[P.P.4

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 2002

Tabled in the House of Assembly and ordered to be published, 14 October 2002

Second Session, Fiftieth Parliament

PART A

Audit Overview

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

2002

Government of South Australia

Auditor-General's Department

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

Telephone +61 +8 8226 9640
Facsimile +61 +8 8226 9688
DX 56208 Victoria Square

E-mail: admin@audit.sa.gov.au
Web: http://www.audit.sa.gov.au

ABN: 53 327 061 410

30 September 2002

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

The Hon I P Lewis, MP
Speaker
House of Assembly
Parliament House
ADELAIDE SA 5000

Gentlemen,

AUDITOR-GENERAL'S REPORT 2001-02

Pursuant to the provisions of the *Public Finance and Audit Act 1987*, I herewith provide to each of you a copy of my 2002 Annual Report. This Report includes the Honourable the Treasurer's Statements for the financial year ended 30 June 2002.

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 and III 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 and III of Part B.

Independent Audit Opinion

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 2002;

(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, Training and Employment — Department of
- Environment and Heritage — Department for
- South Australian Forestry Corporation
- South Australian Metropolitan Fire Service
- South Australian Motor Sport Board
- University of Adelaide
- University of South Australia
- Water, Land and Biodiversity Conservation — Department of

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 Volume I, II or III 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

TABLE OF CONTENTS

STATE FINANCES AND RELATED MATTERS: SOME AUDIT OBSERVATIONS

TABLE OF CONTENTS

TABLE OF CONTENTS

TABLE OF CONTENTS

TABLE OF CONTENTS

MEMORANDUM TO PARLIAMENT

INTRODUCTION

This Audit Report is to be presented to Parliament approximately six (6) months following a general election that resulted in a change of government. It is, in my opinion, timely to mention some matters that have been the basis of audit concern in recent years. However, before doing so, it is necessary to explain the change regarding the presentation and information content of this Annual Report.

Annual Report Presentation

This year's Annual Report has as its focus the reporting on the financial statements and the adequacy of controls exercised by public authorities. It also includes audit commentary on the State's finances. Apart from a brief reference to some matters in this Memorandum and in the agency report commentary contained in Part B of this Annual Report, Part A of this year's Report does not, as in previous years, include the broader audit commentary on particular matters of importance to the Government and the Parliament that are the subject of audit attention and review. These last mentioned matters will be the subject of separate reports to the Parliament throughout the course of the financial year. This approach is consistent with that taken by the Commonwealth and each of the other State and Territory Auditors-General.

This change has been made to allow for the significant demands that exist at this time of the year in meeting the financial statement attest and control requirements of the audit mandate. This does not mean that any less information of importance will be available to the Government and, the Parliament. It simply means that, as in the case of all other Australian Parliaments, this information will be made available during the course of the year, thereby enhancing it's timeliness and relevancy.

Audit Information to Parliament

There has been widespread concern in Australia and internationally regarding the adequacy of audit reporting of issues to stakeholders. The stakeholders in the audit of Government in this State are the members of the South Australian community and, in my opinion, it is essential that the Members of Parliament, as the representatives of the community, have confidence in the preparedness of the audit process to bring to notice matters of importance within the audit mandate.[1]

[1] Evidence to the JCPAA (Commonwealth) with respect to its reference on the role and responsibilities of auditors, media reviews, and evidence to official investigations, has clearly shown instances where auditors have failed to discharge this responsibility.

The following comment was recently made by a senior financial analyst in a discussion of the adequacy of auditing following the Enron (US), HIH and other high profile corporate collapses:[2]

> *Here is how an audit works: the auditor writes a brief formal letter to the Board and the shareholders via the annual report which states that everything is just tip top, true and fair. He/she then writes another - secret - letter to management listing all the problems he/she has found.*
>
> *This is called the management letter, and it is the real audit.*

The analyst makes the point that the information in the management letter should, if it is material in the context of the financial statements, be made available to the governing body and the shareholders as a matter of course. In the private sector it would be rare for the shareholders of public companies to be privy to the matters raised in the management letter.[3]

In the public sector the Auditor-General's Report to the Parliament is not limited 'to the brief formal letter (opinion) to the Board and the shareholders via the annual report'. The Annual Audit Report[4] to the Parliament in South Australia does contain details and comments concerning material matters dealt with in management letter communications to Ministers and/or public sector agency management.

Letters are submitted to the relevant parties following the execution of audits and examinations seeking to raise and clarify issues that have a significance in terms of financial management and control (including the efficient and economic use of resources), any matters of a general or specific accountability nature, and matters relating to compliance with relevant legislative requirements.

STATE FINANCES

Change in Fiscal Strategy

I commented in my last Report that I believed it was imperative for the Government to set out the details of a revised long-term basis for fiscal strategy and related monitoring and reporting.

I emphasised I believed that the Government Finance Statistics (GFS) accrual method suggested by the Department of Treasury and Finance and adopted in April 2000 by all Australian jurisdictions for uniform reporting purposes, was a better basis for the long-term than the cash basis used for the past four year financial plan ending with 2001-02.

---

2 Alan Kohler; Financial Review, 23 March 2002 p. 72.

3 Without being privy to matters raised in the management letter shareholder questions of the auditors at an Annual General Meeting are not informed as to issues of concern that have been raised by the auditor with management.

4 Indeed, the audit mandate as provided in the *Public Finance and Audit Act 1987*, contains both obligatory and discretionary annual reporting duties relating to the accounts and records of the Treasurer and public authorities.

The new Government announced in the 2002-03 Budget the adoption of a long-term strategy on the GFS accrual basis. The primary long term fiscal target is to achieve, on average, zero net borrowing in the general government sector over any four-year term. The effect of this principle is that revenues will fund all operating and capital expenditures.

The 2002-03 Budget commences the path to meeting that long term aim but current projections do not include its specific targeting until the end of the current parliamentary term.

The State's Finances 2001-02

The estimated result for the 2001-02 year was a GFS net borrowing result for the general government sector of $396 million, which is consistent with the previous year, but a deterioration of $187 million from the budgeted result. The deterioration in the estimated result can be mainly attributed to increasing cost pressures, and timing and data revisions including the deferral of budgeted revenue from distributions, offset by increases in revenues. Determination of the actual result is particularly influenced by final agency spending and may differ significantly from the estimated result.

Unfunded superannuation liabilities at 30 June 2002 is estimated to be $3.8 billion and net debt estimated to be $3.4 billion, up $185 million from the previous year. Net debt was, however, steady at 7.5 percent of Gross State Product.

The 2002-03 Budget and Forward Estimates

The adopted fiscal targets essentially confine operating expenses and capital expenditure for the General Government Sector within available revenue. Little real terms growth is expected from revenue sources over the period of the 2002-03 Budget.

Notwithstanding, the Government have budgeted to make major inroads to the level of the GFS General Government Sector net borrowing result experienced in previous years. The Budget forecasts a budgeted GFS General Government Sector net borrowing result for 2002-03 of $75 million, an improvement of $321 million on the estimated 2001-02 result and similar results over the three years to 2005-06.

To achieve these outcomes the Government has; (1) budgeted for targeted savings totalling $967 million over four years; (2) the receipt of distributions from the financial corporations sector of government amounting to $598 million over four years, of which $561 million is from two entities[5]; and (3) revenue measures designed to bring in an additional $56 million in a full year.

The Budget, as is now accustomed practice, projects estimates over a four year period, a time frame that has inherent uncertainty. There are, in Audit's view, considerable risks inherent in the future estimated budgeted results, particularly with respect to the achievement of planned savings and the long term sustainability of the receipt of

---

5 ie South Australian Government Financing Authority and South Australian Asset Management Corporation.

distributions from government entities in the GFS other sectors. The budget picture for this State continues to look tight, as it has for the past few years and there remain significant improvements needed to reach the fiscal target of a balanced budget.

The goal of balanced budgets may be achievable but will require strict control over government expenditures and maximising the use of government revenues. The Government acknowledges this need and has established a range of actions to facilitate achievement of its target. With a long term strategy in place in relation to unfunded superannuation liabilities, and debt reduction no longer a primary target, this is the key challenge in the management of the State's finances.

REVIEW OF THE SOUTH AUSTRALIAN PUBLIC SECTOR

In December 2001 the former Government established a Task Force to review public sector processes.

Review Scope

The Task Force was asked to examine and make recommendations regarding:

- Strategies and proposals to achieve a more productive interaction between government and the community in the formulation and delivery of government policies and programs.

- Strategies and proposals to improve cooperation and interaction between departments and achieve more integrated whole-of-government solutions to policy and program issues.

- Reform of the present accountability and probity framework and process.

This Report on the review titled ‘Public Sector Responsiveness in the 21st Century: A Review of South Australian Processes’ was presented to the new Government in May 2002.

Outcome of Review

The Report of the Task Force presents 121 recommendations on a number of key areas and processes that are currently being considered by the Government.

The Task Force expressed the view that the public sector, in general, comprised talented and hard working people committed to serving the community and the Government.

It concluded, however, that the current governance arrangements of the public sector were inadequate to provide it with sufficient clarity and guidance to achieve what the Government expects in a manner acceptable to government and the community. The Task Force indicated that this inhibits innovation, risk management, accountability, and a focus on outcomes and performance.

The report communicates a significant number of matters that are an echo of many issues that have been the subject of specific concerns and comments in my previous Reports to Parliament.[6]

It is, in my opinion, in the public interest, that the Parliament, Executive Government and the management of the public service address with positive action the substantive findings and recommendations contained in the Report.

PUBLIC GOVERNANCE

Importance of Compliance with Proper Standards by Executive Government

In my opinion, there have been a number of disquieting features in public administration in this State in recent years that raise concerns regarding the propriety of the exercise of the Executive power of Government in certain matters.

In a legal system based on the rule of law, the Executive power of Government may be exercised only for the public good and not for improper purposes.[7] The political and legal safety of the South Australian community is at risk when a culture of disregard for proper standards are practised by those who are responsible for the exercise of the Executive power of the State.

The Task Force in its report on the Public Sector Review stated that it had been 'informed on a number of occasions that the public sector has lost its ability to take managed risks and to give frank and fearless advice'.[8] The report mentioned two factors for this, notably:

- unclear or confused governance arrangements, in particular, a lack of clarity of roles and accountabilities at all levels;
- an intolerance of mistakes.

I consider it important to specify a third factor, ie that of some members of the former Executive Government summarily dismissing advice proffered by the public service when it did not accord with preconceived ideas.[9]

Good government is directly dependent upon the performance of the public sector. In my opinion, the conduct on some occasions of a certain few members of the Executive Government vis-à-vis the public sector during the past several years impaired its capacity to discharge its responsibilities in some matters.[10]

---

6 For example, refer Report of the Auditor-General for the year ended 30 June 1999, Part A.3 relating to matters associated with Public Governance.

7 Three Rivers District Council v Bank of England (No 3) (2000) 3 All ER 1 at 7. 'Improper Purposes' would, in my opinion, include the expenditure of public money for 'party political purposes'. See also comment by Gleeson CJ in *Xenophon v State of South Australia* in the application for leave to appeal to the High Court of Australia.

8 Public Sector Responsiveness in the 21st Century: A Review of South Australian Processes: May 2002, p.6.

9 The Hindmarsh Stadium Redevelopment is an example of this situation.

10 Report of the Auditor-General for the year ended 30 June 1999, Part A.3 relating to matters associated with Senior Executive Contracts.

Governance Arrangements and Processes

Instances of policy failure in recent years have, in my opinion, been the result of inadequacies in public governance arrangements and processes. The objective of good governance is to establish an appropriate framework in order that policy objectives can be thoroughly analysed and achieved economically and effectively.[11]

Audit reports over the past few years have detailed a number of instances where the appropriate framework was either inadequate or not followed to ensure that policy objectives were achieved. Policy failure has occurred with consequential financial cost to the community.

Significant improvement in the current governance framework is also the clear message from the report of the Public Sector Review.

Of specific note, the Public Sector Review Task Force considers that there needs to be clearly defined roles, relationships, accountabilities and operating policies among the key participants in the governance arrangements (ie Cabinet, individual Ministers, Chief Executives, Senior Management Council, etc).

The absence of clarity of roles and accountabilities has been frequently highlighted in previous Audit Reports to the Parliament as a critical matter in need of attention to ensure public confidence in the internal processes of government are not undermined.[12]

Another area of concern that has warranted specific comment in previous Reports to the Parliament relates to the requirement to exercise due diligence. A failure to undertake a proper analysis before committing to a course of action, particularly in relation to significant project and contract related arrangements, can result in a judgment on a matter being made with a blindness to other possibilities. This is not a course that engenders confidence in the processes of government decision making.

The elements of clarity of role and accountability and the exercise of appropriate due diligence are essential to good public governance to minimise the risk of waste and cost associated with policy and project failures.

SERVICE DELIVERY ARRANGEMENTS OF GOVERNMENT

Over the past eight years, there has been an increase in the extent to which services formally provided by government are now being provided by the private sector under contractual arrangements with the Government.

---

11 'Government Governance — Corporate Governance of the Public Sector — Why and How?' (Ministry of Finance, Netherlands, November 2000). See also the several 'frameworks' that have been developed in recent years in this State.

12 Reports of the Auditor-General for the years ended 30 June 1997, 1998, 1999; Part A Audit Overviews.

As in past years, review of certain contractual arrangements still give rise to issues that reveal inadequacies in contract management processes and performance accountability obligations.

In respect of some significant longer term contracts, situations have arisen over the life of the contract where private sector contractors have been unable to fulfil some conditions of the contract. In other instances, situations have occurred where the contract conditions have been formally changed over the term of the contract. Longer term contracts also generally require the Government to consider its position with regard to intended renewal or termination some time before the expiry term of the contract.

In these situations, it is necessary for government in contract amendment, contract renewal or for new contracts, to ensure that due diligence and risk management practices are applied to minimise the associated risks and achieve potential contractual benefits. Consideration of benefits and risks will be influenced by the term of the contract, potential future changes in service delivery requirements, application of non-performance penalties, and the complexities and costs in bringing service delivery back to government where that may be an option for consideration.

IT DEVELOPMENTS AND CONTROL

Over the last three years there have been important developments relating to Information Technology in this State. The Department for Administrative and Information Services (DAIS) is the principal central agency for Information Technology. This Department takes a lead role in the development of an IT Plan for Government and provides consultative policy direction and guidance to agencies. Each agency has responsibility for the security and control of it's own computer operations.

The focus of Audit in this area has been aimed primarily at assessing the adequacy of whole-of-government IT strategic planning, policy standards and guidance, and the adequacy of the control exercised over computer operations of government agencies.

Notwithstanding the developments that have been and are currently taking place, there continue to be 'gaps' in the overall coordination, monitoring and control associated with whole-of-government IT developments, and the security control arrangements within some agencies. In essence, some of the significant matters can be summarised as follows.

Government Planning and Policy

In October 2000, Cabinet endorsed the first iteration of a whole-of-government IT Plan (Information and Communication Services Directions Plan).

Some aspects of the plan have not been commenced or fully developed. These include the recognition of significant projects being undertaken by some government agencies, inclusion of timeframes and outcomes for completion of major projects, and the finalisation of some key plan documentation.

In addition, the whole-of-government IT plan is not used for effective monitoring of major IT projects of agencies. In my opinion, it is essential, that there is active central body coordination and monitoring of major agency planned projects with respect to the whole of-government IT Plan. A decision needs to be made by government as to where DAIS stands in this role.

In relation to policy and guidance matters, government agencies have been operating in the emerging areas of e-commerce and use of the Internet for service delivery without up-to-date guidance. It should be mentioned that a new information security framework document has been substantially completed and it is to be submitted to Cabinet for approval.

More recently, the new Government has commenced a major review of existing Information and Communication Technology (ICT) service arrangements. The aim of the review is to ensure that ICT service arrangements beyond 2005 meet the Government's future requirements.

The outcome from this review may have significant implications for the Government's IT strategic planning, policy guidance, funding and contractual arrangement processes. This is recognised by Government in its establishment of new governance arrangements for ICT strategic planning, policies, and standards at the whole-of-government level.

