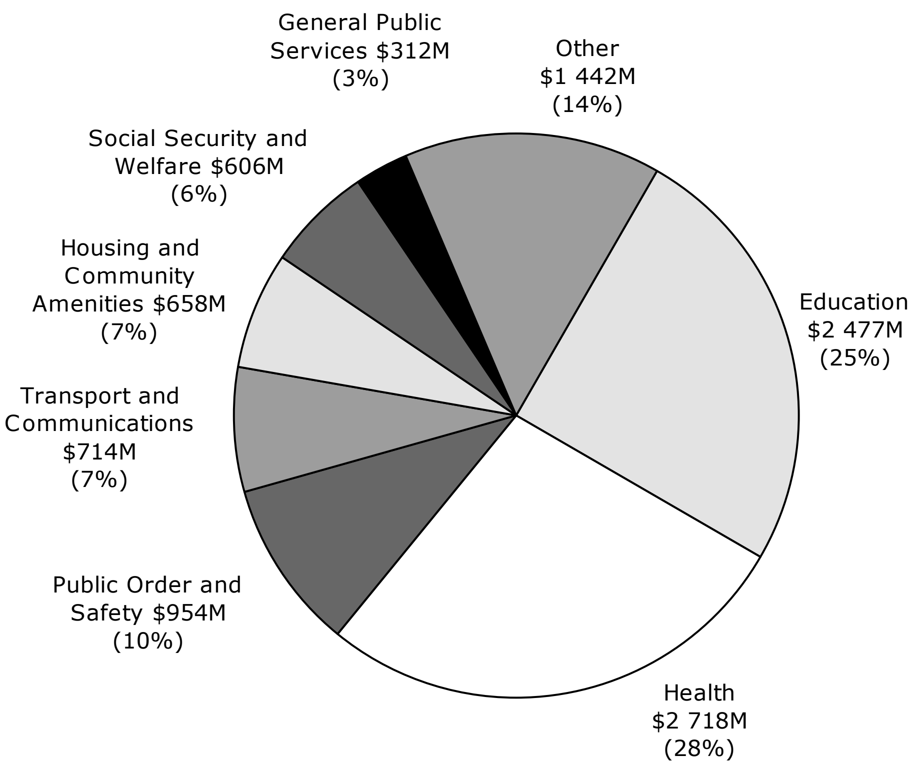
In line with recommendations of the Economic Development Board (EDB 18 and 69), the Office for Infrastructure Development will take a significant role in strategic infrastructure planning for the State in the future, including setting priorities between competing infrastructure needs in line with the State Strategic Plan.

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 nearly one half of expenditure.

The following chart relating to the 2004-05 Budget demonstrates the extent to which the health and education sectors dominate the overall expenditure by the State.

GFS - General Government Sector Expenses by Function[53] (\$'million)



7.4 RISKS TO THE BUDGET OUTCOME

7.4.1 Overview

As mentioned in relation to revenue, the Budget Statement 2004-05 provides detailed consideration of various risks to the expenditure budget and acknowledges the

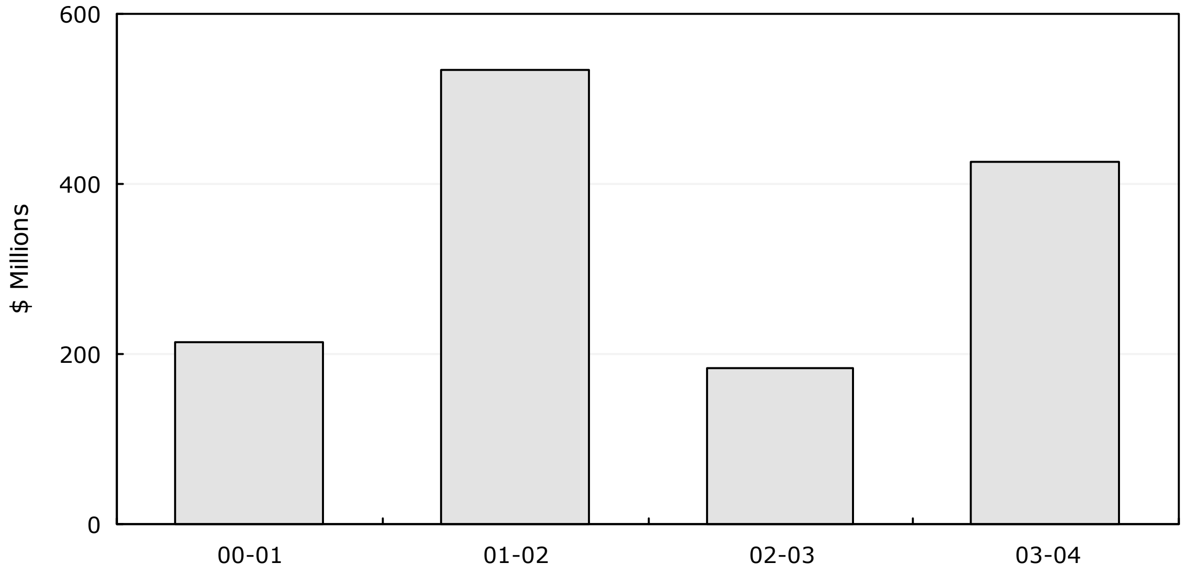
[53] Budget Statement 2004-05, Budget Paper 3, Table 2.6.

management task for achieving budgeted outcomes. 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. To compensate, contingency amounts have been included in the Budget and forward estimates in case salary increases exceed expectations;
- ***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.

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

Difference between Budget and Actual GFS Expenses(a)



(a) 2003-04 is the difference between budget and the estimated result.

The chart highlights that the Government has consistently overspent on its original budget expenditure targets in the last four years.

Ageing Population

The Budget Statement includes the observation that:

> *By keeping debt and the unfunded superannuation liability under control, the Government is creating a positive environment for economic growth and investment in South Australia. Reducing these liabilities also means*

> *that South Australia will be better placed in the future to manage the demands of an ageing population on State budgets.*[54]

In response to an Audit inquiry on any strategic thinking undertaken on the impact of that issue on the State's finances, the Department of Treasury and Finance (DTF) advised that since July 2003 the DTF had collaborated with a private sector forecaster to develop modelling capacity to project South Australian Government finances to 2041-42. A report on this work was being finalised. The results suggested South Australia's long term fiscal pressures will be of a similar magnitude to pressures projected for the Commonwealth Government in the Commonwealth 2002-03 Budget Paper No. 5 *Intergenerational Report 2002-03*. The report stated that after about 15 years, Commonwealth spending was projected to exceed revenue and to prevent the budget moving into deficit, future generations would face higher taxes or governments would need to reduce projected growth in spending.

The report also stated:

> *Although the ageing of the Australian population is not expected to have a major impact on the Commonwealth's budget for at least another 15 years, forward planning for these developments is important, to ensure that governments will be well placed to meet emerging policy challenges in a timely and effective manner. By maintaining sustainable government finances, the Government avoids compromising the wellbeing of future generations by the activities of the current generation.*

DTF also noted work by the Department of the Premier and Cabinet and the release of 'Prosperity Through People: A Population Policy For South Australia'.

Environmental Risks and Contingent Liabilities

The Budget Statement includes the observation that new initiatives in the 2004-05 Budget included $5 million over four years for a site contamination legislative package that supports actions designed to help manage a number of serious site pollution issues across South Australia.[55]

The matter of environmental risks raises the broader issue of changing societal attitudes to responding to past activities that may have incurred liabilities contingent upon future effect and identification.

The nature of such risks is that they may not be known until they arise. The budget papers set out in detail, known contingent liabilities at the time of the Budget. There are no immediate risks to the States finances in the identified liabilities.

7.4.2 Savings

Earlier in this Report recognition has been given to planned savings that have been included in the Budget estimates and that form a significant part of the basis of trying to achieve the long term fiscal strategy.

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[54] Budget Statement 2004-05, Budget Paper 3, page 1.9.

[55] Budget Statement 2004-05, Budget Paper 3, page 1.12.

The Budget includes a number of savings that have been identified by agencies, based on either achieving efficiency or reducing particular services. A summary of those savings for all departmental portfolios that have been identified is as follows:

Table 7.2 - Summary of Budget Savings

	2004-05 $'million	2005-06 $'million	2006-07 $'million	2007-08 $'million
Premier and Cabinet	1	1	1	1
Trade and Economic Development	17	16	17	14
Treasury and Finance	1	2	2	2
Justice	6	6	6	6
Primary Industries and Resources	1	1	1	1
Administrative and Information Services	4	4	4	4
Human Services	11	10	8	8
Environment and Conservation and the River Murray	2	2	2	2
Transport and Urban Planning	9	23	5	5
Further Education, Employment, Science and Technology	3	3	3	3
Education and Children's Services	4	4	4	4
	59	72	53	50

The savings in Table 7.2 are in addition to the $336 million savings initiatives included in the 2003-04 Budget for the 2004-05 to 2006-07 forward years.

Coming out of both the initial savings measures identified in Table 7.2 and any further savings identified as part of expenditure reviews will be a monitoring process to ensure that savings are achieved, and that there is no overspending in other areas. If the above savings are not achieved it is likely there will be stress on the overall Budget outcome. Further comment is provided under section 7.4.4.1 'Budget Monitoring and Reporting'.

7.4.3 Nature of Savings Initiatives

The Budget provides a detailed account of savings and revenue initiatives allowing any reader a detailed knowledge of the description of these initiatives.

It is not possible, however, to anticipate the relative ease with which various initiatives might be implemented or achieved. Neither is it necessarily easy to identify the consequences of some savings initiatives for both the service providers and receivers. Clearly, there are decisions that must be taken to operate within defined resource limits. Many decisions will raise risk issues. It is necessary for all agencies implementing savings initiatives to be well aware of the risks and consequences of their initiatives and indeed, where appropriate, to have conducted formal risk assessments.