However, it is to be noted that, the new governance arrangements do not address the specific responsibility for ICT strategic plan co-ordination and monitoring.

Computing Operations and Control

Audit reviews of agency computer environments and systems during the latter part of 2001-02 have revealed a number of areas where improvements were found necessary to achieve a satisfactory control environment. The outcome from the reviews and any remedial actions taken by agencies will be included in a subsequent Report to Parliament.

At a whole-of-government level, action has been initiated by DAIS to improve a number of management and control aspects of the Government's Wide Area Communications Network (StateNet) operations. A review of StateNet by Audit last year identified significant weaknesses in a number of important management, design, and security matters. These matters were the subject of detailed comment in the 2000-01 Annual Report.

DAIS plans an upgrade of certain security and accessibility components of the StateNet central Internet gateway. This is estimated to cost in the vicinity of $1 million. The upgrade will provide vital protection for all agencies using StateNet.

As regards government use of the Internet, last year's Audit Report included comment regarding the provision of electronic service delivery to the South Australian public, covering matters of a legal, policy, privacy and security control compliance nature. I intend in a subsequent Report to Parliament to report on the status of developments in electronic government and the measures taken by the Government and agencies to mitigate the risks in this emerging area.

AUDIT REVIEWS AND EXAMINATIONS IN PROGRESS

As mentioned in this Memorandum, certain matters will be the subject of separate reports to the Parliament throughout the course of the financial year.

These matters have been initiated as part of this Department's annual audit strategy and plan. In addition, pursuant to section 32 of the *Public Finance and Audit Act 1987*, the Treasurer has referred two matters to the Auditor-General for examination and report.

Matters that are presently under review that will result in a report to the Parliament include the following:

- Review of aspects of Parliamentary allowances.
- Assessment of Procurement Reform across the public sector.
- Valuation and Disposal of Government Property.
- Status of developments in electronic government and the measures taken by the Government and agencies to mitigate associated risks.
- Review of security management and computer environments of specific government agencies.
- Administration of the Emergency Services budget over the last four years with particular emphasis on the management of the Country Fire Service Board (CFS) budget and the funding of the McLaren Vale Ambulance Station.
- Assessment of whether the affairs of the Basketball Association of South Australia (BASA) are being conducted with due regard to economy and efficiency, including identifying whether the undertakings provided by BASA to identify further efficiencies have in fact been achieved.
- Acquisition of a Magnetic Resonance Imaging Machine at the Queen Elizabeth Hospital.
- Indemnification of Ministers for costs and damages in Defamation matters including the indemnity of the Honourable Wayne Matthew MP in an action by Mr Chris Hanna MP.

K I MacPherson
AUDITOR-GENERAL

STATE FINANCES

AND

RELATED MATTERS:

SOME AUDIT OBSERVATIONS

1 SUMMARY OF MAIN POINTS

This section of my Report provides a summary of the more significant audit observations and conclusions resulting from the discussion and analysis of the State's finances, including the management of those finances. References are made to the detailed commentary contained within this Report.

Major Factors Impacting on the State's Finances

The 2001-02 year saw a number of factors that have impacted on the management of the State's finances, including:

- the election of a new government in March 2002;
- the adoption of a new fiscal target
- finalisation of a number of asset sales;
- the continued bedding down of the implementation of national tax reform.

In respect to asset sales, a summary of the South Australian Ports Corporation (Ports Corp) sale is included in Part B of this Report and details in relation to the South Australian Totalizator Agency Board (TAB) will be in a Supplementary Report.

Reporting Frameworks

There is in place a range of reporting frameworks including a series of reports comprising what is known as Government Financial Statistics (GFS) that have been, and in most cases will continue to be, used for reporting on the State's finances. The frameworks are designed to serve the needs of various users, including all levels of government and the public generally. Although there is a place for each of the frameworks, it can make it difficult to draw a consistent and comparable range of data to allow for the analysis of financial performance and the financial position of the State. (section 3.1)

DEVELOPMENT OF A FISCAL STRATEGY

The importance of the budget process is that it should provide structure and discipline to the financial management process, and is, in Audit's view, a necessary element for adequate control over the State's finances. Part of that process is the development of an identified fiscal strategy.

The 2001-02 Budget forecast a possible change in fiscal targets and measurement at the conclusion of the four year plan ending in 2001-02. (section 4.1)

The Government have now indicated that their main fiscal strategy is to achieve average balanced budgets on an accrual basis in the General Government Sector. The effect of this principle is that all operating expenses and all capital expenditures are fully funded from revenues. (section 4.4)

FINANCIAL PERFORMANCE

The estimated result for the 2001-02 year was a GFS net borrowing result for the General Government Sector of $396 million, which is consistent with the previous year, but a deterioration of $187 million from the budgeted result. (section 5.4.1)

The deterioration in the result can be attributed to increasing cost pressures, timing and data revisions and off-setting revenues. (section 5.4.1)

The Budget presented to Parliament in July 2002 details a budgeted GFS net borrowing result for 2002-03 of $75 million, an improvement of $321 million on the estimated 2001-02 result. Although the budgeted result reflects a substantial improvement in financial performance from the previous year, there are, in Audit's view, considerable risks inherent in the future estimated budgeted results, particularly with respect to the achievement of planned savings and the long term sustainability of distributions from government entities in other GFS sectors. (section 5.8.1)

The predicted results show that while some improvement is anticipated towards the target of, on average, zero net borrowings over a parliamentary term, further progress is required to achieve this objective. With the movement in the State's net borrowing result being forecast to improve each year, and with the Government's expenditure review program continuing in 2002-03, this goal may be achievable but will require strict control over government expenditures and maximising the use of government revenues. (section 5.6.1)

Further, with the average net borrowing result over the next four years of $81 million per annum, there is still significant improvement needed to reach the fiscal target of a balanced budget, particularly given that distributions from the financial institutions, which are projected to provide significant benefits over the next four years, will not be available to the same extent in the long term.

The 2002-03 Budget reports a deteriorating performance for the past financial year, but forecasts a dramatic improvement in the financial results for the State's finances over the period (to 2005-06) of the Budget. These matters have been principally determined through budgeting for operating expenditure savings, starting in the 2002-03 year to support long-term improvements in the operating results of the State's finances. (section 5.8.1)

It is observed that the characteristics of the 2002-03 Budget are in line with many before it, the projection of real terms decreases in outlays over the forward period, and when compared to the recent history for outlays, emphasises the need for managing the actual performance against budget and for control of spending. This is particularly an issue for agencies that have identified and submitted savings targets.

Notwithstanding the significant budget improvements, at the end of the Budget cycle, South Australia may still be worse off in terms of some key indicators relative to other states. (section 5.8.3)

Revenue

The forward estimates indicate considerable fluctuations in State own-source revenues as a result of periodic, lumpy distributions to the Budget from public financial institutions, namely South Australian Asset Management Corporation (SAAMC) and South Australian Government Financing Authority (SAFA). This is consistent with past Budget presentations. These distributions have traditionally only been called upon where required for the Government to meet the target Budget result. The budgeted and estimated distributions projected over the period 2002-03 to 2005-06 amount to $561 million and have a substantial negative impact on the total accumulated reserves of each of the institutions. (section 6.1)

As reported for a number of years, a very large influence on taxation income has been the introduction of gaming machines into licensed hotels and clubs, which has meant that gambling taxes continue to be an increasing contributor to State revenues, being estimated at $308 million in 2001-02 and budgeted revenue of $336 million for 2002-03. (section 6.2.1)

Payroll Tax ($591 million in 2001-02) continues to be a principle source of taxation revenue, and by the end of the forward estimates, taxation on payroll will be the largest State taxation source due to estimated employment and earnings growth. (section 6.2.3)

Revenue from the Commonwealth is the most significant source of revenue to the State and has increased over the last two years as a result of the new tax system from $3.3 billion in 1999-2000 to $4.6 billion in 2001-02. However, the long-term benefit to the State's finances of the national taxation reforms is as yet unknown, while the benefits are not projected to commence until 2006-07. (section 6.3)

Expenditure

Going forward, expenses are projected to decrease in real terms from $8.6 billion in 2001-02 to $8.5 billion in 2002-03. Audit analysis indicates that this is against the trend for the four years to 2001-02 where expenses have increased in real terms. This suggests that managing the level of expenses will be essential to achieve set targets. (section 7.1)

Salaries and related costs (estimated to be $3.7 billion in 2001-02) represent a very high proportion (43 percent) of the total General Government Sector expenses. However, given that a number of enterprise agreements have been recently finalised, the impact of agreements for the majority of employees should be known, and the Budget should reflect a reasonably accurate estimate of costs in the immediate years of the estimate period. The Budget identifies that if wages and salaries for public sector employees increased by 1 percent more than is currently factored into the Budget then wage and salary expenditure would increase by approximately $38 million per annum. (section 7.2.1.1)

Other operating and transfer expenses are estimated to fall in real terms from $4 billion in 2001-02 to $3.8 billion in 2002-03. Therefore there is a potential risk to the Budget and forward estimates if savings targets that have been built into the 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. (section 7.2.2)

The State's finances are dictated by the needs of the health and education sectors, which make up nearly one half of expenditure. Therefore, even though the Government has made commitments to increase spending in both the health and education areas, it is unlikely that the level of savings required to meet the fiscal target can be achieved without also making savings in those same sectors. (section 7.3)

Savings

The Budget includes a number of savings that have been identified by agencies, based on either achieving efficiency or reducing particular services. This amount was supplemented with reductions in flexibility for future general cost pressures or new initiatives through the reductions in contingency provisions. Total savings expected are $967 million over the Budget period.

In addition, further expenditure reviews were commenced during 2001-02 in relation to the Education and Human Services portfolios. Reviews with respect to other areas have yet to be established.

If the savings are not achieved it is likely there will be considerable stress on the overall Budget outcome. (section 7.2.7)

FINANCIAL POSITION

Assets

Total general government financial assets are expected to reduce from $13.9 billion in 2001-02 to $13.5 billion in 2002-03 and increase thereafter reaching $14 billion in 2005-06. The decrease for 2002-03 principally reflects the expectation that equity of the General Government Sector in SAAMC and SAFA will decrease by $324 million as a result of distributions back to the General Government Sector. (section 9.2.1)

While there is an expected increase in non-financial assets in 2002-03, this increase is insufficient to cover the reduction in financial assets with a resultant expectation of a decrease in total assets for 2002-03. (section 9.2.1)

Investment assets as at 30 June 2002 for the major investing agencies amounted to $9 billion. (section 9.2.3)

Concerning superannuation investments, there have been average returns over a 10 year period of approximately 6 percent per annum on Australian equity markets and 9 percent per annum returns on the United States' markets. Within this time period, negative returns have also been incurred for three out of the 10 years (including 2001-02), however, this has had minimal impact over the long term. Poor investments returns made during a year, especially on superannuation assets, can have a large adverse impact on the State's short term financial position. (section 9.2.4)

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. (section 9.2.5)

General government non-financial assets are estimated to increase by $218 million in 2002-03 to $11.1 billion and to $11.5 billion by 2005-06. Increases are due primarily to the net acquisition of non-financial assets for the Budget years. (section 9.3.2)

South Australia has a higher ratio of non-financial assets compared with Victoria, and is quite well placed against New South Wales and Queensland. (section 9.3.5)

The new Government has indicated in the 2002-03 Budget its intention to pursue partnership opportunities with the private sector based around commercial agreements where risks in the development of the assets are shared among the party best able to manage these risks. Experience has shown that allocation of risks and returns are a critical issue 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. (section 9.3.6)

Liabilities

Total liabilities for the General Government Sector are expected to grow to $10.6 billion in 2002-03 and to $11.3 billion by 2005-06. (section 10.2.1)

The estimated unfunded superannuation liability as at 30 June 2002 is $3.8 billion. This is an increase of $535 million from 30 June 2001, and is due mainly to a significant fall in investment earnings from assets managed by Superannuation Funds Management Corporation of South Australia (Funds SA) during the year. The fall was due principally to negative returns on international and domestic equities that comprise a large proportion of superannuation assets. (section 10.3.3)

The commitment to fully fund unfunded liabilities was reaffirmed by the Government in the 2002-03 Budget, with the position as at 30 June 2002 remaining consistent with the plan to eliminate unfunded superannuation liabilities by 2034. Additional payments will be required, however, to compensate for reduced earnings in 2001-02 to remain on target. (section 10.3.3)

The assumed rate of return on superannuation assets in the 2001 triennial review was 7.5 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. (section 10.3.5)

Over the 11 year period to 2001-02, on average, investment returns exceeded the budgeted investment-earning rate. Investment returns of other state superannuation schemes are not significantly different over comparative years and have also reached their target rate of return. (section 10.3.5)

On current projections, unfunded liabilities are expected to continue to increase until peaking around the period 2014-15. It is estimated that benefit payments will peak in 2018-19. (section 10.3.7)

Guarantees and contingent liabilities of the Government of South Australia as at 30 June 2001 were valued at $1.9 billion. This is at nominal values without adjustment for the probability of actual liabilities occurring. (section 10.5)

Net Worth and Net Financial Worth

General Government Sector net worth is forecast to decrease by $167 million in 2002-03 to $14.1 billion and rise again in the two years 2004-05 and 2005-06 to $14.2 billion. (section 11.3)

General Government Sector net financial worth is forecast to decrease annually over the forward estimates period from $3.3 billion in 2001-02 with a total decrease of $622 million over the four years to 2005-06 to $2.7 billion. The main reasons for the trends shown is the budgeted decrease in equity in SAAMC and SAFA in 2002-03, and the increase in superannuation liabilities and the persistent net borrowing result over the forward estimates period. (section 11.3)

NET DEBT

The fiscal principles adopted for the 2002-03 Budget 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. (section 12.2.2)

Non-Financial Public Sector net debt is estimated to reduce by $129 million over the four years to 2005-06 from $3.4 billion to $3.3 billion. (section 12.2.2)

Net interest payments make up a very low proportion of total underlying revenues and over the forward estimates, interest costs are to remain stable in comparison to general increases in total revenues with only slight fluctuations with own-source revenues. (section 12.3.5)

BUDGET PREPARATION AND PERFORMANCE MONITORING

In the course of preparing the 2002-03 Budget the Government saw the need to commence a detailed expenditure review process.

The need to establish a review process suggests, in my view, inherent weaknesses in the budget process, notwithstanding reform has been in progress over four years.

I will be seeking further details on the budget process and related financial controls in the next year. (section 14.3.4)

2 INTRODUCTION

The 2001-02 year saw a number of factors that have impacted on the management of the State's finances. They include:

- The election of a new Government in March 2002, with the subsequent changes in focus of aspects of the State's finances. Given the timing of the election close to the normal Budget finalisation time, there was also a revised timetable for the preparation of that Budget, resulting in it being presented to Parliament in July 2002 (rather than the normal May tabling).

- The adoption of a new fiscal target that provides a different focus for the management of the State's finances. In past years I have reported on the previous Government's progress against its financial strategies with the most recent focus being on the four-year plan commencing from the 1998-99 Budget, the first to implement accrual output budgeting. Notwithstanding the accrual perspective, the key budget targets remained cash-based until this year.

- Finalisation of asset sales. Electricity asset disposals had brought significant reductions in net debt, with proceeds from disposals of $4.9 billion used for debt retirement. The current year saw the finalisation of the sales of the Ports Corporation and the South Australian TAB. As a consequence of the asset disposal programs there are reductions to interest rate and other risks, with the trade-off being the loss of major essential service infrastructure assets and the related income streams.

- The continued bedding down of the implementation of national tax reform. Tax reform offered the prospect of long-term improvement in the revenue base and resulted in significant increases in Commonwealth general purpose funding offset by the abolition of some State taxes. The long-term impact of these changes is yet to be determined.

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

- the reporting frameworks that exist for reporting on the State's finances. This is important, as there are a number of statutory and professional reporting requirements, each providing a different perspective;

- some brief analysis of the financial performance of the State for the year, based on some of the different reporting frameworks. This includes looking at the results for the past year, and the Budget and forward amounts 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;

- some observations with respect to several key management issues for the control of State finances.

3 REPORTING FRAMEWORK

3.1 INTRODUCTION

There are in place a range of reporting frameworks that have been, and in most cases will continue to be, used for reporting on the State's finances. Although there is a place for each of them, it can make it difficult to draw a consistent and comparable range of data to allow for the analysis of financial performance and the financial position of the State.

This section provides a brief background for each of the major frameworks, how they differ from each other, and what their usefulness and/or limitations might be. It also gives an overview of the scope of the audit with respect to the frameworks, and where relevant, any issues that may have come out of any audit work undertaken.

The major frameworks referred to throughout this Report include:

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

In last year's Report I indicated that such a range of reporting must be regarded as administratively costly and risks being confusing not only for users, but more importantly for preparers and managers who may find conflicting imperatives arising from the different reporting regimes that affect the quality and usefulness of information and decision making.

Given this situation, during the year the Department of Treasury and Finance (DTF) finalised a review of future financial (the Budget refers to these as fiscal) targets in 2001-02, which followed on from earlier reviews in the previous two years. Following the recommendations of this review the Government has adopted a change to the primary basis for Budget presentation and the specific target/s.

As a consequence, although the AAS framework basis 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 (which is based on the reporting standards of the Australian Bureau of Statistics' (ABS's) Government Financial Statistics (GFS) framework).

As a result of this focus on the UPF framework by DTF, the major proportion of the discussion and analysis is directed at reviewing information that is reported on that basis, with reference to other reporting framework based information as relevant.

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

3.2 UNIFORM PRESENTATION FRAMEWORK (UPF)

3.2.1 Background

For a number of years the ABS have coordinated the collection of financial statistics for all Australian Governments.

The May 1991 Premier's Conference agreed to the introduction of the UPF. The format of the UPF is based on the reporting standards of the ABS's accrual-based GFS framework.[13] All of the States adopted this as the basis for uniform reporting, which was supplementary information reported in Budget and Budget Result documents prepared by each jurisdiction. In this State, the Budget Results for 1999-2000 included a presentation in accordance with the new accrual GFS method. As a consequence future trend analysis in many areas will be limited to a period commencing 1998-99.

For the 2002-03 Budget there has been a change in the presentation focus from the cash-based non-commercial sector to an accrual-based GFS focus. This has resulted in new accrual-based fiscal targets being developed against which future budget results will be assessed. These are discussed later in this section.

Although GFS accrual reporting has many similarities to that under the AAS framework, the GFS framework excludes revaluations arising from a change in market prices, and other changes in the volume of assets that result from discoveries, depletion and destruction of assets.

One reason for this was that it was considered that the interpretation and application of AAS standards is the preserve of the respective treasury and audit offices of each jurisdiction, providing scope for varying interpretations and potentially substantial differences in the reporting of financial information across jurisdictions.

Notwithstanding these differences, the main statements emanating from GFS financial reporting are the operating statement, balance sheet and 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 of government activity are identified, being:

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 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 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

[13] 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).

Financing Authority (SAFA), South Australian Asset Management Corporation (SAAMC), HomeStart Finance and Funds SA.

The consolidation of all sectors represents the total public sector.

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[14] 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 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 for 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 are generally established to make surpluses through the provision of a good or service and provide support to the General Government Sector. As such, the importance of achieving a net operating balance or budget surplus is heavily dependent upon 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 (or Fiscal Balance)*** — measures a government's investment saving balance. This measure includes net capital expenditure, but not the use of capital (ie depreciation). It indicates whether a government is saving more than enough to finance all of its investment spending and is therefore not contributing directly to the current account deficit;

[14] The Non-Financial Public Sector represents a consolidation of the General Government and Public Non-Financial Corporation Sectors.

- ***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 financial assets less total liabilities;

- ***Net Debt*** — comprises gross financial liabilities less the stock of gross financial assets. The items included in this measure are discussed in depth in the Budget Papers.

These measures have been focused on by Audit throughout its discussion of the State's financial performance, financial position and overall financial strength.

As with any analysis, however, there will be certain factors that make up these measures that impact on the interpretation of the numbers. For this reason, in a number of areas additional measures based on those above are used to provide a deeper understanding of the State's finances.

3.2.2 Scope of Audit 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 2002-03 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 broad understanding of the budget preparation process, the data and assumptions are not subject to audit.

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

3.3 NON-COMMERCIAL SECTOR

3.3.1 Background

The non-commercial sector includes virtually all agencies except commercial (profit orientated) agencies of which South Australian Water Corporation is now the largest.

The Government has used the cash-based non-commercial sector operating result as its focus for financial management strategy (the Budget refers to these as fiscal strategy) since the Commission of Audit in 1994. Since 1994 there have been a number of additional or supplementary accrual-based targets introduced. Apart from net debt and unfunded superannuation targets, these have always been subordinate to the cash-based focus in Budgets.

Cash-based systems have a powerful attraction in their simplicity, however, virtually all forms of public sector financial reporting have moved to accrual-based systems. This aligns with the view that improved information is available to the user to support management of resources and decision making.

In addition, I have continually made the observation in past years that the Government's ability to determine central transactions at the finalisation of the budget outcome had been a facility for the Government to achieve published estimated outcomes. The key point to acknowledge is that the achievement of the cash-based budget target was readily accommodated through timing of transactions. It has been the regular practice of previous governments to process transactions at year-end to essentially achieve budgeted outcomes.

This process means the actual result did not relate to the budgeted flows for a year but rather the actual flows as adjusted to achieve the budgeted result. Over the years this final adjustment process had, in my opinion, become administratively cumbersome. It was presentational and did not affect the overall public sector financial position. For this reason it was important that the estimated and final results were not seen, on their own, as a reflection of the Government's ability to meet its budgeted performance. A sound understanding of the changes in the outlays and revenues comprising the result was, in my opinion, vital to interpreting performance.

The key measure of the non-commercial sector that had been focused on by Audit was the underlying surplus/(deficit). This amount was adjusted for abnormal items that occur during the year such as asset disposal proceeds and separation payments.

Because this framework was the basis for the previous Budgets, and because it is still given some recognition in the current fiscal strategies, the 2002-03 Budget Papers[15] provide a statement based on this framework.

3.3.2 Scope of Audit of Non-Commercial Sector Financial Statements

Statements prepared under the non-commercial sector are not subject to audit beyond a high level analytical review. Therefore no opinion can be provided on the accuracy of both historic and prospective figures presented as part of the Budget Papers.

3.4 AUSTRALIAN ACCOUNTING STANDARDS (AAS)

3.4.1 Background

In 1997-98 all Government agencies adopted accrual accounting and financial reporting in accordance with Australian Accounting Standard AAS 29 'Financial Reporting by Government Departments'. As a result, the statutory financial reports that are prepared by individual agencies and subject to audit are compiled using Australian Accounting Standards.

---

15 Budget Statement 2002-03, Budget Paper 3, Appendix B.

In addition, in 1998-99 Accounting Standard AAS 31 'Financial Reporting by Governments' became operative. Whole-of-government financial reports have been prepared in this State since that time.

In the course of audit work it has been noted that in relation to whole-of-government reports, the Government economic entity comprises all sectors of State Government activity, namely:

- general government (government departments);
- public trading enterprises;
- government controlled financial institutions;
- other government controlled entities.

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.

3.4.2 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.

I consider the whole-of-government financial statements an essential component of the various information presented on the State's finances and financial position and are useful to management, governing bodies and other users for making and evaluating decisions about the allocation of scare resources. Further, the accrual-based whole-of-government financial statements provide a mechanism for additional information to be provided to users.

It is over time, through the ability to make a trend analysis of financial performance and financial position, that these statements become an important public sector financial management tool.

Therefore, 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.

3.4.3 Audit Findings and Comments

Following the review of the financial statements for 2000-01 by Audit, a management letter was forwarded to the DTF in February 2002 that contained important reporting and operational considerations that would need to be addressed in order to provide an unqualified audit opinion should legislative changes precipitate the need to provide an audit opinion. The Audit management letter was reproduced in full in the whole-of-government financial statements published by the DTF.[16]

The matters raised included:

- the whole-of-government financial statements excluded certain entities that Audit considered should have been included. Therefore the financial statements do not include all revenues, expenses, assets and liabilities controlled by the Government;
- some of the individual entities consolidated did not have audited information available;
- 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; and
- 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 a number of months before South Australia.

Departmental Response

The Department responded positively to the issues raised above and expected to resolve most issues in time for the financial statements for the year ended 30 June 2002.

---

16 Government of South Australia, Consolidated Financial Statements for the Year Ended 30 June 2001.

Progress continues to be made in whole-of-government financial reporting within South Australia, with the 2000-01 financial statements being the third set of statements subject to audit review. Although limitations still exist with the current reporting process, 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, however, by the more timely completion of the financial statements.

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

3.5.1 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 III of this Report.

3.5.2 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.

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.

3.5.3 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 affects the budget result as 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 are generally not committed to a specific purpose at the time of the Budget.

3.5.4 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 Ministerial payments;

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

- updating and recording of the Treasurer’s Loans.

3.5.5 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 issues raised that Audit believed should be considered. These included:

- the need to improve the process of performing bank reconciliations within the Department of Treasury and Finance (DTF) including advising agencies of their cash balance;

- that a daily cash reconciliation be recorded and reviewed by an independent officer;

- that a reconciliation between the contingency provision spreadsheet and DTF’s general ledger.

DTF responded that each of the matters raised had either been resolved, or that steps had been put in place to implement the Audit recommendations.

4 SUMMARY OF KEY FISCAL MEASURES AND TARGETS

4.1 DEVELOPING A FISCAL TARGET

The importance of the budget process is that it should provide structure and discipline to the financial management process, and is, in Audit's view, an essential element for adequate control over the State's finances. Part of that process is the development of an identified fiscal strategy.

The importance of fiscal targets is that they establish the focus and framework for financial activity, control and accountability. In the private sector they would include profit and return on shareholders funds. In the public sector such measures have little relevance. The matters to be considered in establishing fiscal measures and targets for a state government's wide ranging activities include the following:

- scope of government activity for focus;
- method of recording and reporting;
- fiscal measures;
- specific fiscal targets.

It is also important that measures be understandable and easy to produce, monitor and report.

The previous Government had used the cash-based non-commercial sector as its focus of the fiscal strategy since the recommendations of the Commission of Audit in 1994. The key to the strategy had been for the non-commercial sector to be able to live within the cash resources available to it in each year of a four year budget cycle. These aims have been focused on a key performance indicator, that is, achieving an underlying balanced budget. This was the 'headline' result.

The 2001-02 Budget forecast a possible change in fiscal targets and measurement at the conclusion of the four year plan ending in 2001-02.

The following discusses some considerations in relation to selecting appropriate fiscal targets.

4.2 CASH VERSUS ACCRUAL

The advantages and disadvantages of cash and accrual systems had been debated before 1997-98 when accrual accounting was introduced. Without going over those arguments it is relevant to make a number of observations from more recent experience.

The key argument in the past for accrual accounting was that the cash basis does not capture all financial implications of a years' activity. In my view, experience to date is that accrual reporting better captures the impact of all transactions (including accruing liabilities and revenues). Subsets of information can be derived from that base for specific management and control purposes.

I have indicated previously that one matter in relation to the cash-based system is the way in which the budgeted result can be, and is, achieved through final central adjustments. This process meant the actual result did not necessarily relate to the budgeted flows for a year but rather the actual flows as adjusted to achieve the budgeted result.

While accrual reporting does not eliminate the opportunity for such adjustments, the process is less likely to occur. This would particularly be so if the focus shifted to an explanation of variations and performance over a cycle (rather than one year) to allow for unplanned impacts such as changes of inter-governmental arrangements.

I have already outlined that the two methods of recording and reporting on an accrual basis are the AAS and GFS bases. The GFS basis is clearly favoured by the state treasuries as it has been adopted for uniform reporting as agreed by the states. It is considered a robust methodology that allows comparison between jurisdictions. AAS is, as mentioned, used by individual agencies and in whole-of-government reporting and the business community. It is therefore well known.

Again, for government financial reporting, aspects of AAS reporting are not seen as relevant as they are for the private sector. The GFS method is therefore the more favoured methodology by Commonwealth, State and Territory Treasuries, particularly for budget strategy.

4.3 FISCAL MEASURES IN OTHER JURISDICTIONS

In considering the matter of 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	Underlying 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	Achieving a sustainable fiscal surplus
Victoria	Short Term: Target Operating Surplus of $100 million for the General Government Sector based on generally accepted accounting principles (GAAP). 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, as measured in Government Financial Statistics terms.
WA	There should be an accrual operating surplus for the General Government Sector.
Tasmania	To strengthen the State's financial position, the State Budget will be managed in surplus on a long-term sustainable basis to achieve the Government's net debt targets.
ACT	Maintenance of a balanced budget over the economic cycle (from 2002-03 to 2005-06).
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 states, the most prevalent position is to target net operating surpluses in the General Government Sector, based on the GFS accrual method.

4.4 SOUTH AUSTRALIAN FISCAL TARGETS

In my last Report I noted that in my opinion, it would be timely for the matter of appropriate fiscal targets for the State to be addressed in the near future. The circumstances were such that I believed it was imperative for the Government to set out the detail of a revised long-term basis for fiscal strategy and related monitoring and reporting.

During the year the Government finalised a new fiscal strategy for the management of the State's finances, which is set out in detail in Chapter 2 of the Budget Statement presented by the Government as part of the Budget.

The Government have indicated that their main fiscal strategy is to achieve average balanced budgets in the General Government Sector.

Further, the Budget Papers 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 an AA 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 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. General government investing expenditure is not undertaken to generate future revenue streams and therefore must be met from current revenue streams or operating surpluses. This target ensures no growth in general government net debt from operating or investing expenditure.

The long-term fiscal target underlying this Budget is to achieve, on average, zero net borrowing in the General Government Sector. This is an accrual-based target.

The fiscal targets for the 2002-03 Budget are:

- non-commercial sector underlying cash balance or better in 2002-03 and across the forward estimates;
- from the end of the current parliamentary term the Government will target budget outcomes of average zero net borrowing in the General Government Sector over any four year term.

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.

4.5 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, in my opinion, is the following.

General government is only part of the overall public sector as it does not include Public Non-Financial or Financial Corporations. While transactions with the other sectors will be included in the General Government Sector results, I believe it important that relevant information also be available for the PNFC sector in particular. Currently the General Government Sector picks up four year forward estimates for that sector. By comparison, the PNFC published data is only for the immediate budget year. I believe it important that comparative period information be available for users so as not to lose sight of the broader public sector activity.

5 STATEMENT OF FINANCIAL PERFORMANCE

5.1 OVERVIEW

Up until the 2002-03 Budget the annual budget outcome focus has been on a cash-based calculation of the sum of all financing transactions, (except provisions) being the difference between recurrent and capital outlays and revenues and grants.

Further, the practice was that the underlying result excluded major 'one off' items, ie of a non-recurring nature, and other adjustments that by their size and nature, were abnormal.

As discussed previously, the focus from 2002-03 onwards is on outcomes under the accrual-based GFS framework. Although results have been reported on this basis in the past, the main targets were cash-based consistent with an approach adopted at the beginning of a four year focus on State finances.

In Audit's view, there is considerable merit in now changing the attention to the accrual-based GFS outcomes for reasons including it:

- adopts principles of accrual accounting, which ensures the elimination of some previously discretionary timing of transactions that could impact on the result;
- is based on an independently determined and maintained framework;
- is a framework that has been agreed to be used by all Australian governments, and therefore provides a basis for comparisons between different jurisdictions.

That is not to say that other frameworks are now irrelevant, and the following discussion, while focusing on the financial performance on an accrual GFS basis, also considers results under the alternative frameworks to provide some different perspectives, and to allow some comparisons to historic reported targets and results.

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

- the estimated actual result for 2001-02, and how it compares both to the prior year numbers and the budgeted amounts;
- the Budget for 2002-03 having regard to the estimated actual result for 2001-02;
- a longer term view of the forecast results going forward to 2005-06.