The nature of savings initiatives include:

- better targeting of expenditure;
- rationalisation of administrative activities;
- reduced Information Technology (EDS) charges; and
- capital program rescheduling to accommodate a number of priority initiatives.

Due to their materiality the following specific savings initiatives by the Department of Trade and Economic Development (DTED) are of particular note.

- **Organisational Restructure** — the creation of DTED by the renaming of the former Department of Business, Manufacturing and Trade and abolishment of the Office of Economic Development and transfer of its functions to DTED, is estimated to result in savings in back office and subsidy costs totalling $40 million over the forward estimates period.

- **Industry Investment Attraction Fund (IIAF)** — the Government intends to address industry assistance in a more strategic fashion and so the IIAF arrangements are being allowed to run down. This is estimated to result in savings of $23 million over the forward estimates period.

Given that it is not possible to address the full breadth of activities included in the identified savings initiatives, I have made the following limited observations to highlight some principles I believe are important.

7.4.3.1 Considerations Regarding Savings Initiatives — Legislative Responsibilities

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. There will be, in my opinion, little discretion available for agencies in some matters, and as a consequence there may be limited opportunities for cost savings.

7.4.3.2 Considerations Regarding Savings Initiatives — Shared Services

Shared services relates to the centralisation of administrative support services for a number of government agencies rather than each operating individual and possibly duplicative services and systems.

Shared services are certainly not a new concept either between public sector agencies or with private providers. In relation to the increasing use of such arrangements, I would observe that in order for such arrangements to be successful in both efficiency of costs and effectiveness for controlling and managing operations, their implementation needs careful planning and risk analysis.

Individual chief executives are responsible for ensuring the operation of effective control frameworks and mechanisms for their agencies.

Where shared services are in place, the service provider takes on responsibility to ensure that their obligations as a service provider are met. Users of shared services are also responsible to ensure they are receiving appropriate service and that the overall controls relevant for their agency are maintained.

Clarity of these 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, DTF have advised that monitoring and managing processes are unchanged from the previous year and include:

- strictly limiting changes to the approved Budget;
- 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 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 the 2003-04 Budget the carryover policy was tightened to reduce the overall level of carryovers, and to make some carryovers conditional upon agencies demonstrating actual future expenditure. The intention of this change in policy was to strengthen controls over Budget outcomes by restricting access to previously unspent allocations.

The 2004-05 Budget saw a continuation of this policy.

7.4.4.3 Risks Associated with Carryover Policy and Other Fiscal Constraints

In my 2003-04 Report I stated that it would be important for DTF to monitor whether the tightening of the carryover policy (or any other significant policy change for that matter) has the unintended consequence of encouraging agencies to 'spend up', particularly at year end.

In the course of the 2003-04 audit of the Attorney General's Department an instance arose where I was advised of transactions involving payments, not with respect to goods and services received by the Department but to transfer funds, unspent in one year, to the Crown Solicitor's Trust Account from which they could be expended in the following year.

The payments amounted to $3.1 million in 2002-03 and $2.8 million in 2003-04.

It is my view that this arrangement was not in compliance with the *Public Finance and Audit Act 1987* and relevant Treasurer's Instructions which are frameworks for the control, management, and accountability, of the State's finances.

Details of this matter are provided in Part B of this Report under the Attorney General's Department.

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 an analysis and interpretation of the data available regarding the State public sector financial position.[56]

Two sets of information are referred to within these sections namely:

- GFS Data — which is the focus of the Budget Papers. The GFS basis data 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 (formerly known as the public trading enterprise sector and including the South Australian Water Corporation, Forestry SA and TransAdelaide).[57]

- 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 2003-04 year at the time of this Report. AAS 31 data is generally completed about the end of December each year therefore the most recent available data at this time is as at 30 June 2003. Notwithstanding, references are made to highlight some of the differences in the presented positions.

8.1.1 Key GFS Measures

Three key GFS measures of the State's financial position, namely net worth, net financial worth and net debt were explained in section 3.2.1.

Specific commentary is provided in separate sections that follow on these key measures.

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

General Government Sector data for the eight year period to 2007-08 is presented below.

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56 Budget Statement 2004-05, Budget Paper 3, Appendix A, includes the financial data in statements described as 'Balance Sheet'. This Report uses the title 'Statement of Financial Position'.

57 Budget Statement 2004-05, Budget Paper 3, Appendix D details agencies within the respective sectors.

Table 8.1 — GFS - General Government Sector Financial Position (Nominal Terms)

	2000-01 Actual $'million	2001-02 Actual $'million	2002-03 Actual $'million	2003-04 Estimated Result $'million	2004-05 Estimate $'million	2005-06 Estimate $'million	2006-07 Estimate $'million	2007-08 Estimate $'million
Total financial assets	13 673	14 012	14 157	15 231	15 327	15 521	15 895	16 342
Non-financial assets	10 697	11 146	11 788	11 834	11 873	11 910	11 988	12 117
Total assets	24 371	25 158	25 945	27 065	27 200	27 431	27 883	28 459
Liabilities	9 583	10 453	10 658	11 838	11 670	11 597	11 601	11 655
Net worth	14 788	14 706	15 288	15 227	15 529	15 834	16 282	16 804
Net financial worth	4 091	3 559	3 500	3 393	3 656	3 923	4 294	4 687
Net debt	1 246	1 303	666	382	314	64	(155)	(429)

Of note is the expectation that:

- both assets and liabilities will increase across the forward estimates although liabilities decrease to 2005-06 and then increase;
- net worth (assets less liabilities) decreased from 2000-01 to 2001-02 and from 2002-03 to 2003-04 increases thereafter as asset growth outstrips liability increases;
- net financial worth (financial assets less liabilities) decreases until 2003-04 and then increases for the period of the forward estimates;
- net debt is estimated to decrease and then be eliminated by 2006-07.

Further commentary is provided on each of these matters in the following sections.

8.2.2 GFS - Non-Financial Public Sector Financial Position

The following table provides available time series data for the Non-Financial Public Sector.

Table 8.2 — GFS - Non-Financial Public Sector Financial Position (Nominal Terms)

	2000-01 Actual $'million	2001-02 Actual $'million	2002-03 Actual $'million	2003-04 Estimated Result $'million	2004-05 Estimate $'million	2005-06 Estimate $'million	2006-07 Estimate $'million	2007-08 Estimate $'million
Total financial assets	3 666	3 720	3 100	3 429	3 406	3 582	3 863	4 252
Non-financial assets	21 925	22 622	24 098	25 032	25 195	25 348	25 503	25 627
Assets	25 592	26 342	27 199	28 461	28 601	28 930	29 365	29 879
Liabilities	10 776	11 622	11 911	13 234	13 072	13 096	13 083	13 076
Net Worth	14 816	14 721	15 288	15 227	15 529	15 834	16 282	16 804
Net Financial Worth	(7 109)	(7 902)	(8 811)	(9 806)	(9 666)	(9 514)	(9 221)	(8 824)
Net Debt	3 223	3 317	2 696	2 522	2 418	2 227	1 990	1 613

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;

- net financial worth is negative as liabilities exceed financial assets and is estimated to improve in the forward estimates period;

- net debt is estimated to improve in 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

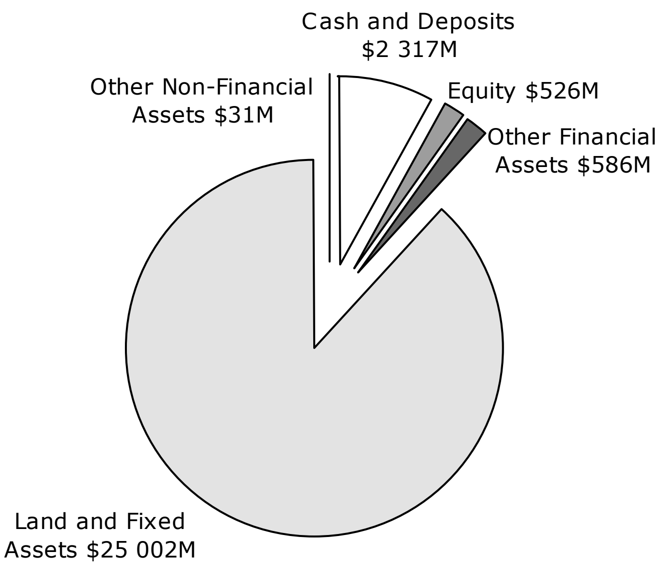
9.1 INTRODUCTION

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. 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, 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 2004 for the Non-Financial Public Sector.

GFS - Non-Financial Public Sector Assets at 30 June 2004 ($'million)



Non-financial assets clearly represent the vast majority of State assets being 88 percent of the total. These assets are approximately evenly 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.

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 $2.7 billion from 2000-01 to $16.3 billion in 2007-08. This is attributable to increases in cash deposits of $805 million, $2.2 billion in equity interests and decreases in other financial assets.

9.2.2 Agency Financial Assets

The majority of the Government's financial assets are held by agencies mainly classified as financial institutions (ie the Public Financial Corporations Sector). Accordingly, the gross value of those financial assets is not directly evident in the General Government Sector financial statements. The main financial asset holding agencies are:

- Funds SA
- Motor Accident Commission (MAC)
- South Australian Asset Management Corporation (SAAMC)
- South Australian Government Financing Authority (SAFA)
- South Australian Government Captive Insurance Corporation (SAICORP).

A large proportion of these investments are held to fund longer-term liabilities such as superannuation and insurance claims against the State.

These investments comprise a range of different classes of assets, and depending on the investment policy or framework of each organisation may include investments in cash, fixed interest, marketable securities, domestic and international equities, property and/or inflation linked assets.

The following table shows the major holdings of investment assets as at 30 June 2004 for the above named 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 2004 $'million	Total 30 June 2003 $'million
Funds SA [c]	2 135	2 421	640	1 438	6 634	5 410
MAC	266	184	917	119	1 486	1 260
SAICORP	56	40	48	28	172	146
SAAMC	-	-	-	586	586	765
SAFA	-	-	-	1 254	1 254	1 860
Total	2 457	2 645	1 605	3 425	10 132	9 441

(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 2004.
(b) Excludes WorkCover.
(c) These amounts relate to superannuation assets set aside for funding future superannuation benefit payments.