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.

Limitations on Analysis

Even though, as I have indicated, there are a number of advantages in adopting the GFS framework for primary targets, there are still some limitations on the data when analysing results, which must be considered to put things in context. These limitations include:

- When considering the estimated result for 2001-02 it must be emphasised that these results are only estimates. Past experience has been that actual results have varied substantially from the estimated result. While such variations have been small relative to the level of activity of the State (eg expenses in excess of $8 billion) when the budget result target is essentially zero, variations are significant. This is a matter relevant to monitoring budget performance discussed later.

- As the focus is on the General Government Sector, there is still some ability for the results to be manipulated through the timing of certain discretionary amounts, the most obvious being the distributions from other GFS sectors. This particular aspect is discussed throughout the following analysis in trying to ‘normalise’ the results to identify particular trends underlying the data. With respect to this point the approach of the Budget presentation has been to isolate the distributions on the face of the operating statement, which makes it easier for the reader to readily identify the amounts.
- 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 the arrangements for public sector superannuation liabilities and their funding in Queensland.

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 2002-03

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

The long-term fiscal target underlying this Budget is to achieve, on average, zero net borrowing in the General Government Sector. The fiscal targets for the 2002-03 Budget are:

- non-commercial sector underlying cash balance or better in 2002-03 and across the forward estimates;
- from the end of the current parliamentary term the Government will target budget outcomes of average zero net borrowing in the General Government Sector over any four year term.

The Government’s long-term objective is for general government operating expenses and investing expenditure to be met entirely by revenues.

The influence of the fiscal targets on the 2002-03 Budget, that is for 2002-03 and the forward estimate years is immediate and obvious. From 2002-03 the Government have budgeted to make major inroads to the level of the GFS net borrowing result experienced in previous years.

Essentially, the strategies limit any expenses to be within the revenues estimated to be attainable in each of the budget years. Accordingly, if little real terms growth is expected from revenue sources, to be consistent with the fiscal targets, expenditure patterns are obliged to track revenues, that is little or no real terms growth.

The 2002-03 Budget is framed in this manner.

5.3 RISKS AND MANAGEMENT TASKS FOR THE 2002-03 BUDGET

Immediately, the risk to the budget is the possibility of higher levels of growth in expenses - there must be management controls to monitor and mitigate this risk. 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.

I have observed in past Reports that better than budgeted revenue outcomes, offsetting expenditure levels that have periodically grown beyond the rates budgeted, have been fundamental to the results reported in past years. By the end of the last four year financial plan, notwithstanding various revenue measures and the disposal of major public sector assets, the GFS net borrowing result for the General Government Sector remained at $396 million and averaged $391 million over the four years to 2001-02.[17]

It will be noted in the commentary that follows, that to provide some latitude in expenses across the 2002-03 Budget estimates years, there are:

- targeted savings totalling $967 million over four years;[18]
- revenue measures designed to bring in an additional $56 million in a full year;[19]
- reliance on distributions from the financial corporations sector of government amounting to $598 million over four years,[20] of which $561 million is from two entities.

Also, notwithstanding these measures, it is projected that by the end of the Budget forward estimates, 2005-06, there remains a challenge to actually achieve the fiscal targets set. At this time, there will be additional pressures from the finalisation of enterprise agreements (that may or may not be within allowances held within the Budget estimates) and, should events follow the projections set out in the 2002-03 Budget, there will be little in the way of financial reserves available from the financial corporations providing the majority of distributions.

Accordingly, the budget picture for this State continues to look tight, as it has for the past few years.

Past Reports have noted the matters of persistent past deficits, internal transfers and use of reserves and controlling outlays.[21] The commentary that follows in sections 5 to 7 provides further analysis of the 2002-03 Budget and related control issues that the Government has identified in response to the Budget position and its fiscal targets.

---

17 It should be noted that GFS net borrowing was not a target of the last four year plan. Further, if not for the deferral of budgeted distributions from the financial corporations of $276 million, the estimated result for the General Government Sector would have been a net borrowing result of $120 million against an estimate of $209 million. The deferred distributions are now budgeted to occur over the four years of the 2002-03 Budget, mainly in 2002-03.

18 Budget Statement 2002-03, Budget Paper 3, Table 3.2.

19 Budget Statement 2002-03, Budget Paper 3, Table 4.1.

20 Budget Statement 2002-03, Budget Paper 3, Table 4.16.

21 Report of the Auditor-General for the year ended 30 June 2001, Part A pp 22-23.

5.4 ESTIMATED RESULT FOR 2001-02

5.4.1 GFS Accruals

The estimated result for the year was a GFS net borrowing result of $396 million, which is consistent with the previous year, but a deterioration of $187 million from the budgeted result.

The following table shows the estimated result for 2001-02 in comparison to the original budget estimate, and the actual result for the 2000-01 financial year, and identifies the differences to the 2001-02 Budget.

	2000-01 Actual $'million	2001-02 Budget $'million	2001-02 Estimated Result $'million	Difference $'million	Difference Percent
Operating Revenue					
Taxation revenue	**2 197**	**1 984**	**2 173**	189	9
Sales of goods and services	**982**	**759**	**813**	54	7
Other State source revenue	**295**	**254**	**295**	41	14
Commonwealth grants (current)	**3 986**	**4 241**	**4 419**	178	4
Commonwealth grants (capital)	**164**	**179**	**174**	(5)	(3)
Other grants	**5**	**1**	**37**	36	97
Total Operating Revenue	**7 630**	**7 418**	**7 911**	493	6
Less: Operating Expenses					
Gross operating expenses (excluding depreciation)	**5 894**	**5 765**	**6 123**	358	6
Current transfers	**1 545**	**1 447**	**1 539**	92	6
Capital transfers	**43**	**88**	**41**	(47)	(115)
Total Operating Expenses	**7 482**	**7 300**	**7 704**	403	5
Current Operating Surplus Before Interest Depreciation and Distributions	**147**	**118**	**207**	91	43
Less: Net interest expense	**184**	**143**	**145**	2	1
Less: Nominal superannuation interest expense	**248**	**239**	**244**	5	2
Add: Distributions received from PNFCs and PFCs	**310**	**575**	**279**	(296)	(106)
Less: depreciation	**322**	**350**	**386**	36	9
GFS Net Operating Balance	**(297)**	**(38)**	**(288)**	(250)	84
Gross fixed capital formation	**427**	**519**	**492**	(27)	(5)
Less: depreciation	**322**	**350**	**386**	36	9
Add: change in inventories	**-3**	**1**	**1**	0	0
Total Net Acquisition of Non-financial Assets	**102**	**171**	**108**	(63)	(59)
GFS Net Lending (Borrowing)	**(399)**	**(209)**	**(396)**	(187)	47

Note: Totals may not add due to rounding.

As shown above, events have occurred during the 2001-02 financial year resulting in significant changes to the original budget estimates. In total, the adjustments have resulted in a worse than budgeted estimated GFS net borrowing result for the State. A reconciliation of the budgeted GFS net borrowing result to the estimated result for 2001-02 follows:

Reconciliation of Net Borrowing Result 2001-02

2001-02 Budget Net Borrowing Result		(209)
Carryover from 2000-01	(18)	
Parameter effects:		
Taxation revenue	190	
Commonwealth Grants	64	
Royalties	(13)	
Nominal Super expense	(5)	
Interest expense	(6)	
Asset sales - costs	(72)	
Headroom supplementation	(20)	
Timing and data revisions	(189)	
Cost pressures	(127)	
Savings measures	22	
Operating initiatives	(13)	
		(187)
2001-02 Estimated Net Borrowing Result		(396)

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

- ***Increasing Cost Pressures*** — including enterprise bargaining agreements that were negotiated during the year and had not been finalised at the time of original Budget. Although allowance was made in the 2001-02 Budget, finalisation of the negotiations resulted in costs above the provision allowed for.
- ***Timing and Data Revisions*** — the three major items in respect to timing and data revisions were:
  - — Advice from agencies of under expenditure of $322 million at the time of preparing the 2002-03 Budget.
  - — Budgeted slippage[22] of $180 million included in the 2001-02 Budget. This offsets, in part, the $322 million under expenditure, resulting in a net $142 million improvement to the 2001-02 estimated result.

[22] Slippage is under expenditure by agencies from their approved budgets, and has been a significant factor in past budgets. Any variance from budgeted slippage will impact on the Budget result. Audit has been advised that factoring slippage into Budget determinations ceased in framing the 2002-03 Budget.

— Deferral of distributions from SAAMC and SAFA of $276 million recognising the need to fund carryover of expenditure to future budget periods. DTF advised that the carryover of $205 million of expenditure into 2002-03 was approved.

- ***Asset Sales*** — costs associated with the sale of South Australian Ports Corporation and SA TAB Pty Ltd which were not initially included in the 2001-02 Budget.
- ***Taxation Revenue*** — stamp duties exceeded expectations by $109 million due mainly to a stronger than budgeted for property market and the additional First Home Owners Grant scheme. Payroll tax and gambling tax receipts were also expected to be above the original Budget amounts.
- ***Commonwealth Grants*** — the increase relates to better then expected receipts of general purpose funding under the Guaranteed Minimum Amount (GMA) arrangements from the Commonwealth Government.

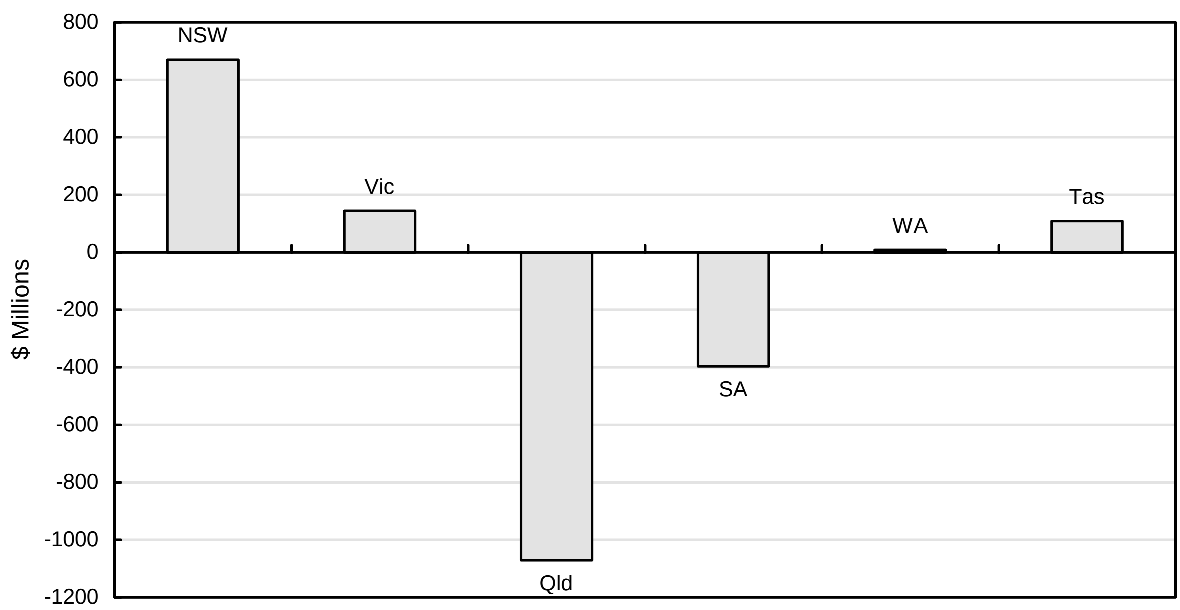
More detailed discussions on some of the reasons are included in the sections on ‘revenue’ and ‘expenditure’ later in this Report.

The nature of the movement is consistent with previous years, where any cost pressures or other unexpected stresses on expenditure have tended to be off-set by one-off revenue gains from various sources. This has been the case again in 2001-02 where the deterioration in the result can, in part, be attributed to the timing and data revisions as explained.

Comparisons to Other States

The following chart shows the estimated GFS General Government Sector net lending (borrowing) result for each of the mainland states for the year ended 30 June 2002.

GFS - General Government Sector Estimated Net Lending (Borrowing) Result for 2001-02



The above chart shows that the result for South Australia was worse than each of the other mainland states with the exception of Queensland. With respect to Queensland it should be noted that the structure of their superannuation liabilities (which are fully funded) is such that any movement in investments supporting the liability directly affects the net operating balance, whereas for South Australia such impacts are indirect and smoothed over years.

On the other hand, had the distributions been received from the financial institutions as budgeted, the South Australian result may have looked significantly better against the other states.

5.4.2 Non-Commercial Sector

Given that the balancing of the non-commercial sector budget has previously been the cornerstone of the State finances fiscal strategy, it is relevant to include some brief commentary on the result for 2001-02 under that framework.

The 2001-02 year was the final year of the previous Government's four year financial plan announced in the 1998-99 Budget. The Government's 2001-02 Budget objective under the plan was to achieve an underlying balanced cash budget (including current and capital spending) for the non-commercial sector.

The 2001-02 estimated budget outcome is presented below in summary form.

Cash-Based Non-Commercial Sector 2001-02

	2001-02 Budget $'million	2001-02 Estimated Result $'million	Difference $'million
Current outlays	(6 765)	(7 195)	(430)
Capital outlays	(638)	(626)	12
Own source revenues	2 858	2 825	(33)
Grants received	4 415	4 593	178
Financing transactions	80	82	2
	(50)	(321)	(271)
TVSP, asset sale and other sundry costs	52	259	207
Underlying Surplus/(Deficit)	2	(62)	(64)

The estimated result is a deficit of $62 million. This represents a $64 million deterioration on the original Budget.

The key differences between the original budgeted amounts and the estimated result are as explained for the General Government Sector, adjusted for:

- costs associated with the disposal of South Australian Ports Corporation and the South Australian Totalizator Agency Board;

- payments for Targeted Voluntary Separation Packages and agency expenditures deferred from 1999-2000.

These adjustments are accounted for in the line TVSP, asset sale and other sundry costs.

However, as explained in previous Reports this number is particularly sensitive to the timing of discretionary amounts (in particular past service superannuation payments and distributions from the commercial sector). Had the focus been on the non-commercial public sector as a fiscal target, as it has been in the past, it is possible that the discretionary amounts could have been used to achieve the desired actual outcome.

5.4.3 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 2001-02 was $6141 million. Actual payments were $6080 million, well within appropriation authority.

The result on the Consolidated Account for 2001-02 was a deficit of $120 million ($151 million in 2000-01). This net borrowing was determined after total receipts of $6 billion and payments of $6.1 billion.

The cash deficit of $120 million exceeded the budget amount by $49 million.

This financing requirement was financed through additional borrowings from SAFA.

The key differences between actual and budgeted amounts were:

- large increases in stamp duties receipts of $147 million due partly to higher than expected housing activity brought on from lower interest rates and the First Home Owners Grant (FHOG) Scheme;

- a high proportion of Commonwealth Specific Purpose Grants that were originally budgeted to go into the consolidated account totalling $273 million were subsequently approved to be receipted directly to the Department of Education, Training and Employment special deposit account instead. This resulted in lower amounts being appropriated to the administered items of the Department of Education, Training and Employment;

- lower than budgeted distributions from SAAMC and SAFA with a total effect of $276 million. These receipts were not required by the Government for the 2001-02 year and have been held over to future Budgets; and

- higher than expected FHOG payments of $36 million and payments of superannuation and pension provisions of $56 million.

Further details of this 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'.[23]

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 2001-02 Budget included contingency funds totalling $113 million ($172 million), which when added to the $175 million ($175 million) available from the GAF provided uncommitted flexibility within the Budget of $288 million ($347 million) or 4.7 percent (5.6 percent) of the total of the *Appropriation Act 1999* and the GAF.

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 effect the budget result as they are already figured into that result. Use of the GAF, on the other hand, is an additional expense for the Budget result.

The following table sets out the availability and use of these funds in 2001-02.

	Authority $'million	Actual Payments $'million
Governor's Appropriation Fund	175	52
Total contingency provisions	113	67
Total Flexibility	288	119

Details of the purpose of the actual payments from the GAF are provided in Statement K of the Treasurer's Statements.[24]

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 from the line 'Administered Items for Department of Treasury and Finance' in Statement A of the Treasurer's Statements.