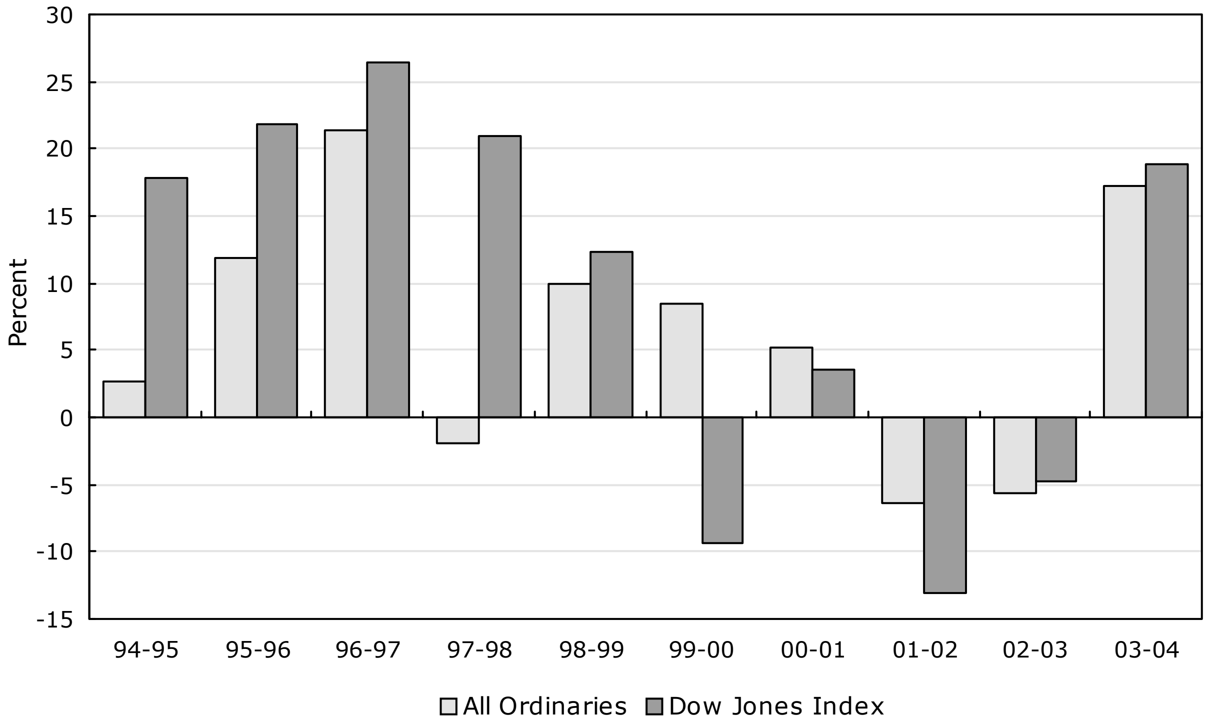
9.2.3 Domestic and International Equities

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. For the purposes of this discussion, however, the following chart shows the volatility of investing in equity markets as reflected in the All Ordinaries and the Dow Jones Composite Index and the differing annual returns that have been received for the past 10 years.

All Ordinaries and Dow Jones Index Movements



There have been average returns over the 10 year period to 2004 of approximately 5 percent per annum on Australian equity markets and 8 percent per annum returns on the United States' markets. Within this time period, negative returns have also been incurred for four out of the 10 years in both the Australian and United States' Markets.

Funds SA, with assets of $6.6 billion at 30 June 2004, 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.

Funds SA use derivative instruments to hedge approximately 20 percent of their foreign currency exposures on their international equities portfolio. Motor Accident Commission hedges certain financial assets and claim liabilities denominated in foreign currencies but does not hedge foreign equity investments. SAICORP hedges approximately 24 percent of its international equity portfolio.

Each of these entities are therefore accepting and subjecting themselves to the risk of unfavourable movements in exchange rates but are also in a position to take advantage of favourable movements. Such movements affect the overall returns gained from these investments.

Many of the above organisations also hedge against specific risks such as interest rate and general consumer prices (such as CPI increases) through investing in fixed asset securities, inflation linked securities and derivatives.

9.3 NON-FINANCIAL ASSETS

9.3.1 Composition and Valuation of Non-Financial Assets

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 evenly held by the General Government and Public Non-Financial Corporation Sectors.

In accordance with the Treasurer's Accounting Policy Statements, major assets are subject to regular revaluation. Valuation of public sector assets, particularly General Government Sector assets, is a subjective process. Valuations will reflect the specific circumstances of individual government 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.

9.3.2 GFS - General Government Sector Non-Financial Assets

Table 8.1 shows that non-financial assets are estimated to increase continuously over the forward estimates period and in total by $1.4 billion from 2000-01 to $12.1 billion in 2007-08.

The main increase over the period 2000-01 to 2007-08 was in 2002-03 and related to an asset revaluation done on the State's land and 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. For the four years to 2007-08, net acquisitions are estimated to amount to $185 million of which $90 million is budgeted for 2007-08. The larger growth expectations in 2007-08 simply reflect projected spending provided in the Budget.

9.3.3 GFS - Non-Financial Public Sector Non-Financial Assets

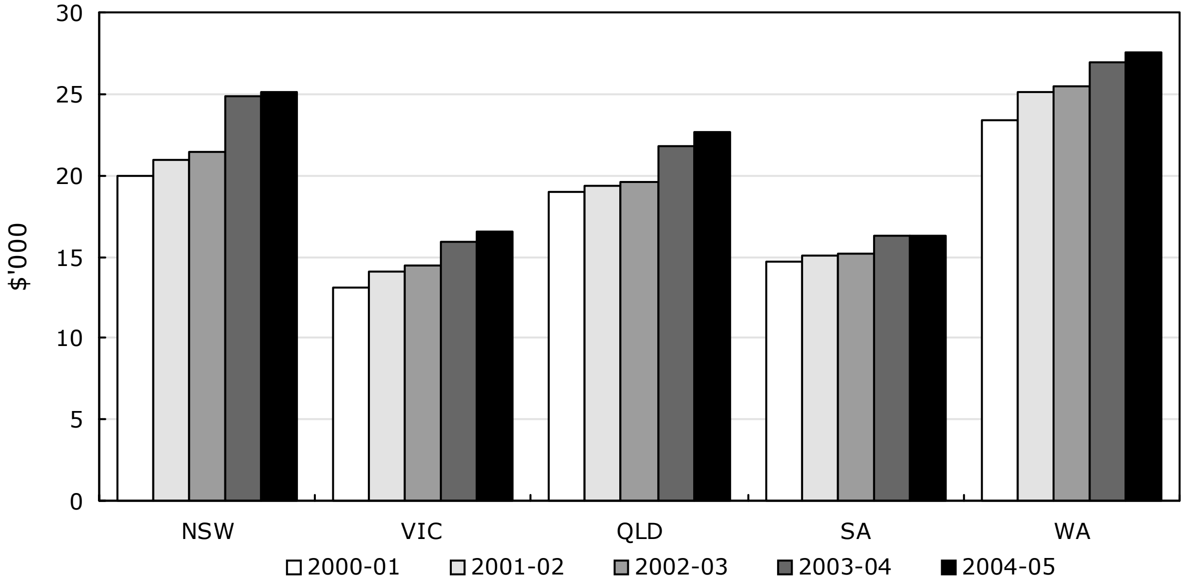
Table 8.2 shows that the value of non-financial assets for the Non-Financial Public Sector are estimated to increase by $934 million in 2003-04 to $25.0 billion, and a further $595 million by 2007-08 to $25.6 billion.

The main reasons for the increase are revaluations for the State's other major water, sewerage and drainage systems which increased by $188 million in 2003-04.

9.3.4 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.

GFS - Non-Financial Public 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 reflecting in part asset disposal programs.

9.3.5 Public Private Partnerships (PPP)

The Government's Public Private Partnership (PPP) program, Partnerships SA, will deliver major infrastructure developments to the State.[58] The PPP program is identifying projects where the private sector can more effectively manage the risks associated with providing services to the public.

The partnership arrangement is based around a commercial agreement where risks in the arrangement are shared among the party best able to manage these risks (ie the Government or private sector organisation). The private sector organisation is paid on the basis of meeting pre-determined performance and quality standards. Experience has shown that clear identification and specification of outputs required and allocation of risks and returns are critical issues in achieving value for money outcomes from such arrangements. In this regard identification and understanding of relevant risks and their costs is crucial.

Potential projects that qualify for consideration under this initiative are required to meet a value for money test, and where this is absent, conventional procurement options are considered.

[58] Capital Investment Statement 2004-05, Budget Paper 5, p.1.

The Department of Treasury and Finance has released detailed guidelines of the principles applying to these arrangements.[59]

9.3.5.1 Projects Under Investigation

In 2003-04, the Government investigated a number of PPP projects including:

- Regional police stations and courts
- State Swimming Centre
- Adelaide Women's Prison
- Youth Detention Centre to replace the facility at Magill.

The regional police stations and courts project is currently undergoing a selected tender process where three short listed private sector consortia are bidding for this project. In addition, the Government sought Expressions of Interest from the private sector in early 2004 for the PPP delivery of the new State Swimming Centre. Submissions from that process are currently being evaluated.

Due to difficulties in locating adequate sites for the facilities the Government has decided to defer the procurement of the women's prison and the youth detention centre. The Government still considers that these facilities need to be redeveloped and the project assessment for both facilities will be completed in 2004-05, including the selection of appropriate sites.

9.3.5.2 On or Off Balance Sheet

An important characteristic of projects successfully implemented as PPPs is that they may not be included in capital expenditure. If so, pursuing such projects allows government to provide public facilities that could not otherwise be made available at the time because of fiscal limitations. Whether or not this is the case will be determined having regard to where the principal risks lie for any project - with government or the private sector.

If projects are off-balance sheet, to the extent that new services are provided to the Government by the private sector, a cost will be reflected in current expenses.

[59] Department of Treasury and Finance Public Private Partnership Unit 'Private Sector Participation in the Provision of Public Services - Guidelines for the Private Sector', operative 1 September 2002.

10 LIABILITIES

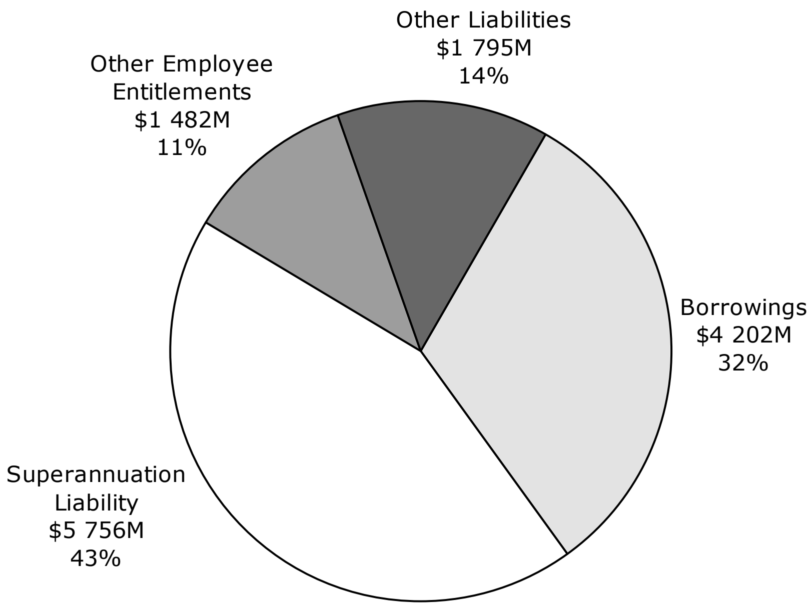
10.1 INTRODUCTION

The 2004-05 Budget, reaffirmed a number of fiscal principles set out in the 2003-04 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 detailed commentary on that matter.

The following chart shows the estimated composition of liabilities of the State as at 30 June 2004 for the Non-Financial Public Sector.

GFS - Non-Financial Public Sector Estimated Liabilities at 30 June 2004 ($'million)



The chart highlights that the two main categories of liabilities are borrowings and superannuation liabilities.

10.2 ANALYSIS OF LIABILITIES

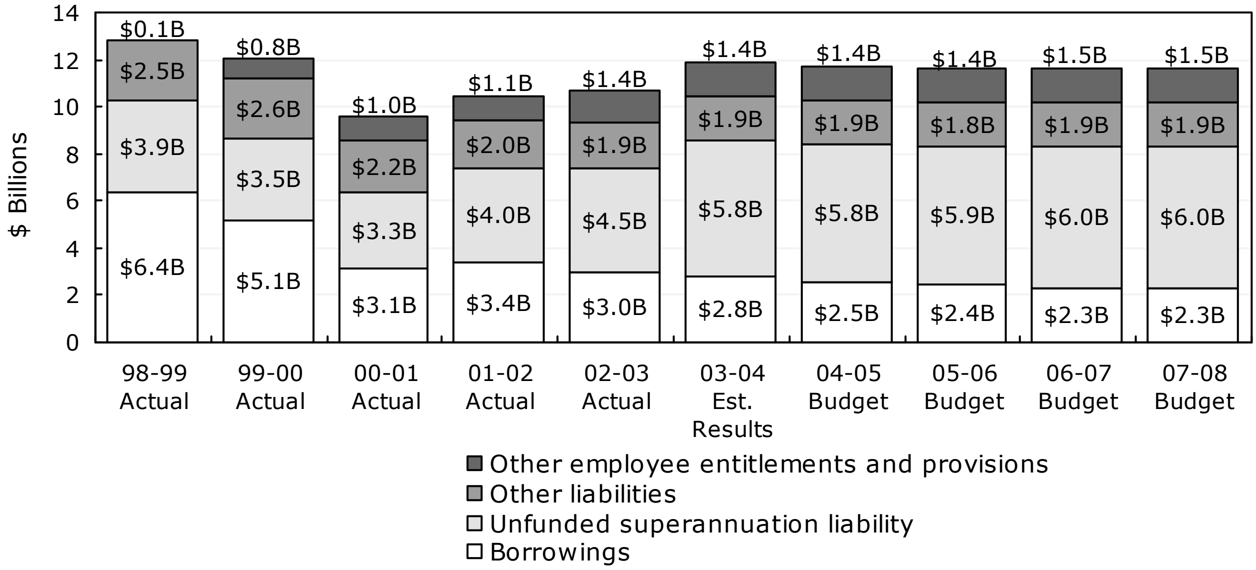
Time series data is now presented in the Budget Statement.[60] The charts in this Section are based on that data.

[60] Budget Statement 2004-05, Budget Paper 3, Appendix B Tables B.4 and B.9.

10.2.1 GFS - General Government Sector Liabilities

The following chart shows trends in the main elements of total liabilities for the ten years to 2007-08.

GFS - General Government Sector Liabilities (Nominal Terms)

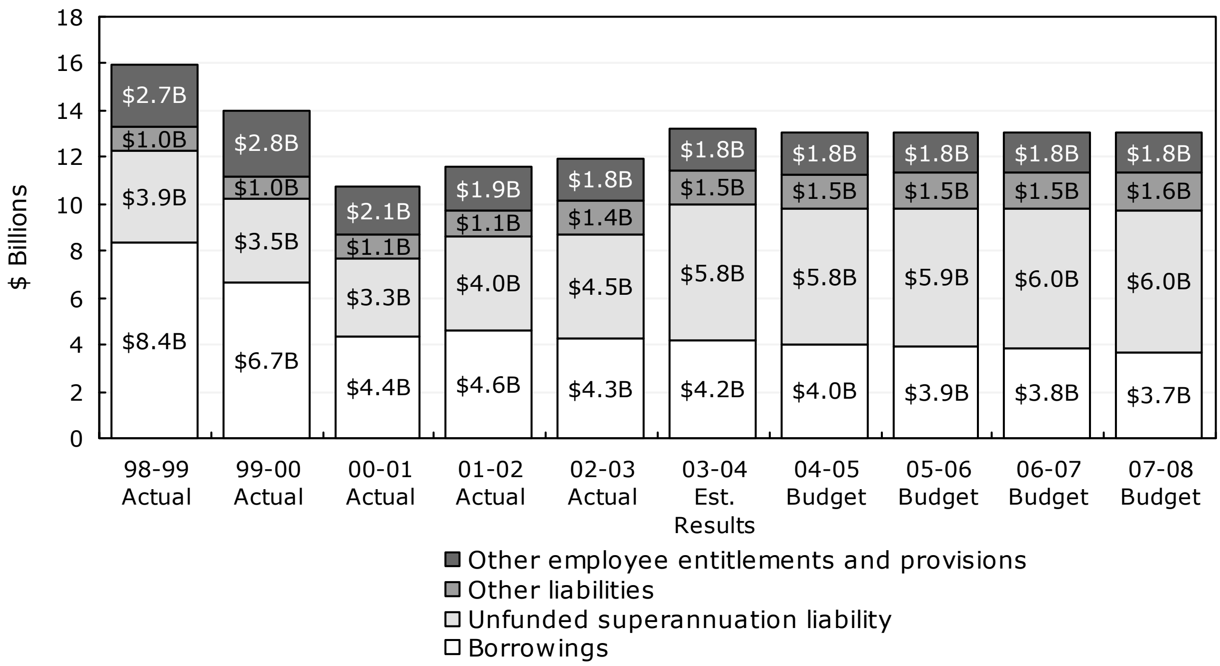


Total liabilities are expected to reduce over the period of the forward estimates, with the unfunded Superannuation liabilities and Other employee entitlements and provisions categories showing some increase in nominal terms. The most significant is the estimated decline in the borrowing liability of $516 million; and the estimated growth in the superannuation liability of $280 million, over the four years to 2007-08.

10.2.2 GFS - Non-Financial Public Sector Liabilities

The following chart shows the ten year trend in liabilities for this sector.

GFS - Non-Financial Public Sector Liabilities (Nominal Terms)



The major reduction in liabilities from the application of proceeds from asset disposals in 1999-2000 and 2000-01 is clearly evident.

This chart also shows the slight fall in total liabilities over the period of the forward estimates. The major increase in 2003-04 is due to superannuation liabilities that are estimated to increase $1 392 million over the two years to 2004-05.

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 superannuation liabilities as they fall due. It is now commonplace for governments to have a long-term funding strategy and this is the case in this State.

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.

In estimating the liabilities, a range of variable factors are taken into account, key among them are assumptions of salary earnings, investment earnings on superannuation assets, inflation and demographic details such as mortality rates. Also important are the scheduled past service contributions by the Government.

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.

The superannuation liability may change periodically as assumptions and experience change. This is an accepted fact for this type of liability. It is, however, important to understand that the change to liabilities in this instance results from a best estimate process based on assumptions and expectations based on past circumstances and performance in calculating the liability.

In the 1999-2000 Budget, the target with respect to fully funding superannuation liabilities was extended from 2024 to 2034.

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 2004, the estimated unfunded liability is $5.8 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 will be based around 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 2003

In the 2003-04 Budget, unfunded superannuation liability as at 30 June 2003 was estimated to be $4.5 billion. This estimate has been revised to an actual outcome. The following table shows the major adjustments that comprise the movement in the estimated and actual unfunded superannuation liability at 30 June 2003.

Table 10.1 — Estimated and Actual Unfunded Superannuation Liabilities As at 30 June 2003

	$'million	**$'million**
Estimated Unfunded Liability (2003-04 Budget)		4 494
Less: Higher earnings against assumed	(95)	
Add: Triennial review of Police Superannuation scheme	52	
Less: Other	(6)	
Total changes		(49)
Actual outcome 30 June 2003		4 445

As shown, the most recent triennial review that was performed on the Police Superannuation Scheme resulted in an increase of $52 million in the liability.