As can be seen from the above table the flexibility arrangements within the 2001-02 Budget were sufficient to meet additional costs.

23 Report of the Auditor-General for the year ended 30 June 2002, Part B, Volume III, Appendix.

24 Report of the Auditor-General for the year ended 30 June 2002, Part B, Volume III, Appendix.

5.4.4 AAS 31 Results

The following briefly discusses the financial result of the AAS 31 statements as at 30 June 2001.

As previously discussed, there are some limitations in analysing AAS 31 data particularly due to the timing of its preparation each year, however they do provide the opportunity to observe the financial result of the Government using a full accrual accounting basis, and the consolidation of all sectors.

The following table summarises the financial result for the year ending 30 June 2001, with comparative amounts from 2000 and 1999.

AAS 31 Financial performance (1999-2001)

	1999 $'million	2000 $'million	2001 $'million
Revenues			
Taxation	1 729	2 081	2 031
Grants	3 697	3 925	4 361
Sale of Goods and Services	3 964	3 788	3 122
Investment revenues	1 048	1 552	871
Net revenues from asset disposals (a)	64	1 137	268
Other	526	575	717
	11 028	13 058	11 370
Expenses			
Employee expenses	3 660	3 298	3 526
Supplies and Services	2 814	3 149	3 008
Grants and Subsidies	1 387	1 497	1 356
Borrowing cost expenses	1 554	2 119	921
Other	1 953	1 908	1 734
	11 368	11 971	10 545
Net Surplus/(Deficit)	(340)	1 087	825
Increase in Asset revaluation reserve	215	353	1 184
Increase (Decrease) on adoption of new standard	(178)	6	348
Total Changes in Equity	(303)	1 446	2 357

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

The financial performance result has progressively improved each year from 1999. The past two years results have been assisted through major asset revaluations and sales of government electricity businesses (ETSA), which have brought large net surpluses.

The following briefly explains the large movements in 2001 revenue and expense amounts.

Revenue

Total operating revenue for the 2000-2001 financial year was $11.4 billion; an decrease of approximately $1.7 billion on the revenues earned in the 1999-2000 financial year. The decrease was due mainly to the following:

- *Investment Revenue* — decreased by $681 million due to devaluation of investments, primarily domestic and international equities. This movement is primarily a reflection of the weaker investment returns received this financial year on overseas and domestic equities.

  It is expected that lower investment revenue will again be recognised in 2001-02 due to negative returns on domestic and international equities.

  Further details on investment returns on equities are provided in the section on 'Assets'.

- *Net Revenues from Asset Disposals* — decreased by $869 million due to fewer proceeds being received from the disposal of the State's electricity infrastructure in comparison to the previous year.

- *Asset Revaluation Increments* — increased by $831 million, which mainly represents the revaluation increments made on Transport SA's road network assets.

Expenses

Total expenses decreased by $1426 million during the financial year. These decreases were mainly derived from a large reduction in borrowing costs of $1198 million due to a:

- decrease of $603 million in the imputed interest expense on superannuation fund deposits;

- reduction in interest on borrowings of $414 million reflecting the reduced level of borrowings owed by the State.

5.5 2002-03 BUDGETED RESULTS

The following focuses on the trends arising from the 2002-03 Budget tabled in Parliament in July 2002. It provides an overview of the expected result and provides the context for discussions on individual lines of the Budget later. Given that the fiscal targets are now focused on the accrual-based GFS framework, the analysis deals only with that framework.

5.5.1 GFS - General Government Sector - Operating Statement

The Budget presented to Parliament in July 2002 details a budget GFS net borrowing result for 2002-03 of $75 million an improvement of $321 million on the estimated 2001-02 result.

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

	2001-02 Estimated Result $'million	2002-03 Budget $'million	Difference $'million	Difference Percent
Operating Revenue				
Taxation revenue	**2 173**	**2 183**	10	0.5
Sales of goods and services	**813**	**832**	19	2.3
Other State source revenue	**295**	**292**	(3)	(1.0)
Commonwealth grants (current)	**4 419**	**4 528**	109	2.5
Commonwealth grants (capital)	**174**	**153**	(21)	(12.1)
Other grants	**37**	**40**	3	8.1
Total Operating Revenue	**7 911**	**8 027**	116	1.5
Less: Operating Expenses				
Gross operating expenses (excluding depreciation)	**6 123**	**6 179**	56	0.9
Current transfers	**1 539**	**1 500**	(39)	(2.5)
Capital transfers	**41**	**43**	2	4.9
Total Operating Expenses	**7 704**	**7 723**	19	0.3
Current operating surplus before interest depreciation and distributions	**207**	**305**	98	47.3
Less: Net interest expense	**145**	**164**	19	13.1
Less: Nominal superannuation interest expense	**244**	**284**	40	16.4
Add: Distributions received from PNFCs and PFCs	**279**	**635**	356	127.6
Less: depreciation	**386**	**388**	2	0.5
GFS Net Operating Balance	**(288)**	**104**	392	(136.1)
Less: Net Acquisition of non-financial assets				
Gross fixed capital formation	**492**	**565**	73	14.8
Less: depreciation	**386**	**388**	2	0.5
Add: change in inventories	**1**	**2**	1	100.0
Total net acquisition of non-financial assets	**108**	**179**	71	65.7
GFS Net Lending (Borrowing)	**(396)**	**(75)**	321	(81.1)

Note: Totals may not add due to rounding.

It can be seen from the above table that the improvement for the 2002-03 year is due mainly to a:

- small increase in operating revenues below the level of CPI (2.75 percent for 2002-03), due mainly to increased Commonwealth funding and reflecting decreases in taxes associated with a softening of the property market;

- negligible increase in operating expenses associated with targeted savings, notwithstanding previous upward trends. This issue is discussed further under the heading '7.2.7 - Savings'.

- large increase ($356 million) in the distributions received from Public Non-Financial Corporations and Public Financial Corporations. This increase reflects a discretionary timing difference, rather than a fundamental change in the ability of the entities in that sector to be able to provide improved distributions on an ongoing basis. In particular there was a deferral of budgeted distributions from SAAMC and SAFA of $276 million initially budgeted for in the 2001-02 financial year.

Although the budgeted result reflects a substantial improvement in financial performance from the previous year, there are, in Audit's view, considerable risks inherent in the budgeted result, particularly with respect to the achievement of planned savings and the long-term sustainability of distributions from government entities in the other sectors.

Each of these factors is considered further in the context of the longer-term trends discussed later in this Report.

5.5.2 GFS Other Sectors

The GFS net borrowing result for the Public Non-Financial Corporation Sector is budgeted to be a deficit of $83 million a decrease of $203 million on the estimated result for 2001-02 ($120 million net lending or surplus). The main determinant of the results for this sector is the timing of net capital expenditure in any particular year. The change for the 2002-03 is mainly as a result of the 2001-02 year including $176 million proceeds from the sale of Ports Corp and TAB.

At the time of preparing this Report no data was available with respect to the GFS Public Financial Institutions Sector, and as a result the 'all sectors' budget.

5.5.3 Non-Commercial Sector

In previous years I have provided a detailed analysis of the budget numbers in respect of the non-commercial sector. This recognised that this framework was the primary fiscal target that underpinned the Government's financial management processes.

Although 2002-03 Budget data has been provided in this format (refer to Appendix B to Budget Paper 3), Audit has not made this sector a focus of attention.

Notwithstanding, it was noted that the 2002-03 Budget shows an underlying surplus of $92 million for 2002-03 an improvement of $154 million over the estimated result for 2001-02.

The key points from the 2002-03 Non-Commercial Sector data are:

- The results are reliant on maintaining operating expenses below the anticipated level of inflation. As discussed later in this Report, this does not reflect past actual experience.

- The forward estimates include distributions received from financial institutions (SAAMC and SAFA) that are not sustainable in the long term.

The above points confirm that there will be limited flexibility in the Budget going forward, particularly if it is intended to retain a strategic fiscal target of a zero net borrowing result over a four year period.

5.6 A LONGER TERM PERSPECTIVE OF FINANCIAL PERFORMANCE

The Budget presented by the Government also includes forward projections extending to the 2005-06 year in addition to the detailed information relating to the 2002-03 year. In addition, although this is the first year that the GFS framework has been adopted for fiscal targets, historical information 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.

The following table provides some perspective of the overall result to which those individual elements contribute.

GFS - General Government Sector Operating Statement
Time Series (a)

Operating Revenue	1998-99 (b) Actual $'million	1999-2000 Actual $'million	2000-01 Actual $'million	2001-02 Estimated Result $'million	2002-03 Budget $'million	2003-04 Estimate $'million	2004-05 Estimate $'million	2005-06 Estimate $'million
Taxation revenue	2 435	2 748	2 197	2 173	2 183	2 310	2 399	2 428
Sales of goods and services	945	696	982	813	832	824	842	873
Other State source revenue (c)	279	195	295	295	292	302	308	309
Commonwealth grants (current)	2 867	3 091	3 986	4 419	4 528	4 604	4 661	4 847
Commonwealth grants (capital)	188	209	164	174	153	150	153	141
Other grants	0	7	5	37	40	38	39	40
Total Operating Revenue	6 714	6 946	7 630	7 911	8 027	8 229	8 402	8 639
Operating Expenses								
Gross operating expenses excluding depreciation	5 178	5 357	5 894	6 123	6 179	6 210	6 294	6 481
Current transfers	1 206	1 345	1 545	1 539	1 500	1 510	1 571	1 631
Capital transfers	61	59	43	41	43	39	16	11
Total Operating Expenses	6 445	6 761	7 482	7 704	7 723	7 759	7 881	8 123
Current Operating Surplus Before Interest, Depreciation and Distributions	269	185	147	207	305	470	521	515
Less: Net interest expense	496	387	184	145	164	161	163	167
Less: Nominal superannuation interest expense	277	274	248	244	284	290	297	303
Add: Distributions received from PNFCs	502	450	266	244	294	286	299	294
Add: Distributions received from PFCs	52	33	44	35	341	74	124	59
Less: Depreciation	331	337	322	386	388	394	393	397
Equals **GFS Net Operating Balance**	(282)	(330)	(297)	(288)	104	(15)	92	1
Less **Net Acquisition of Non-Financial Assets**								
Gross fixed capital formation	347	478	427	492	565	465	550	494
Less: Depreciation	331	337	322	386	388	394	393	397
Add : Change in inventories	(2)	(0)	(3)	1	2	2	0	0
Equals: Total net acquisition of non-financial assets	15	140	102	108	179	74	157	97
Equals **GFS Net Lending/(Borrowing)**	(297)	(471)	(399)	(396)	(75)	(88)	(65)	(96)

(a) The GFS net operating balance and GFS net lending/(borrowing) are consistent with those aggregates produced pursuant to the Uniform Presentation Agreement in Appendix A of the 2002-03 Budget Statement. Items in the table have been reordered to present the current operating surplus which is comparable to the concept of EBIDD (earning before interest, dividends and depreciation).

(b) 1998-99 data has been derived from the ABS 2000-01 GFE publication

(c) Excluding capital grants and distributions received from PTEs and PFIs

Note - Totals may not add due to rounding

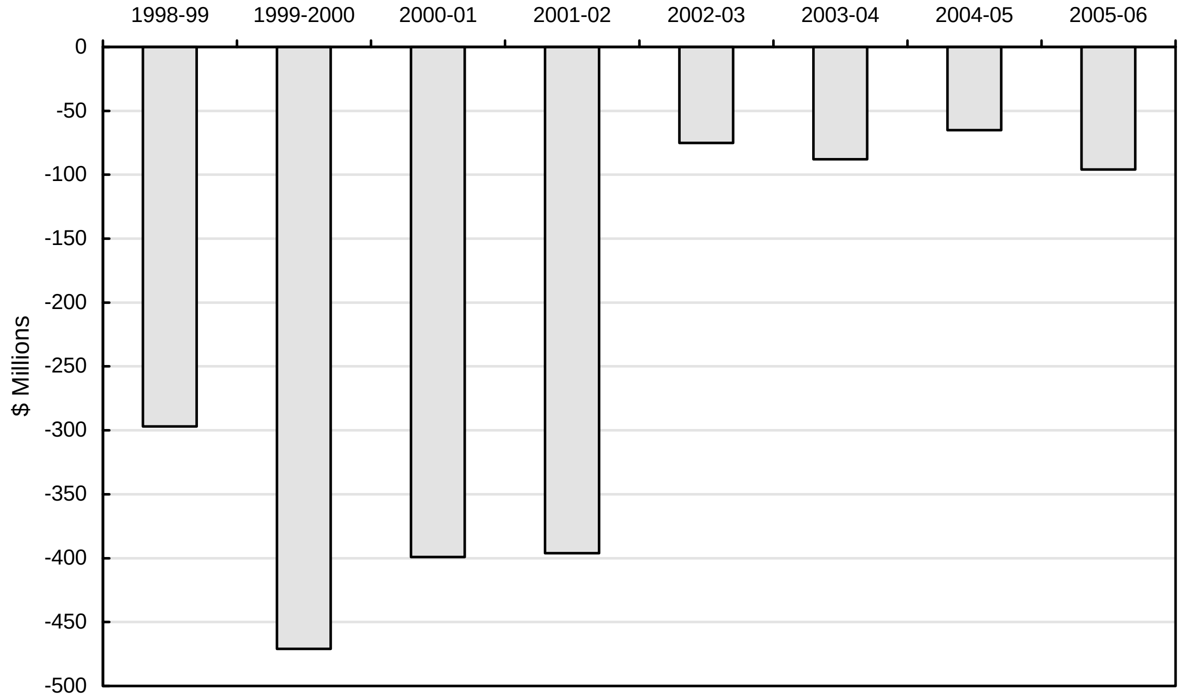
The table highlights the extent to which the GFS net borrowing result has been budgeted to be significantly lower in each of the next four years than has been achieved in the four years to 2001-02.

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

As discussed earlier, the GFS net lending (borrowing) result provides an indicator of whether a government is saving more than enough to finance all of its investment spending and is therefore not contributing directly to the current account deficit.

The following chart shows the GFS net 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 Borrowing Result



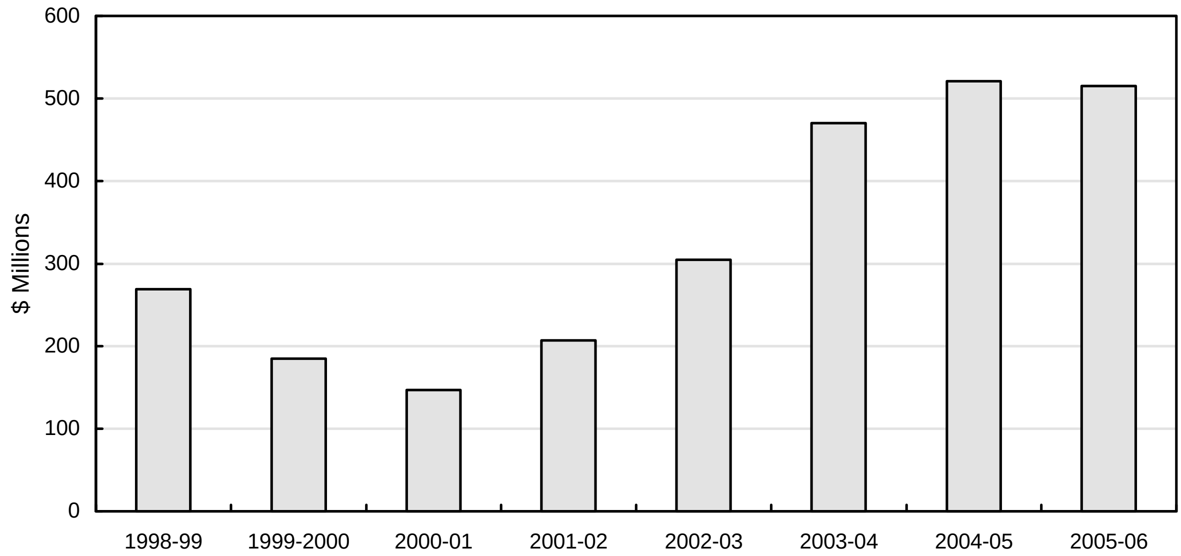
The results show that while improvements have been made towards the target of average zero net borrowings over a parliamentary term, further progress is required to be made to achieve this objective. With the movement in the State's net borrowing result being forecast to improve each year, and with the Government's expenditure review program continuing in 2002-03, this goal may be achievable but will require strict control over government expenditures and maximising the use of government revenues.