The higher earnings against assumed of $95 million is the difference between the estimated earnings (negative 3.7 percent in the 2003-04 Budget) and actual investment earning rates (negative 0.6 percent).

10.3.4 Estimated Unfunded Superannuation Liability at 30 June 2004

The following table sets out the major elements that comprise the movement for the actual unfunded superannuation liabilities at 30 June 2003 to the 30 June 2004 estimated liability.

Table 10.2 — Estimated Unfunded Superannuation Liabilities
As at 30 June 2004

		$'million	$'million
Actual 30 June 2003			4 445
Add:	Nominal interest	354	
Less:	Past service payments	(236)	
Add:	Change in earning and discount rate assumptions	1 418	
Less:	Higher earnings against assumed	(230)	
Add:	Other	5	
Total changes			1 311
Estimated Closing Balance June 2004			5 756

The estimated unfunded superannuation liability as at 30 June 2004 is $5.8 billion. This is an increase of $1311 million from the 30 June 2003 actual liability, due mainly to the change in earning and discount rate assumptions.

The increase was due principally to the Government adopting a revised discount rate, consistent with a new accounting standard for employee benefits under Australian equivalents to International Financial Reporting Standards (AIFRS). While the new standard does not apply until reporting periods commencing on or after 1 January 2005, its application to the budget estimates recognises the practicality and significance of the new standard to this liability.

The AIFRS, requires superannuation liabilities to be valued using the national government bond rate (or similar rate). A discount rate of 6.0 percent has been adopted in the 2004-05 Budget to value the superannuation liability, in accordance with revised accounting standard. Prior to the 2003-04 Mid-Year Budget Review, the Government had used a 7.5 percent discount rate which reflected the expected earnings on investments. This change in the discount rate has increased the unfunded superannuation liability by around $1.4 billion. In addition, the assumed long-term earnings rate on superannuation assets has been revised to 7.0 percent per annum from 7.5 percent per annum to ensure consistency with Funds SA's long-term target rate of return.

Higher earnings were estimated to be achieved against the assumed investment earnings. In the 2003-04 Budget assumed investment earnings for the year ending 30 June 2004 was 7.0 percent, while the revised estimated earning rate used this year was 14.8 percent for all superannuation scheme assets.

10.3.5 Analysis of Investment Earnings Assumptions

A number of assumptions are used when determining the estimated unfunded liability. A summary of these is as follows:

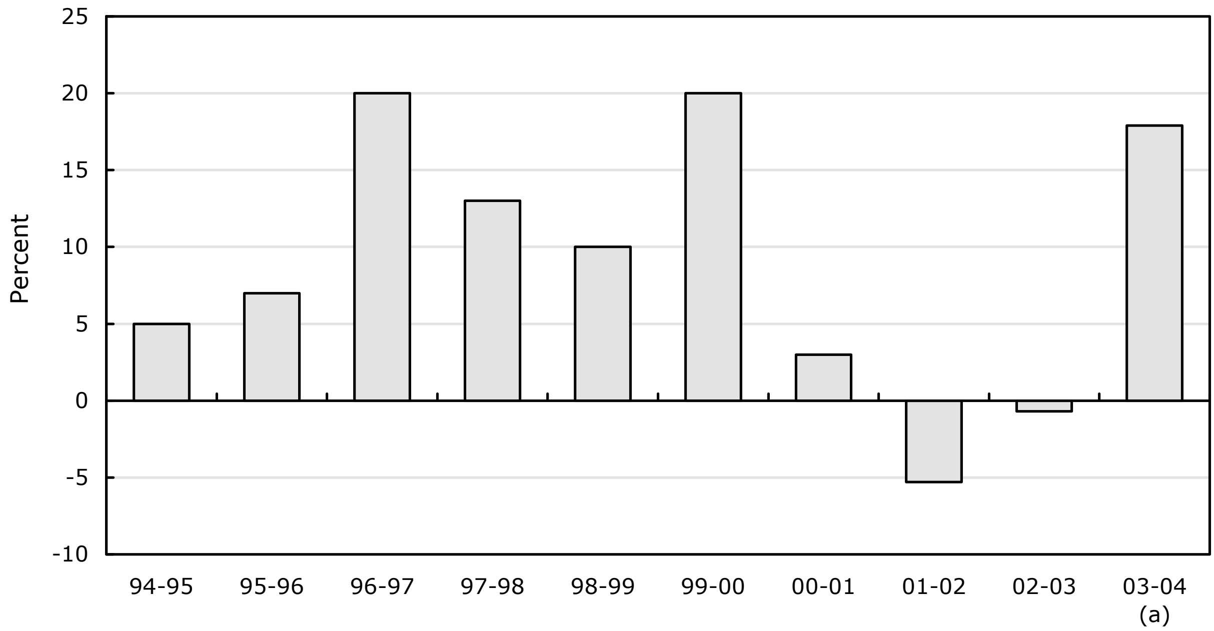
- Earnings on Investments 7.0 percent per annum
- Discount Rate 6.0 percent per annum

- Inflationary salary increases 4.0 percent per annum
- Pension Increases 2.5 percent per annum

It is important to note that a major investment objective of Funds SA is to achieve long-term returns of 4.5 percent in excess of inflation. That being the case, any assessment of the appropriateness of the assumed investment return rate needs to be made over the long-term.

In this regard, the following chart shows investment returns over the past 10 years for the State's defined benefit superannuation schemes.

Return On Defined Benefit Assets 1994-95 to 2003-04



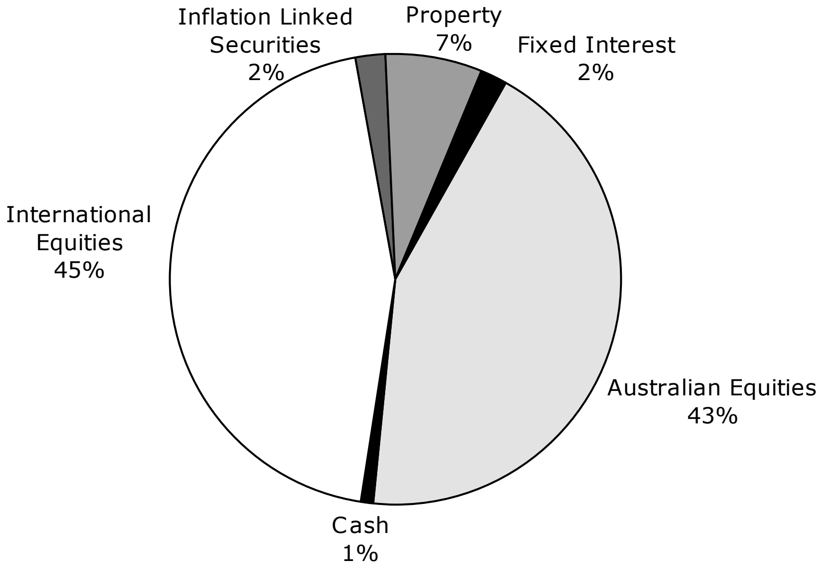
(a) Estimate at time of 2004-05 Budget

Average investment returns over the ten year period approximate 8 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, provide no indication as to what future returns will be.

Investment earnings on superannuation assets are very much susceptible to economic conditions, financial markets and Funds SA's investment strategy. The following chart details a structural analysis of net income earned by Funds SA in 2003-04. The high percentage relating to domestic and international equities, partly explains the negative investment earning results for the two years ending 2002-03. However, equities markets have performed strongly in 2003-04.

Net Income Earned from Investment Activities 2003-04



10.3.6 Sensitivity of Discount Rate Changes on the Unfunded Liability

A change in the discount rate assumption can greatly impact upon the unfunded superannuation liability in any one year. The following table shows the unfunded liability using different assumptions for the discount rate, and in all cases, the assumed earnings rate for 2003-04 is 14.8 percent.

The long term earning rate assumption no longer affects the unfunded liability as at 30 June 2004 but does affect the level of past service payments required to fully fund superannuation liabilities by 2034.

Table 10.3 — Unfunded Liability using different Discount Rates (30 June 2004)

Assumed Discount Rate Percent	Unfunded Liability 30 June 2004 $'million	Difference From 6.0 Percent $'million
5.5	6 329	573
6.0	5 756	-
6.5	5 241	(515)
7.0	4 774	(982)
7.5	4 351	(1 405)
8.0	3 966	(1 790)

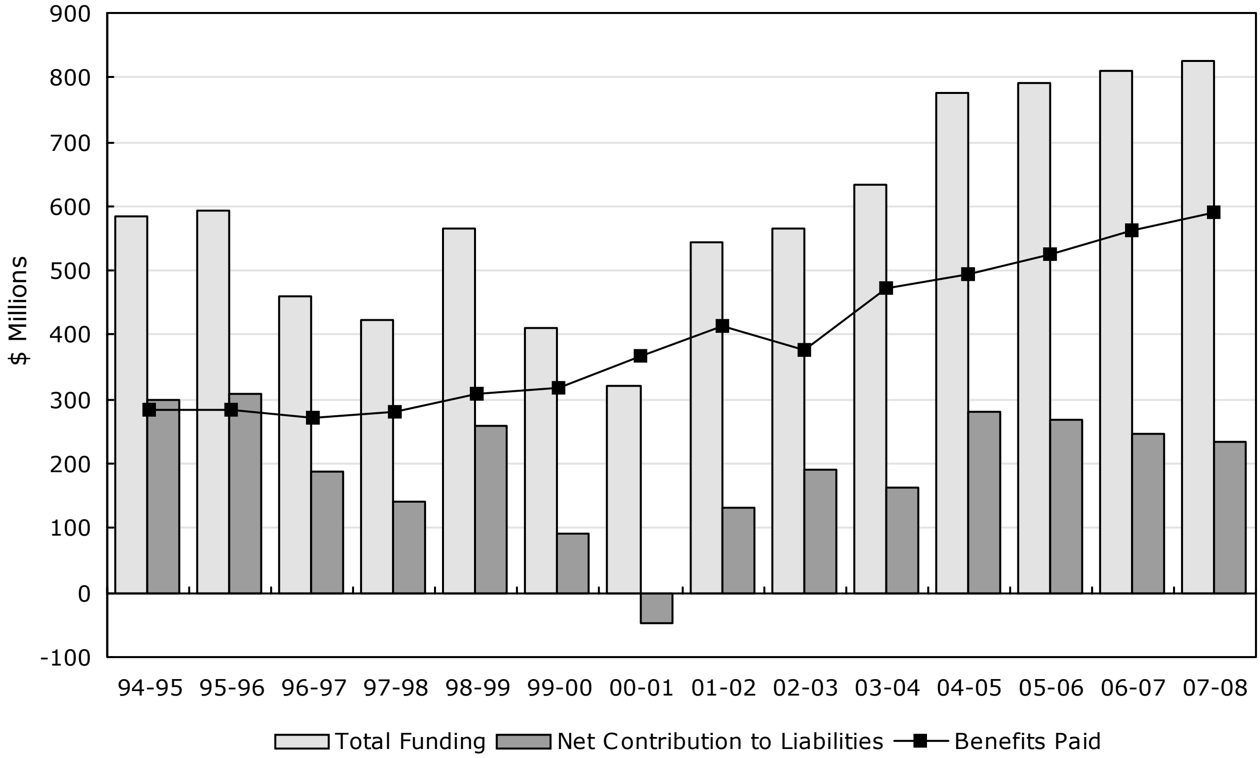
This analysis reinforces the inherent sensitivity that the unfunded liability calculation has upon its assumptions, in particular discount rates.

10.3.7 Superannuation Funding

In 2004-05, total superannuation funding is budgeted to be 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).

Audit's approach, so as to obtain a meaningful picture of developments over time, has been to deduct from the figures for total superannuation funding, the amounts paid as benefits so as to obtain consistent measures, over time, of the net contribution to the funding of superannuation liabilities currently accruing or which have accrued in the past. The following chart, showing the trends in total funding, benefits paid and net superannuation contributions over the period of the table.

Superannuation Benefits and Contributions



It can be seen that:

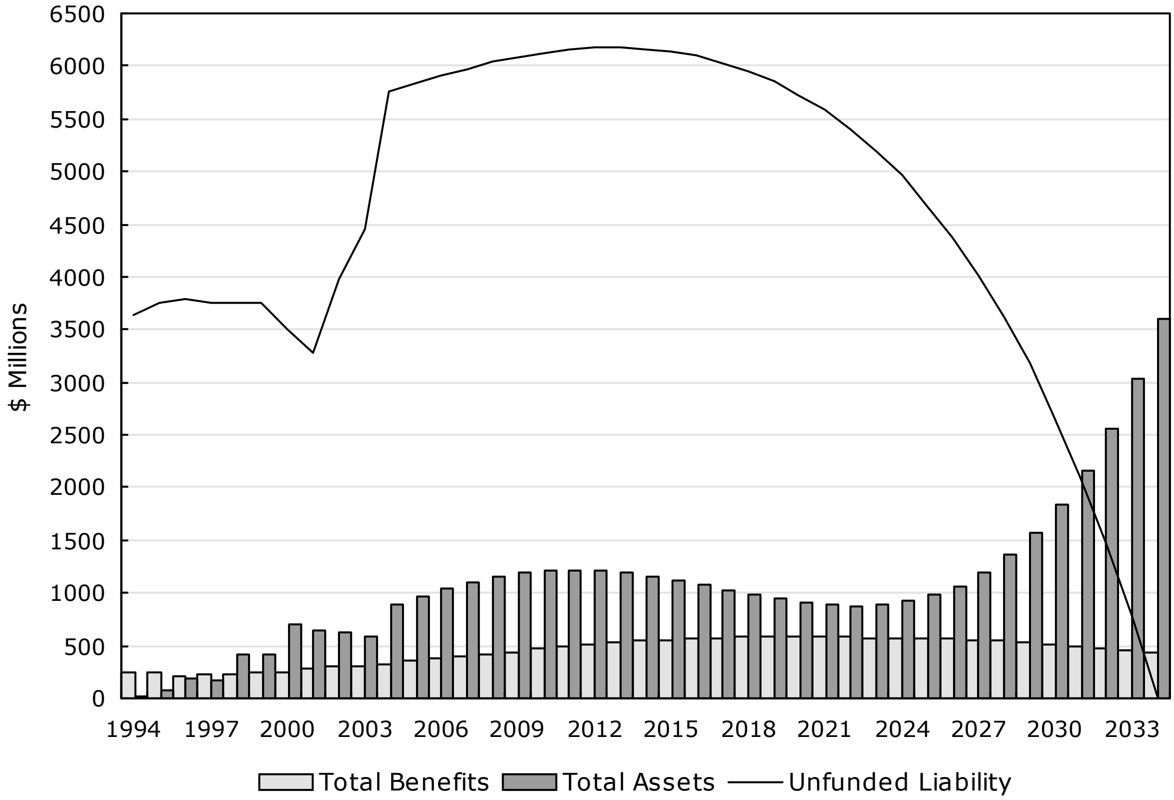
- total funding for superannuation is expected to increase over the period reviewed;
- benefit payments increase over the forward estimate period;
- net contributions to funding of superannuation liabilities are projected to be higher from 2004-05 onwards (with a declining trend) than in recent years.

The commitment to fully fund unfunded liabilities was reaffirmed by the Government in the 2004-05 Budget Papers, with the position as at 30 June 2004 remaining consistent with the plan to eliminate unfunded superannuation liabilities by 2034. Additional funding contributions will be required, however, to compensate for reduced earnings in 2002-03 to remain on target. All other things being equal, investment performance above the long term earning assumption in any year may provide an ongoing benefit to future Budget results.

10.3.8 Peak in Unfunded Superannuation Liabilities

The following chart shows the current estimates of benefits payments, assets and unfunded liabilities for superannuation for the State Scheme and the Police Superannuation Schemes — the major and unfunded schemes.

Superannuation Benefit Payments,
Total Assets and Total Unfunded Liabilities [(a)]



(a) Data includes closed Pension and Lump Sum Schemes

The chart shows that on current projections, unfunded liabilities are expected to continue to increase until peaking around the period 2015-16. It is estimated that benefit payments will peak in 2018-19.

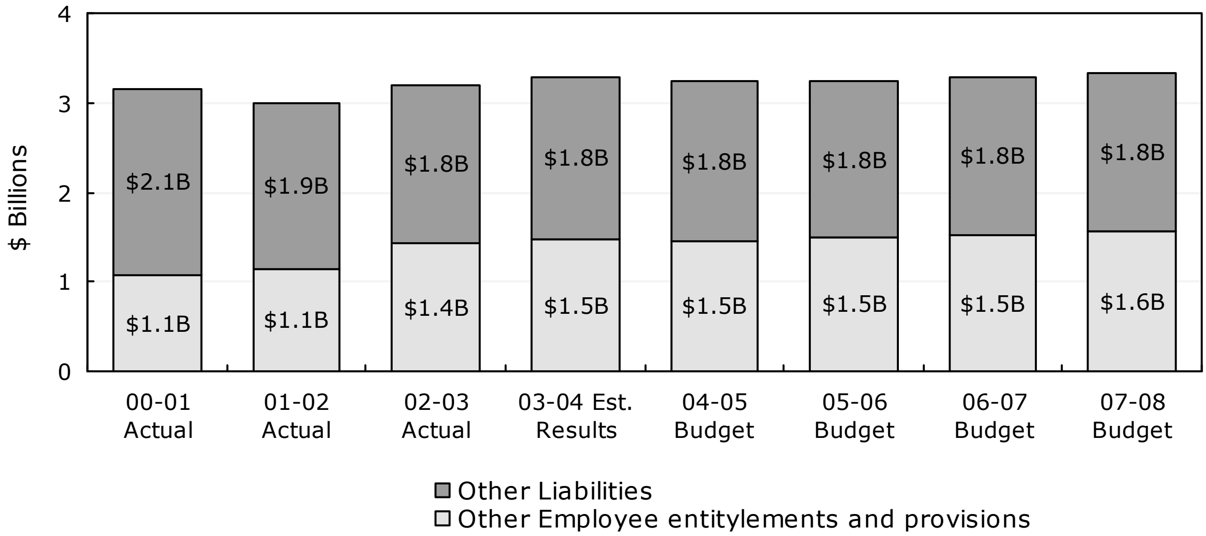
The Government's target to fully fund superannuation liabilities by 2034 is on track based on these estimates.

10.4 OTHER LIABILITIES

Other liabilities include provisions for other employee entitlements (in particular long service leave provisions), workers compensation, and other liabilities of entities including outstanding insurance claims.

The following chart shows the value of Non-Financial Public Sector other liabilities estimated for the eight years to 2007-08.

GFS — Non-Financial Public Sector Other Liabilities



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:

- long service leave provisions amounting to $806 million for 2003-04 and $829 million in 2004-05. Long service leave is calculated by an estimation process in most cases subject to guidelines issued by the Department of Treasury and Finance;
- workers compensation totalling $276 million for 2003-04 and $276 million in 2004-05;
- outstanding claims payable to entities external to SA Government for the South Australian Government Captive Insurance Corporation (SAICORP) amount to $155 million for 2002-03 and $160 million in 2003-04. 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 $45 million at 30 June 2004 (negative $48 million at 30 June 2003). Details of SAICORP's operations are included in Part B of this Report.

10.5 CONTINGENT LIABILITIES

As reported in the Budget Papers[61] 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.

[61] Budget Statement 2004-05, Budget Paper 3, p7.9 – 7.18.