Further, with the average deficit over the next four years of $81 million per annum, there is still significant improvements needed to reach the fiscal target of a balanced budget, particular given that distributions from the financial institutions, which provide significant benefits over the next four years, will not be available to the same extent in the long term.

To understand what is behind the improvements going forward, it is useful to look at the performance from a couple of other perspectives. This is particularly important given the comments that have continually been made concerning the use of distributions from entities in other sectors to 'manage' the bottom line.

Current operating surplus before interest, depreciation, and distributions removes the effects of such distributions and items such as interest and nominal superannuation interest, which although extremely important, are as much a result of past decisions as something that is more directly controllable in the short term. The following chart shows the current operating surplus before interest, depreciation, and distributions for the period as shown in the GFS - General Government Sector Operating Statement Time Series table.

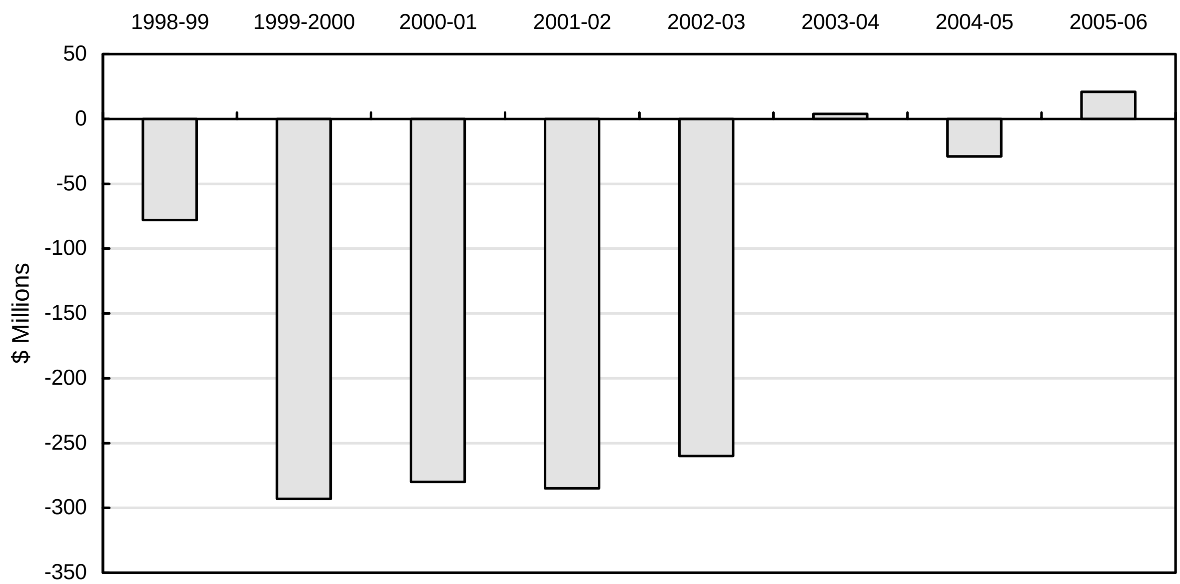
Current Operating Surplus before Interest, Depreciation and Distributions



The chart shows that this indicator declined in the three years to 2000-01, but shows improvements in the 2001-02 financial year, and continued improvement over the next three years before levelling out. The reasons for the improvements relate mainly to budgeted revenue measures and budgeted savings in expenditure lines.

One weakness in the above indicator is that it does not reflect another item of the overall GFS operating statement that is directly manageable. Expenditure on gross fixed capital formation (or capital expenditure) is an item that can be actively managed in the short term and which has had a significant impact on the GFS net lending (borrowing) result each year. Adjusting the current operating surplus before interest, depreciation, and distributions for gross fixed capital formation provides another indicator of the elements of the operating statement that are more controllable or manageable. The following chart shows that indicator for the period as shown in the GFS - General Government Sector Operating Statement Time Series table.

Current Operating Surplus before Interest, Depreciation and Distributions less Capital Expenditure



The chart shows that following a large deterioration in 1999-2000, there has been little change in the indicator over the three years to 2001-02 (as opposed to the gradual deterioration identified in other measures) and that there is only marginal improvement budgeted for in 2002-03. This reflects that many of the savings measures that have been planned to start in the current financial year are offset by a budgeted increase in capital expenditure. There is a dramatic change predicted in the final three years however, as a reduction in capital expenditure, together with budgeted savings in other areas make an impact, and that impact is constantly maintained.

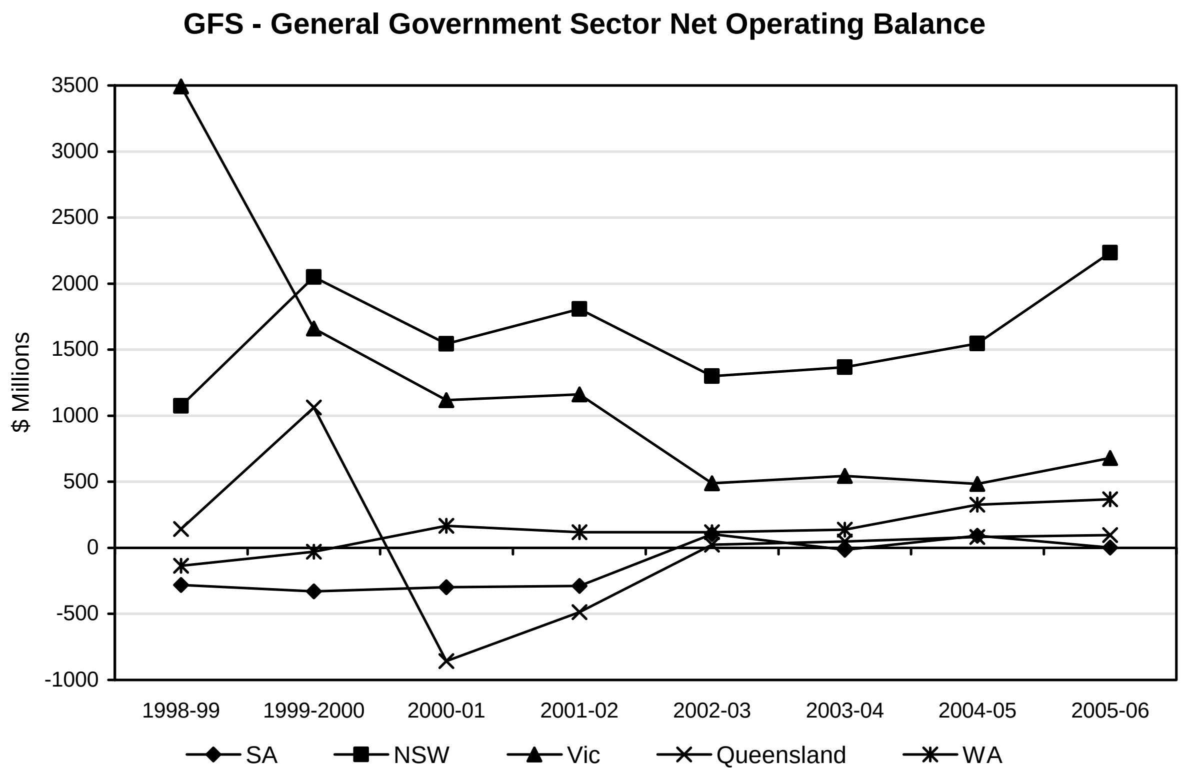
5.7 COMPARISON WITH OTHER STATES

The GFS accrual information is available for all states (subject to timing) 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 give a flavour of what might be expected to occur in the future.

Net Operating Balance

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

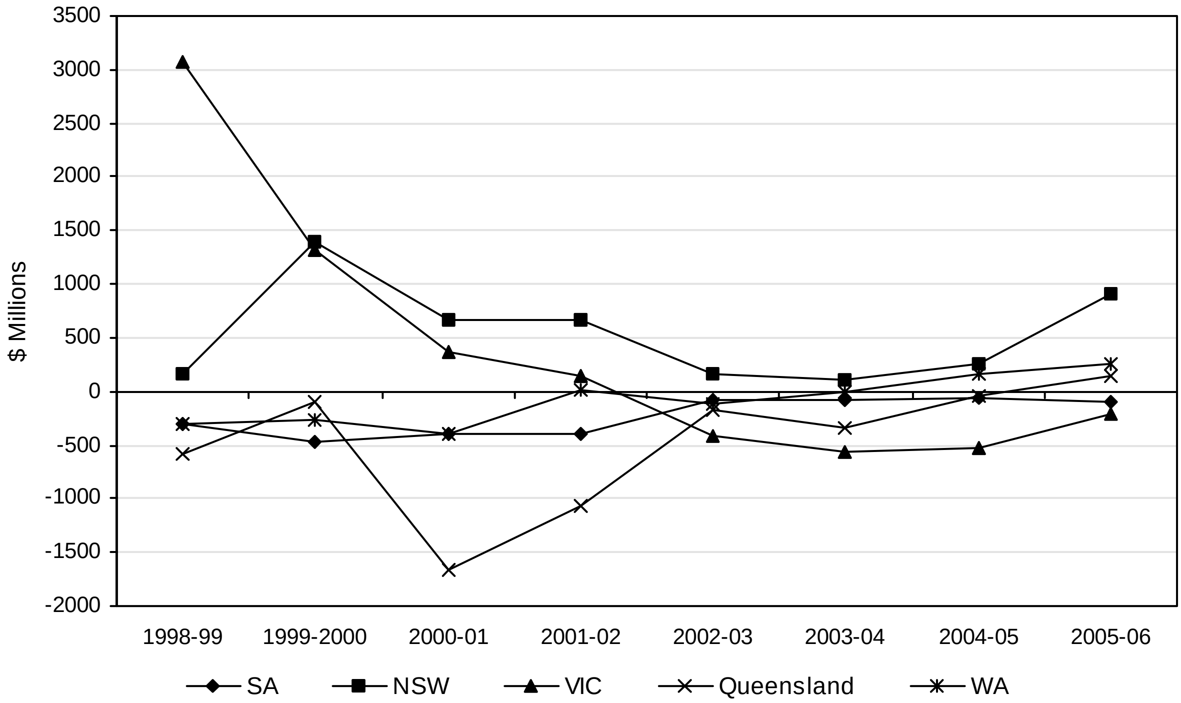


The chart shows that currently only South Australia and Queensland have net operating balance deficiencies in 2001-02. With respect to Queensland it should be noted that the structure of their superannuation liabilities (which are fully funded) is such that any movement in investments supporting the liability affects directly the net operating balance, whereas for South Australia such impacts are indirect and smoothed over years. As a result, by the end of the forecast period South Australia is expected to have the worst net operating balance of any of the mainland States.

GFS Net Lending (Borrowing)

The GFS net lending (borrowing) result represents whether a government has funded capital expenditure, net of deprecation expense, from a surplus net operating balance. The following chart compares some trends with the mainland States.

GFS - General Government Sector Net Lending (Borrowing) Result



As detailed in the chart, most states (including South Australia) are projecting consistent improvements in this indicator. By the end of the forecast period only South Australia and Victoria will be in a net borrowing result, although comparisons with Victoria are somewhat difficult due to their use of a ‘Growing Victoria Infrastructure Reserve’.

5.8 CONCLUDING OBSERVATIONS

5.8.1 Budget Forecasts

The 2002-03 Budget reports a deteriorating performance for the past financial year, but forecasts a dramatic improvement in the financial results for the State finances over the period of the Budget.

These matters have been determined principally through budgeting for operating expenditure savings, starting in the 2002-03 year to support long-term improvements in the operating results of the State's finances.

The outlay trends are matched by revenue trends. Within total revenues, of the two key revenue items, taxation receipts are projected to rise in real terms while Commonwealth general-purpose grants are projected to be steady in real terms over the forward estimates. It is notable that outlay increases experienced to date 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. This prospect heightens the importance of controlling outlays within targets. Importantly, the Budget continues to incorporate provisions for unplanned outlays and emerging priorities that will assist in this management task.

5.8.2 Distributions from Reserves

The other matter of some significance to past Budgets is that large distributions from the reserves of SAAMC and SAFA have been projected in most Budgets but have been deferred in most cases, generally because they were not needed to achieve target Budget results. In fact, with the exception of the $20 million dividend received from SAFA in 2001-02, there have been no distributions from SAFA and SAAMC since 1997-98 other than income tax equivalents. The 2002-03 Budget projects distributions from the two institutions totalling $561 million over four years with $324 million in 2002-03. I remain of the view that such distributions from SAAMC and SAFA are unsustainable, as these entities have no capacity to replace amounts of this magnitude going forward.

5.8.3 Managing Performance

The characteristics of the 2002-03 Budget are in line with many before it, the projection of real terms decreases in outlays over the forward period, and when compared to the recent history for outlays, emphasises the need for managing the actual performance against budget and for control of spending. This is particularly an issue for agencies that have identified and submitted savings targets.

Notwithstanding the significant budget improvements, at the end of the Budget cycle, South Australia may still be worse off in terms of some key indicators to other mainland states and will remain in a net borrowing position. This will provide for further challenges going forward.

6 REVENUE

Having considered the overall result of the State's finances, this section looks at some of the components that impact on the result.

6.1 OVERVIEW

Since 2000-01 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 and replaced by Commonwealth funding in the form of Goods and Services Tax (GST) revenue grants and transitional grants.

Another significant change relates to the effects of the disposal of electricity businesses, which were completed in 2000-01. This has the effect of reducing revenue from commercial public trading entities.

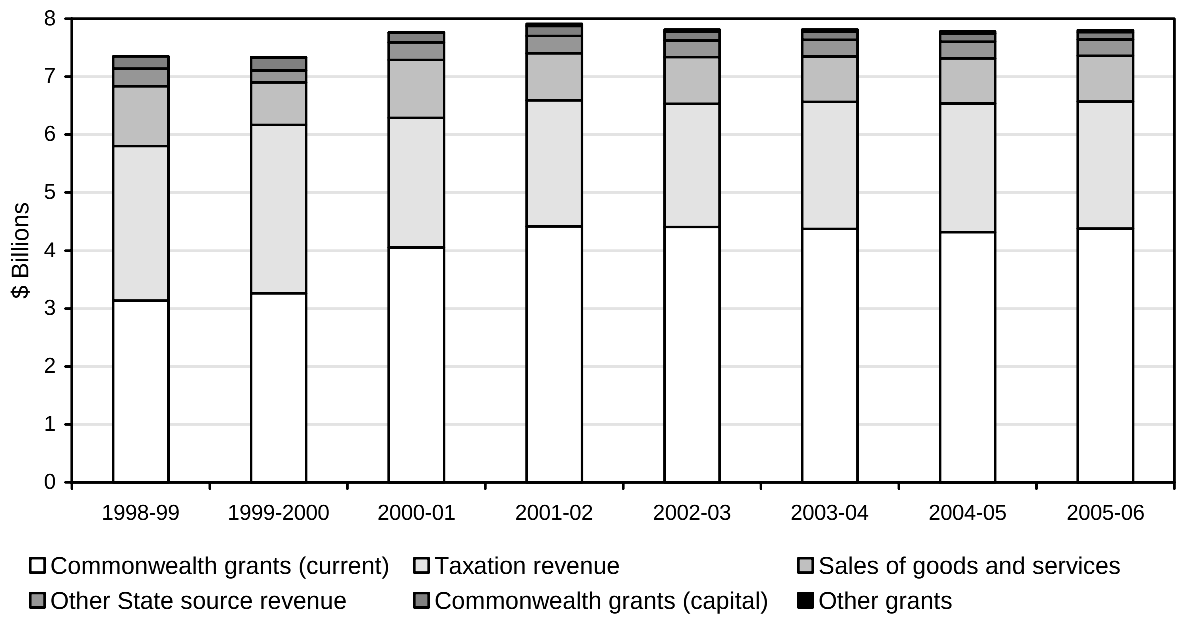
Finally, the forward estimates indicate considerable fluctuations in other State own-source revenues as a result of periodic, lumpy distributions to the Budget from public financial institutions, namely SAAMC and SAFA. This is consistent with Budget presentations for a number of years. As discussed previously, these distributions are traditionally only called upon where required for the Government to meet the target Budget result. Past experience has been that budgeted distributions have been deferred.

Revenues for the General Government Sector are made up of operating revenues and distributions from corporations in other sectors (non-financial and financial corporations).

Total GFS operating revenues are estimated to be $7.9 billion in 2001-02, an increase of $281 million (3.7 percent) over the previous year. Budgeted operating revenue for 2002-03 is $8 billion and increase of $116 million (1.5 percent).

The makeup of GFS operating revenue in real terms is shown in the following chart.

GFS - General Government Sector Operating Revenues (Real) (a)



(a) Estimated June 2002 values

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

- There have been real increases in total GFS revenue up to 2001-02. This can be explained in part by increased revenues related to First Home Owner Grant payments and the flow through to taxation revenue of a strong property market.
- The trend for total revenues is a slight real terms decrease in total revenues from 2001-02 to the end of the forward estimate period in 2005-06, due partly to anticipated declines in property values.
- The effect of the changes relating 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.

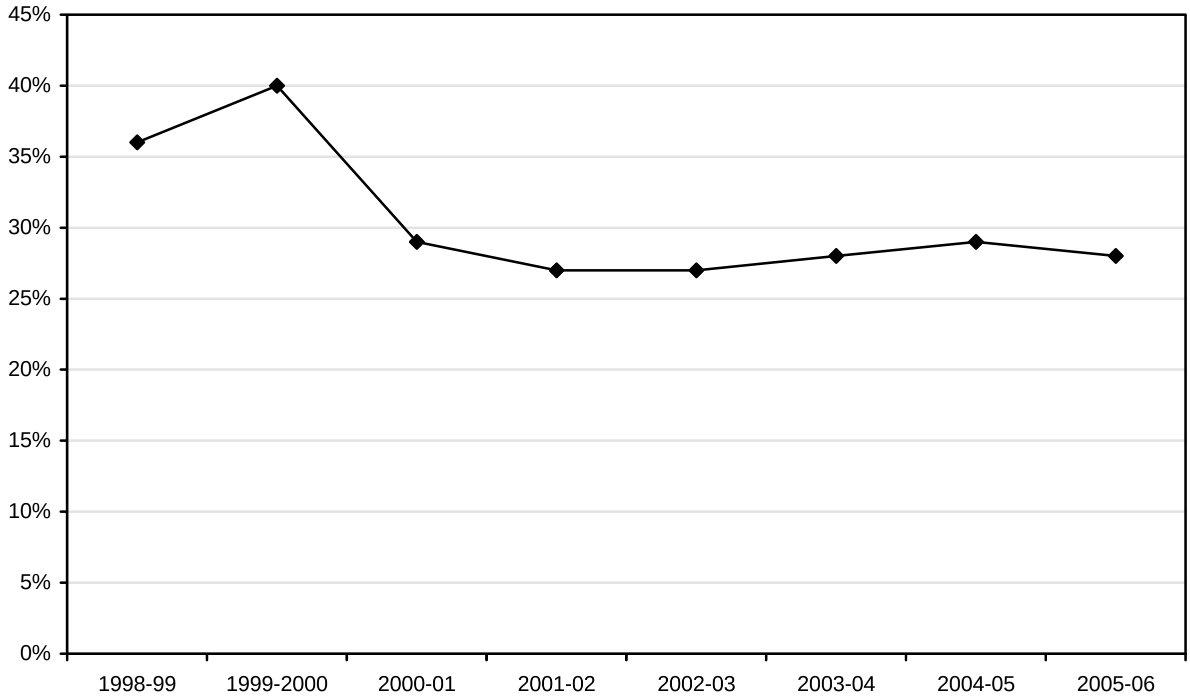
In addition, estimated distributions from corporations for 2001-02 are $279 million, a decrease of $31 million over the previous year, but $356 million less than the amount budgeted for in 2002-03 ($635 million). Further discussion on this revenue item is undertaken later under the heading '6.4 - Other Revenue'.

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

6.2 STATE TAXES

The reliance on State taxation decreased slightly in July 2000 following the introduction of the new tax system, but still remains a key source of revenue over which the Government has control. State taxes still represent approximately 27 percent of GFS operating revenues.

Taxation Revenue as a Percentage of Total Operating Revenue

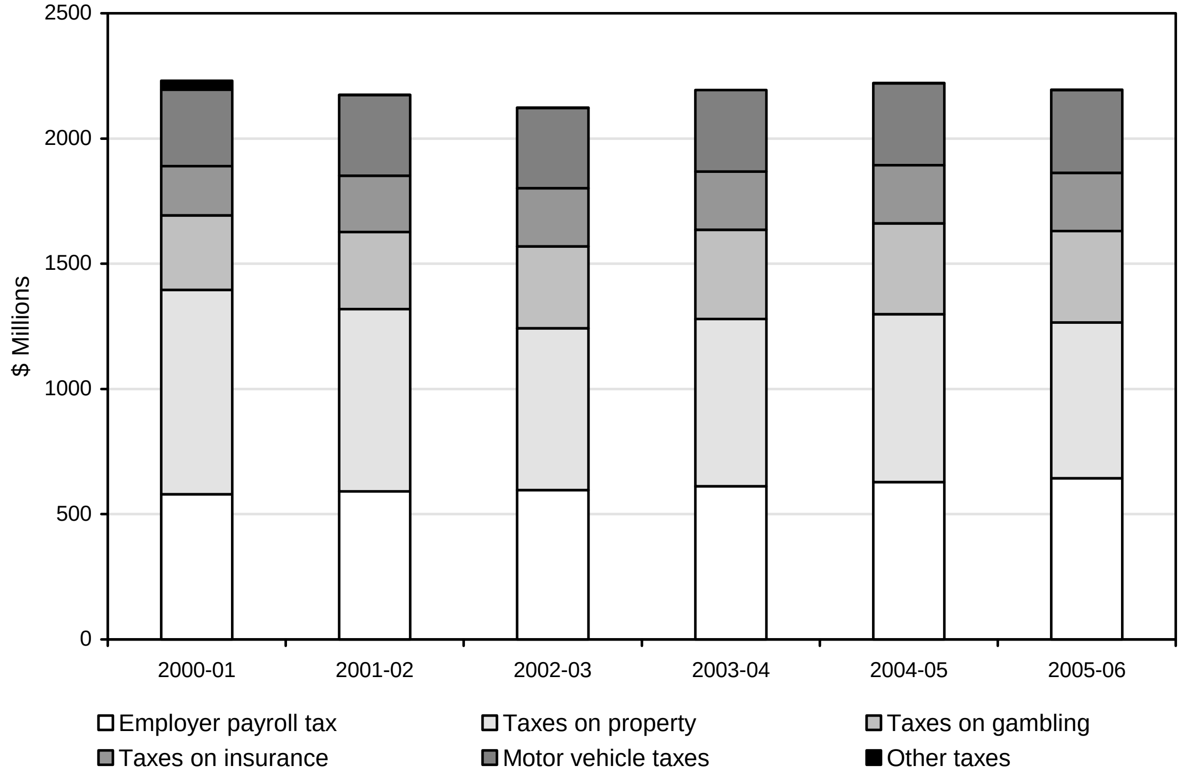


Total taxation receipts for 2001-02 are estimated to be $2.2 billion a decrease of $24 million (1.1 percent) over the previous year, but was $189 million (9.5 percent) above budget. This improvement on budget was due mainly to:

- increased stamp duty receipts due to buoyancy in the property market;
- greater than expected receipt of payroll, gambling and insurance taxes.

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 of the forward estimates.

Taxation Revenue (Real) (a)



(a) Estimated June 2002 values

The chart demonstrates that the overall revenue from taxation is expected to rise in real terms from 2002-03.

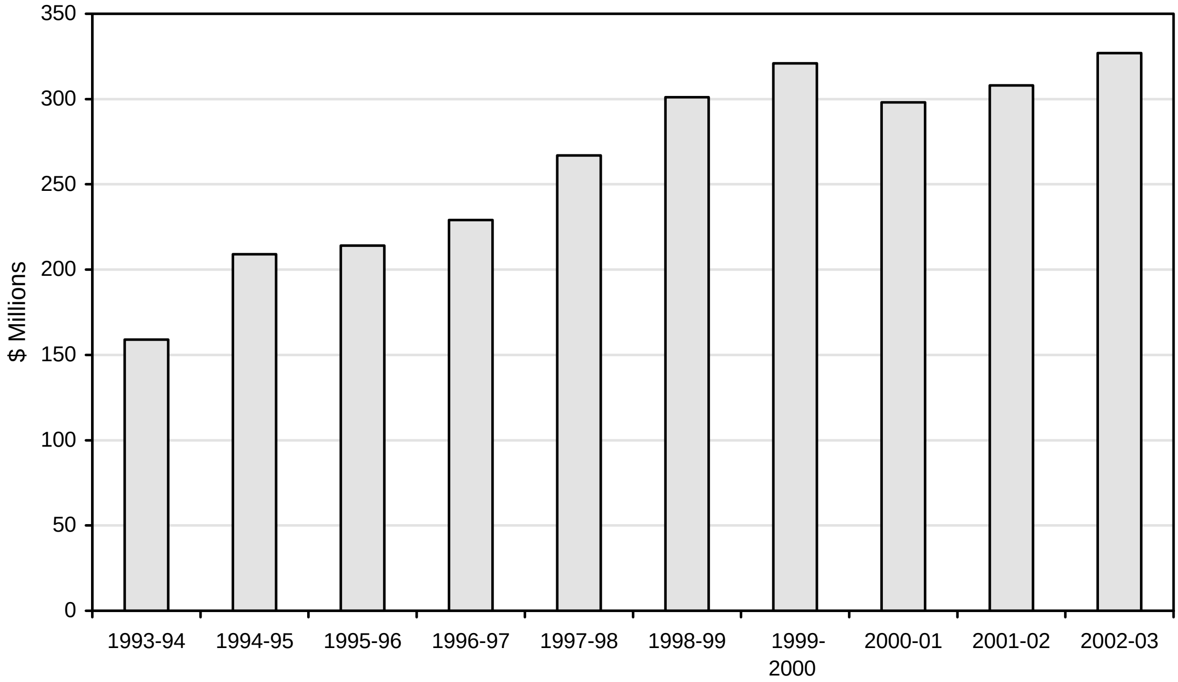
The following discussion provides a brief overview of the main components of taxation revenue.

6.2.1 Gambling Taxes

As reported for a number of years, a very large influence on taxation income has been the introduction of gaming machines into licensed hotels and clubs.

The following chart shows the main components of gambling taxes (in real terms) and highlights the significance of gaming machine taxes.

Gambling Taxes (Real) (a)



(a) Estimated June 2002 values

The chart highlights the increasing contribution that gaming machines tax has made to the State's Budget.

DTF have indicated that taxes on gambling amounting to $307.9 million[25] are forecast to exceed budget in 2001-02 ($289.3 million) due mainly to a higher than budgeted level of receipts from taxes on gaming machines ($211.6 million, budget $192.7 million). Strong projected growth in gambling tax receipts in 2002-03 and 2003-04 mainly reflects the impact of policy measures taken in this Budget to increase the net tax take from the more profitable gaming venues.

6.2.2 Property Taxes

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

Property taxes are estimated to total $727.5 million in 2001-02 and budgeted to be $663.7 million in 2002-03.[26]

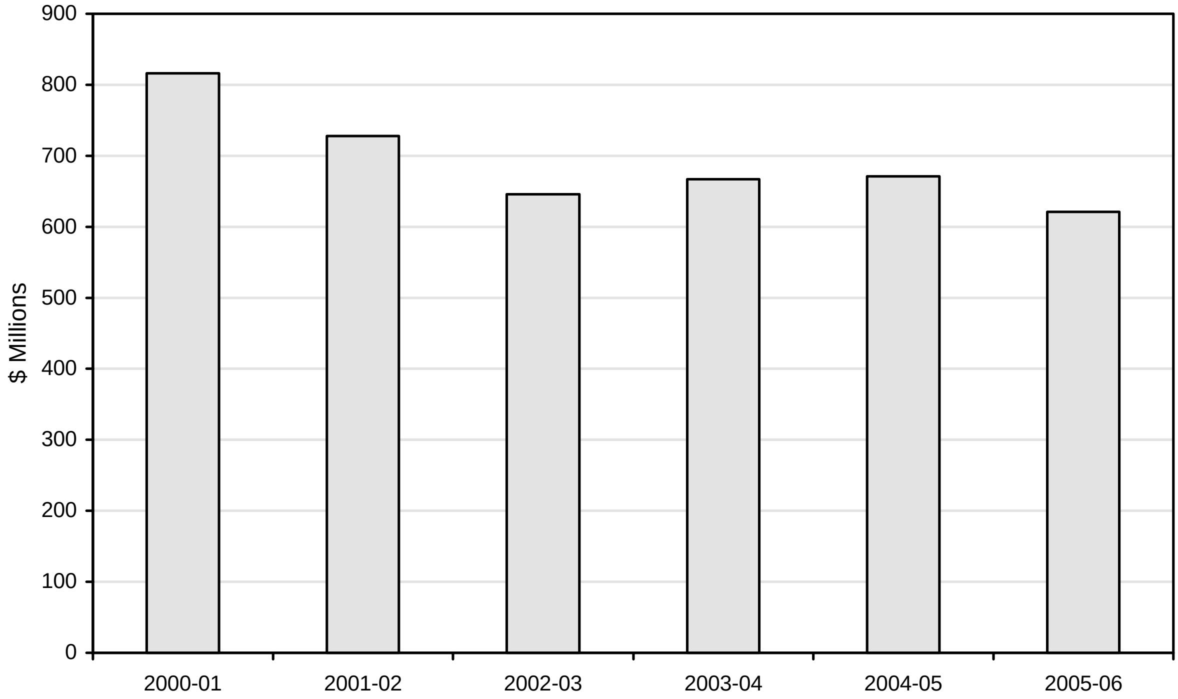
---

[25] Budget Statement 2002-03, Budget Paper 3, Table 4.12.

[26] Budget Statement 2002-03, Budget Paper 3, Table 4.11.

The following chart shows the trend in property taxes (in real terms) and highlights the budgeted real terms reduction in this item over the Budget period.

Taxes on Property (Real) **(a)**



(a) Estimated June 2002 values

Although there was growth in stamp duty revenue due to increased property values, tax revenue from all forms of property taxes declined in 2001-02, reflecting the abolition of financial institutions duty (FID) and stamp duty on listed marketable securities as part of national taxation reforms and the 'one off' impact in 2000-01 of stamp duty raised from electricity asset sales.

Further, real decreases in 2002-03 reflect an expectation that the property market will weaken in 2002-03. This influence on property tax revenue is partially offset by the revenue gains from policy measures taken in the 2002-03 Budget to raise additional revenue from stamp duty on conveyances and rental.

6.2.3 Payroll Tax

Payroll Tax continues to be a principle source of taxation revenue, and by the end of the forward estimates, taxation on payroll will be the largest State taxation source.