- 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 2003 were valued at $1.2 billion ($1.3 billion as at 30 June 2002). This is at nominal values without adjustment for the probability of actual liabilities occurring.

Identification and reporting of contingent liabilities has been a matter raised by Audit over a number of years.

The 2004-05 Budget Statement reports on a number of matters that have arisen over recent years.

These matters highlight the importance of reporting and managing contingent liabilities from their time of incurrence.

11 NET WORTH AND NET FINANCIAL WORTH

11.1 NET WORTH AND OTHER MEASURES

I have stated in past Reports that net debt and unfunded superannuation liabilities are similar liabilities. Accordingly, to focus only on net debt will not necessarily provide a reader with an appropriate indicator of financial position. The following discussion incorporates measures of net worth and net financial worth that are used in GFS financial reporting. These are broader measures than net debt.

11.2 SOME QUALIFYING OBSERVATIONS

Before considering the measures, a number of observations might be made as to their usefulness. 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.

There are a number of points that should be noted in regard to the value of non-financial assets reported by jurisdictions. These values can reflect varying valuation approaches between states and higher asset values can also reflect higher infrastructure needs for population differences. Higher asset values can be associated with higher debt levels. A final observation is that infrastructure can 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 set out trends in net worth and the net financial worth for the General Government Sector.

The table highlights that:

- net worth is forecast to decrease by $61 million in 2003-04 and rise thereafter in the four years to 2007-08, with a total increase over the forward estimates period of $1.6 billion;
- net financial worth is forecast to decrease by $107 million in 2003-04 and rise thereafter in the four years to 2007-08, with a total increase over the forward estimates period of $1.3 billion.

The main reasons for the decrease in 2003-04 are the increase in superannuation liabilities offset by the increase in equity.

The increase in net financial worth over the forward estimates period is because:

- liabilities are projected to fall by $185 million reflecting a projected $516 million reduction in debt offset by smaller growth in other liabilities;
- financial assets are projected to increase by $1.1 billion reflecting, in particular, a projected growth in equity and cash and deposits.

The Budget Papers for 2004-05[62] provide a reconciliation of movements in General Government net worth. That reconciliation highlights the change in net worth arising from:

- operating transactions, as shown by the item GFS Net Operating Balance in the Operating Statement. That item, the excess of GFS revenues over GFS expenses, is estimated to contribute $665 million toward the improvement in General Government net worth over the forward estimates period.

- other economic flows — over the forward estimates period this item contributes $912 million toward the improvement in General Government net worth. Of particular note is the $447 million movement in net assets of PFCs (major contributors are the Motor Accident Commission, WorkCover Corporation and the SA Community Housing Authority) and $348 million movement in net assets of PNFCs.

The reconciliation also highlights the impact of revaluations on net worth.

11.4 NET WORTH PER CAPITA

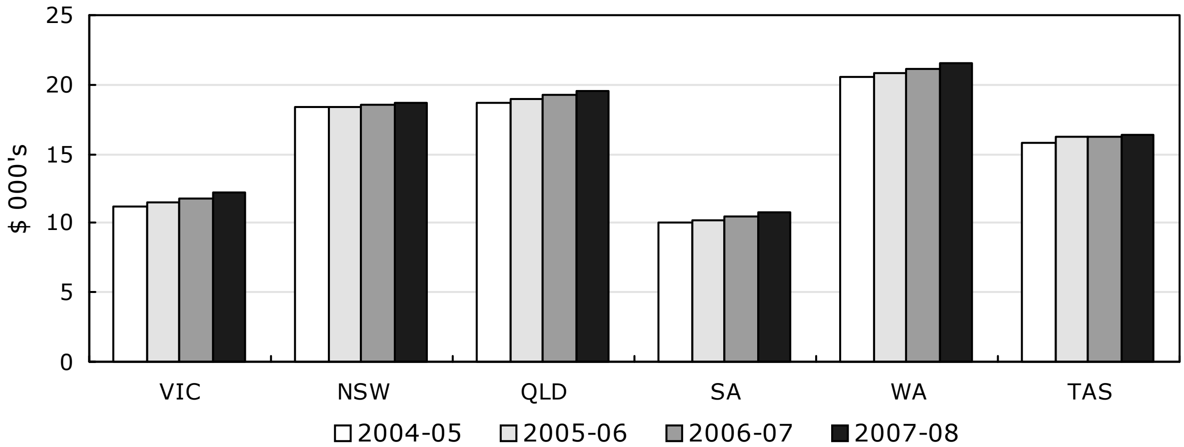
General Government Sector net worth is calculated as total assets (physical and financial) less total liabilities (debt, superannuation, other) and therefore highlights the net change in these items.

Financial assets include the equity of Public Non-Financial Corporations and Public Financial Corporations held by the General Government Sector.

As an indicator, net worth is subject to the influence of valuations of assets, which can vary widely for a range of reasons - eg markets, methodology adopted. 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.

GFS - General Government Sector Net Worth per Capita



[62] Budget Statement 2004-05, Table 5.2.

The chart shows the increase in net worth in this State through to 2007-08 based on current budget settings.

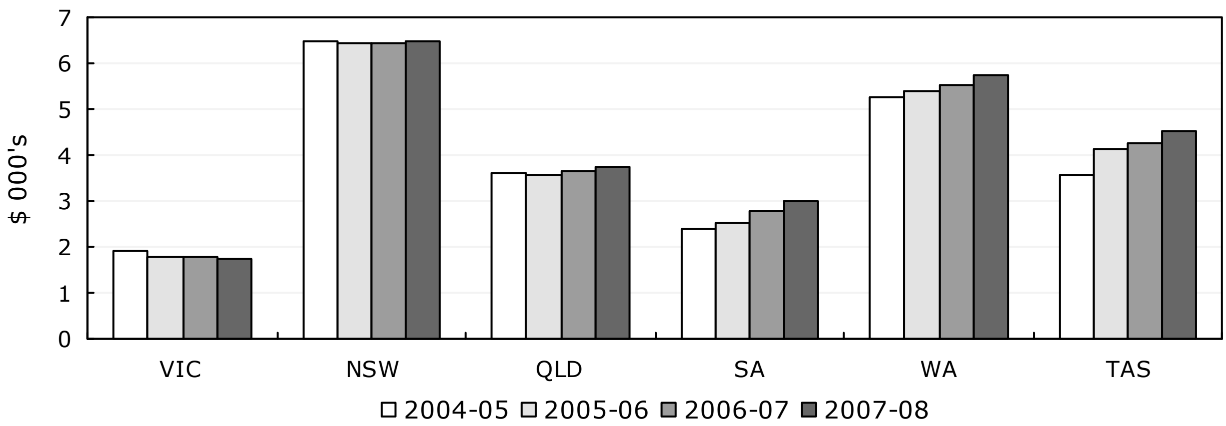
The positions of South Australia and Victoria again stand out. Differences arising between the states reflect the histories of policy decisions made and financial outcomes. More particularly, South Australia and Victoria suffered major losses in relation to financial institutions that severely eroded their net worth. Both States have also had major asset disposal programs.

The data suggests that the states with the higher net worth have additional assets for provision of services or disposal notwithstanding differences that might arise from measurement issues.

11.5 NET FINANCIAL WORTH PER CAPITA

The following chart plots Budget data for all States.

GFS - General Government Sector Net Financial Worth per Capita



The chart shows the increase in net financial worth in this State through to 2007-08 based on current budget settings and its anticipated improvement against Victoria, New South Wales and Queensland over the period.

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.

Disposal of publicly owned electricity assets over two years to 2001 resulted in $4.9 billion being used to retire debt of the State and lower interest payments by the State over the long term.[63]

As a result of the estimated net lending outcomes consistent with current fiscal strategy Net debt is approaching historically low levels.

12.1.1 Definition of Net Debt

Net debt 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.

12.1.2 Indebtedness of the Treasurer

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

12.2 CURRENT FISCAL STRATEGY AND NET DEBT

Current Budget strategy includes the goal of achieving, on average, zero net borrowings in the General Government Sector.[64] This strategy and other announced fiscal principles are consistent with maintaining no growth in net debt. The strategy is expected to be exceeded over the period of the 2004-05 budget and forward estimates.

Importantly, the fiscal principles adopted for the 2002-03, 2003-04 and 2004-05 Budgets highlight that reduction of net debt is no longer a primary Budget target but a by product of other specific principles. This is consistent with the much lower level of debt.

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63 Debt reductions achieved by the State in recent years would, all other things being equal, coincide with overall balance sheet reduction as they result from major asset disposals. A further aim of the Government with regard to commercial asset disposals was to reduce the Government's exposure to a range of operational, financial (including interest rate) and economic risks that had the capacity, if they could not be appropriately managed, to impact on future finances. These can be regarded as structural improvements in the State's financial position to the extent that risk is avoided.

64 Budget Statement 2004-05, Budget Paper 3, p1.2.

12.3 NET DEBT AND RELATED TRENDS

12.3.1 Debt and Other Liability Measures and Indicators

The following commentary provides some measures of net debt and related costs from both an historic and prospective view.

12.3.2 Longer Term Trends in the Level of Debt

The following table shows data on a long-term basis looking forward. The impact of the use of proceeds from the electricity disposal process is clearly visible, and sees a reduction in real terms of Public Sector net indebtedness of $6.3 billion since 1999. Forward estimates show that net debt is projected to fall in real terms to $1.5 billion in 2008.

Table 12.1 — South Australian Public Sector Net Indebtedness 1999 to 2008

New Series	General Government $'million	PNFCs $'million	Total (Nominal Prices) $'million	Real Terms [(a)] $'million	Per Capita (Real Terms) $	Percentage of GSP Percent
1999	4 780	2 878	7 658	8 869	5 921	19.4
2000	1 920	2 435	4 355	4 955	3 293	10.6
2001	1 246	1 977	3 223	3 503	2 316	7.3
2002	1 303	2 014	3 317	3 538	2 329	7.0
2003	666	2 030	2 696	2 804	1 836	5.5
2004[(b)]	382	2 140	2 522	2 522	1 642	4.8
2005[(c)]	314	2 105	2 418	2 359	1 530	4.4
2006[(c)]	64	2 163	2 227	2 131	1 376	3.9
2007[(c)]	(155)	2 145	1 990	1 866	1 201	3.3
2008[(c)]	(429)	2 042	1 613	1 483	951	2.5

(a) Estimated June 2004 values
(b) Estimated result
(c) Projections

Following the use of proceeds from the disposal of the State's electricity assets for debt retirement in 1999 through to 2001, at 30 June 2004 net debt of the Non-Financial Public Sector is estimated to be $2.5 billion (4.8 percent of South Australia's Gross State Product). This is now more than 50 percent lower than the balance of unfunded superannuation liabilities, which is estimated to be $5.8 billion at 30 June 2004.

Total net debt is projected to steadily decrease in real and nominal terms over the period of the 2004-05 Budget to 2007-08.

Over the forward estimates net debt decreases in the General Government Sector by $811 million due to projected budget surpluses. Indeed, the 2004-05 Budget projects a negative net debt of $429 million by 2007-08. Net debt of the Public Non-Financial Corporations decreases by $98 million over the same period.

Most debt resides with the Public Non-Financial Corporation 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.

12.3.3 Debt Affordability and Servicing

As discussed previously, lower interest payments, ie from the levels seen prior to the disposal of electricity assets starting in 1999, are predicted over the forward estimates.

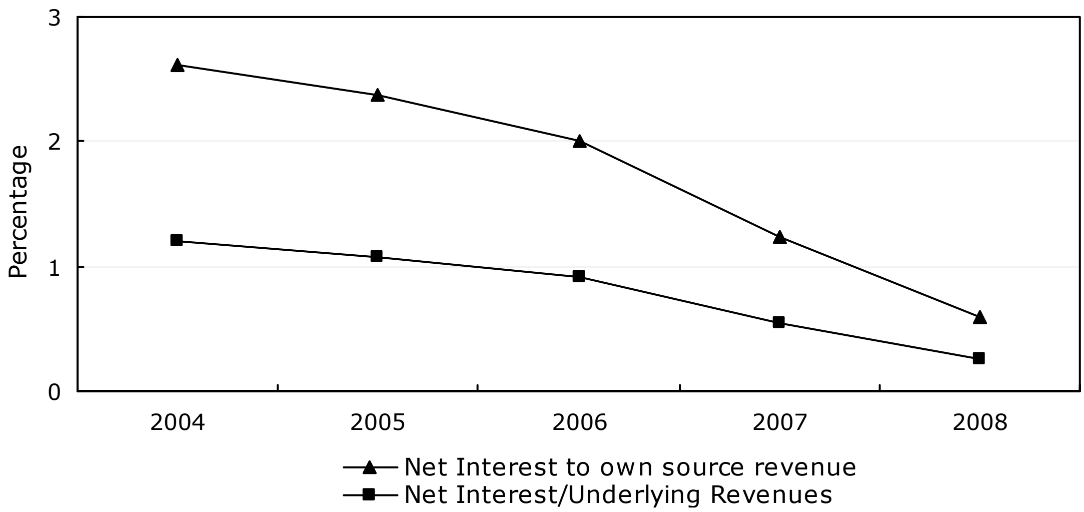
12.3.3.1Net Interest Expenses to State Revenues

The following indicators, using the General Government Sector data, show the projected affordability of net debt by comparing net interest cost to State revenue measures:

- Net interest cost to underlying revenues shows the proportion of total State revenues consumed in meeting net interest costs.

- Net interest cost to own source revenues shows the proportion of State sourced revenues consumed in meeting net interest costs. Own source revenue herein excludes distributions from PFCs and PNFCs.

Debt Affordability Ratios



The chart shows that:

- net interest expenses absorb a very low proportion of total underlying revenues;

- over the forward estimates, net interest expenses are to decrease in comparison to total revenues and own source revenues as a result of projected cash surpluses and decreases in net debt.

12.4 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.

Following the disposal of electricity assets over the period to 2001 and various smaller transactions, there has been a net reduction of $4.1 billion or 57 percent in the balance of the Indebtedness of the Treasurer to SAFA from $7.2 billion at 30 June 1999 to $3.1 billion as at 30 June 2004. These amounts are published annually in the Treasurer's Statements.[65]

Past Reports have discussed debt management issues in considerable detail with a focus on matters relevant to the determination of policy and on performance. The following sets out the current status of policy related matters in the light of the asset disposals.

12.4.1 Debt Management Policy

A Government review of debt management policy was discussed at length in the 2000-01 Audit Report. 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 2003-04 financial year.

What this means in practice is that the average maturity of the debt portfolio will be lower than it previously was. As noted in my last Report, 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.

65 Report of the Auditor-General for the year ended 30 June 2004, Part B, Volume V, Appendix.

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 2003, and the following commentary has therefore been kept purposely brief.

The following summarises the financial position for the five financial years 1998-99 to 2002-03.

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
Assets					
Cash and investments	6 008	7 577	4 987	4 658	5 689
Superannuation assets	3 996	4 916	5 175	5 057	5 277
Physical assets	22 825	20 817	21 934	22 621	24 234
Other	4 255	3 587	2 199	2 460	2 063
TOTAL ASSETS	37 084	36 897	34 295	34 796	37 263
Liabilities					
Unfunded superannuation	3 909	3 544	3 262	3 987	4 445
Borrowings	13 243	11 173	6 992	6 754	6 734
Employee entitlements	1 028	1 024	1 108	1 208	1 440
Superannuation liabilities	3 945	5 117	5 300	5 183	5 411
Other	4 476	4 110	3 347	3 736	4 727
TOTAL LIABILITIES	26 601	24 968	20 009	20 868	22 759
NET ASSETS	10 483	11 929	14 286	13 928	14 504

The $576 million increase in net assets for 2002-03 was due to an increase in Cash and Investments ($1031 million) and Physical Assets ($1613 million), offset by increases in Unfunded Superannuation ($458 million) and Other Liabilities ($993 million).

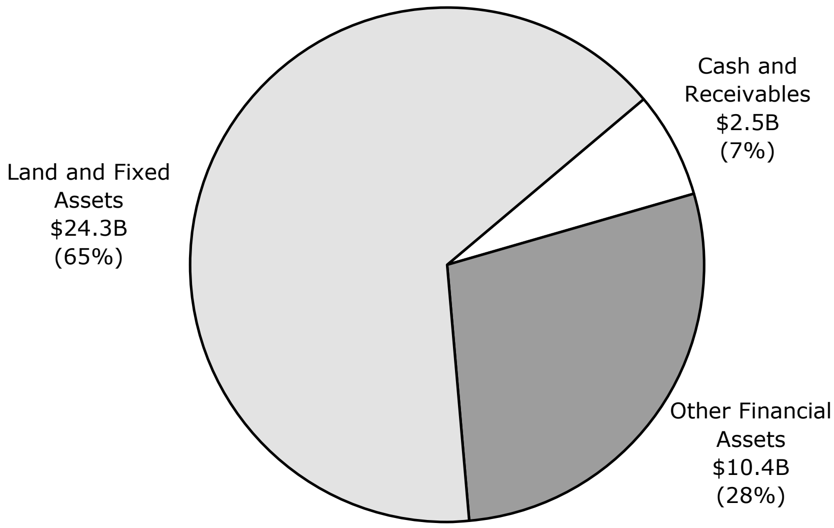
These movements mirror changes reported under the GFS methodology earlier in the Report.

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 tables show the composition of assets under the control of the State.

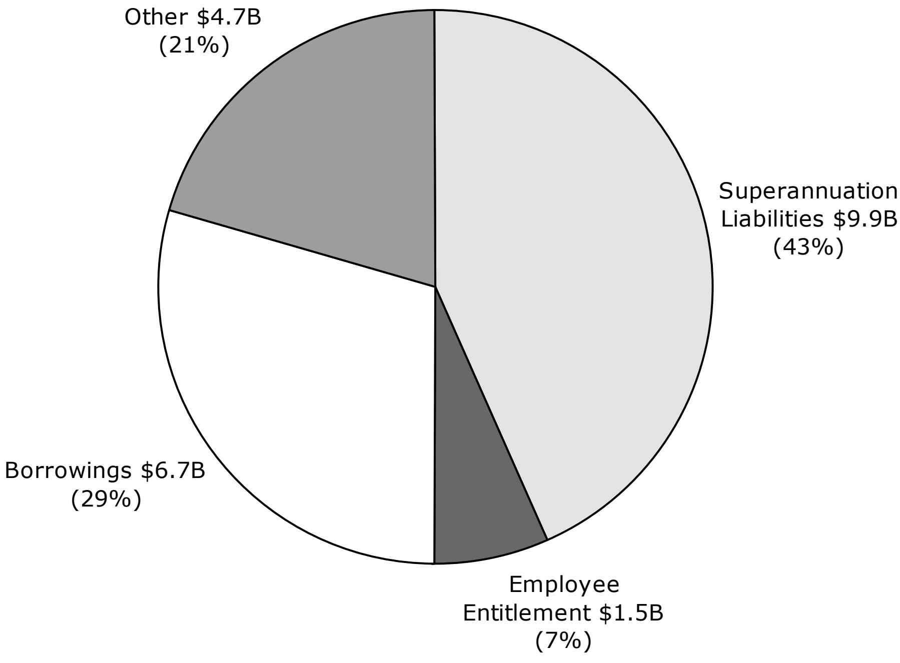
Composition of Total Assets as at 30 June 2003 ($'billion)



13.2 WHOLE-OF-GOVERNMENT LIABILITIES

The following table shows the Government's reported liabilities as at 30 June 2003. The table shows that borrowings and superannuation liabilities are the most significant liabilities. These make up 73 percent of the total liabilities as shown below.

Composition of Total Liabilities as at 30 June 2003 ($'billion)



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