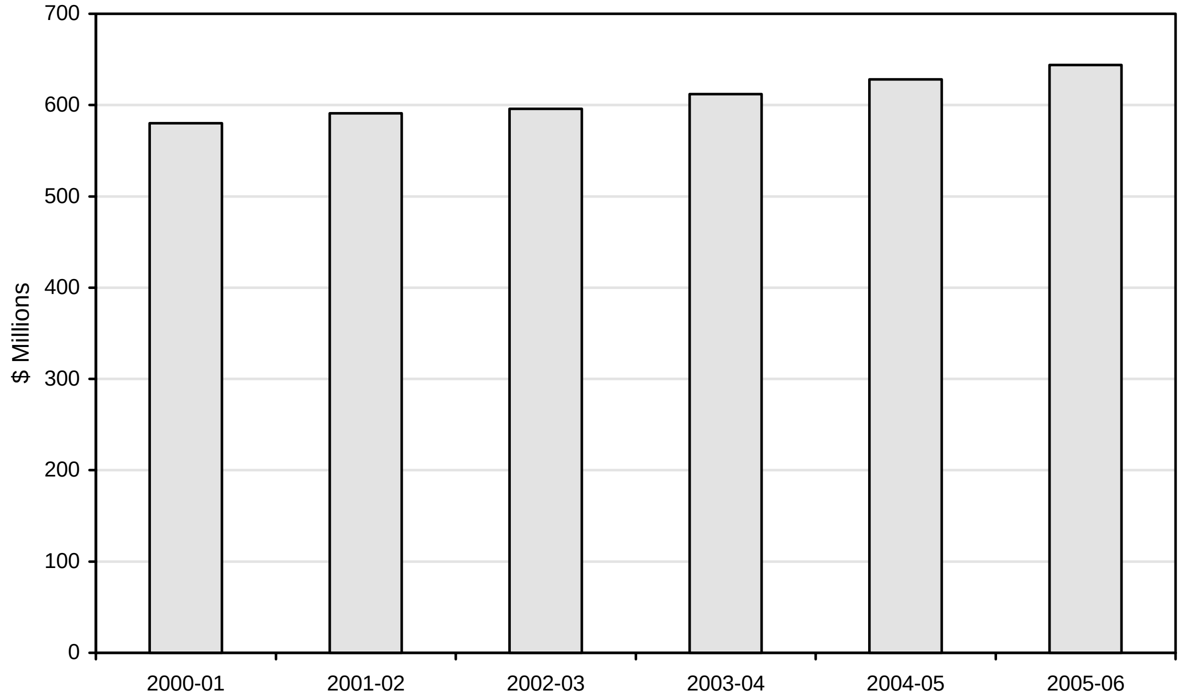
Employer payroll taxes are estimated to total $591.3 million in 2001-02 and budgeted to be $613 million in 2002-03.[27]

---

[27] Budget Statement 2002-03, Budget Paper 3, Table 4.10.

The following chart shows that payroll tax revenue is anticipated to continue to increase in real terms over the forward estimates.

Employer Payroll Tax (Real) (a)



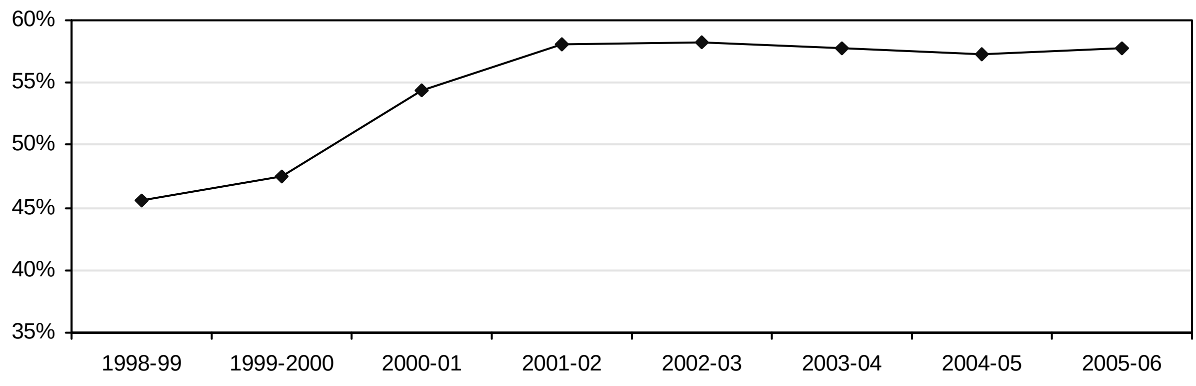
(a) Estimated June 2002 values

The growth in payroll tax receipts over the period reflects estimated employment and earnings growth.

6.3 COMMONWEALTH FUNDING

Revenue from the Commonwealth is the most significant source of revenue to the State representing 58 percent of total operating revenue in 2001-02. The significance has increased over the last two years as a result of the new tax system, as demonstrated in the following chart.

Commonwealth Grants as a Percentage of Total Operating Revenue

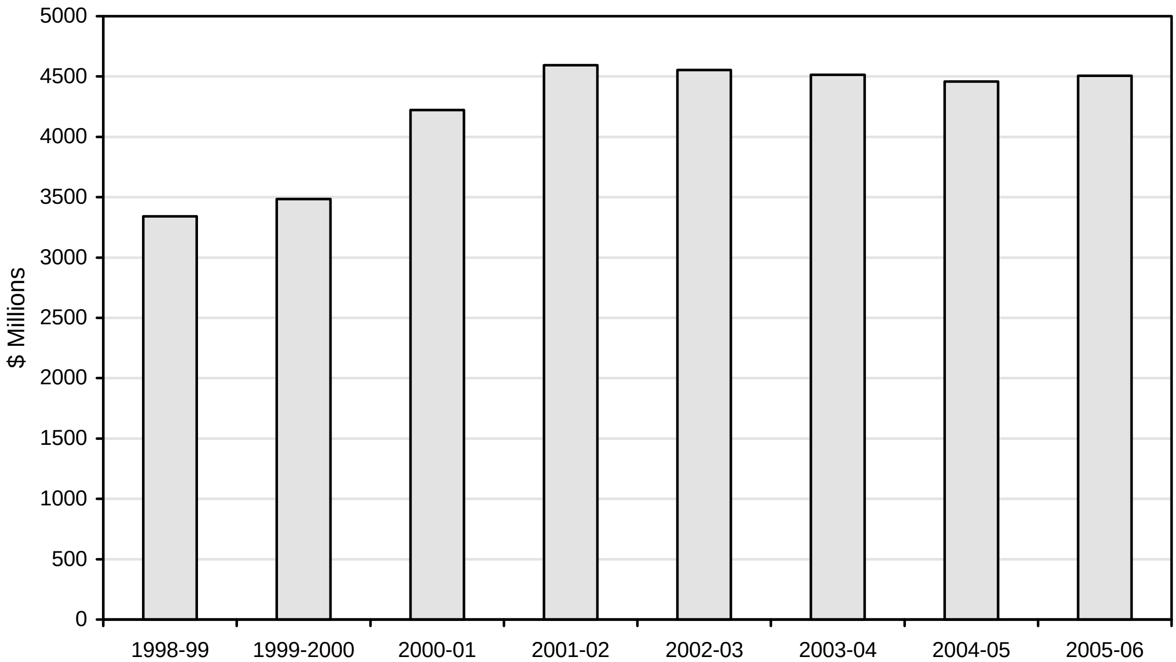


The Department of Treasury and Finance have indicated that Commonwealth grants are expected to grow by less than inflation over the forward estimates period. Moderate real terms growth in 2005-06 reflects increases in Special Purpose Payments and the replacement of the debits tax. The abolition of debits tax from 1 July 2005 is subject to review by the Ministerial Council.

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 that 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, supplementary funding is expected to be required up to and including 2005-06.

The following chart shows the Commonwealth grants revenue (in real terms), and demonstrates the impact of the national taxation reforms, and the slight decrease over the forward period.

Commonwealth Grants (Real) (a)



(a) Estimated June 2002 values

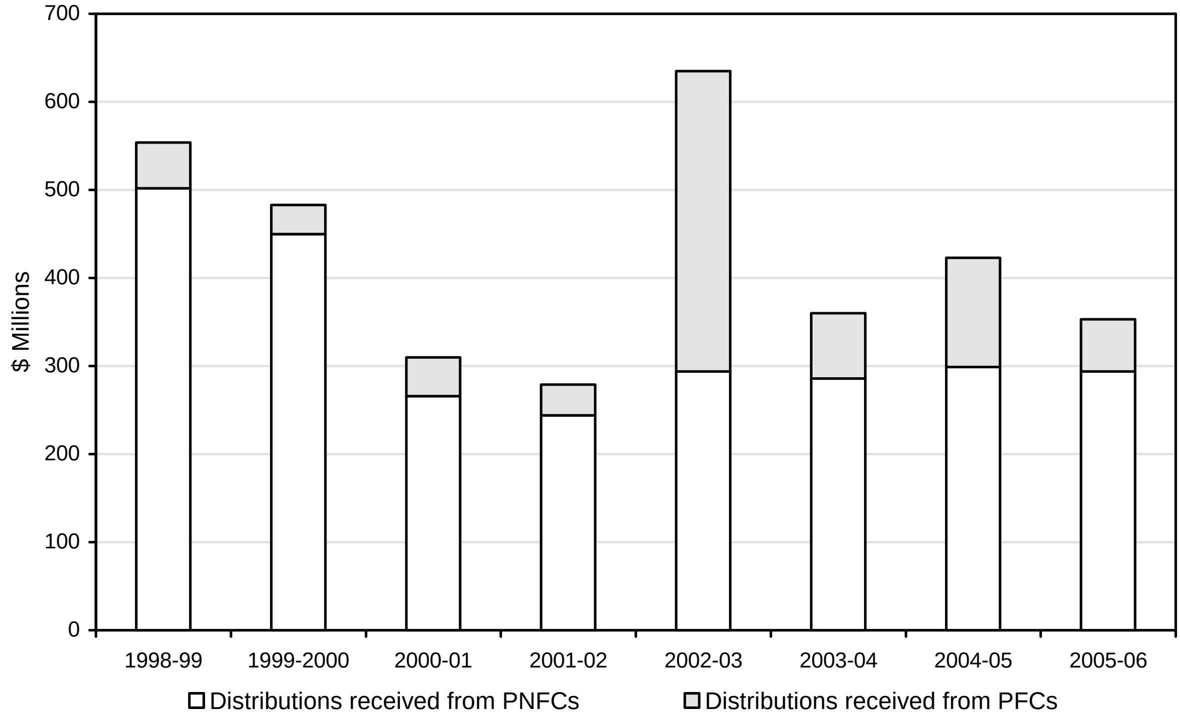
The long-term benefit to the State's finances of the national taxation reforms is as yet unknown, however, the benefits are not projected to commence until 2006-07.

6.4 OTHER REVENUE

A significant component of revenue in the GFS General Government Sector operating statement is that relating to distributions received, which is made up of both tax equivalent payments and dividends from other government entities. They are significant not only in terms of their size, but because they provide an opportunity for the Government to 'manage' the bottom line given the discretionary nature of the distributions.

The distributions come from two other GFS sectors, namely the Public Non-Financial Corporations (PNFCs) and the Public Financial Corporations (PFCs).

Distributions Received by the General Government Sector



6.4.1 Public Non-Financial Corporations

In past years, by far the largest component of distributions from PNFC has been returns from the electricity sector as dividends and income tax equivalents. As a result of the disposal of the electricity businesses PNFC distributions have now reduced markedly. However, it must be recognised that net interest expense has also reduced markedly.

Effectively the main distributions of any consequence are obtained from South Australian Water Corporation, which was estimated to provide $206 million in 2001-02 increasing to $240 million in 2002-03. Further details are provided under South Australian Water Corporation in Part B of this Report.

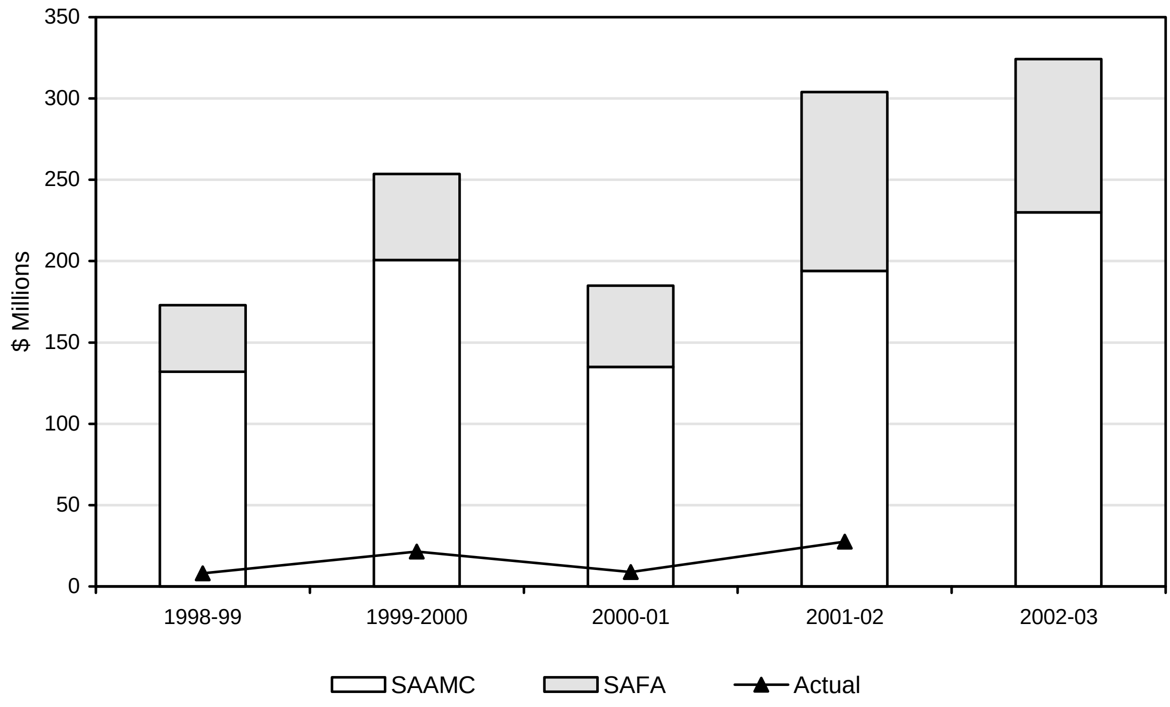
6.4.2 Public Financial Corporations

The main source of revenue projected from the PFC category is income from SAAMC and SAFA and these fluctuate over the forward estimates period due to the way distributions are managed to achieve the required result.

Distributions from these entities have in recent years been estimated to provide large amounts to the Budget but have generally not been required. This is illustrated by the 2000-01 Budget where $109 million was estimated to be received from SAAMC. This entire amount was deferred to 2001-02 and was subsequently deferred further.

The following chart demonstrates the budgeted and actual distributions for the four years to 2001-02 together with the budgeted amount for 2002-03. The lumpiness of the SAAMC and SAFA contributions is evident.

Budgeted and Actual Distributions



Projected distributions for the period of the Budget are as follows:

Projected Distributions from SAFA and SAAMC

	2002-03 $'millions	2003-04 $'millions	2004-05 $'millions	2005-06 $'millions	Total $'millions
SAFA	94.3	25.7	44.2	52.2	216.4
SAAMC	230.0	41.8	73.2	0.0	345.0
	324.3	67.5	117.4	52.2	561.4

The distributions projected to 2005-06 have a substantial negative impact on the total accumulated reserves of each of the institutions which as at 30 June 2002 were $366 million for SAAMC and $266 million for SAFA.

In regard to SAFA, a review of its capitalisation by the Department of Treasury and Finance has determined that it currently retains a higher level of capital than is required for its ongoing operation. Its retained earnings will be reduced to $75 million. As a result, the level of earnings that SAFA could be expected to make in future periods (beyond the forward estimates) would not be able to sustain distributions at a level anywhere near those detailed above.

With respect to SAAMC the distributions over the forward estimates represent the expected final amounts to be received from it.

7 EXPENDITURE

7.1 OVERVIEW

For 2001-02 estimated GFS expenses total $7.7 billon and are estimated to exceed budget by $404 million or 5.5 percent. In addition, net interest expense is estimated at $145 million (an increase over budget of $2 million) and capital payments estimated at $492 million (a decrease of $27 million). A summary of major expenses for the General Government Sector against budget is as follows:

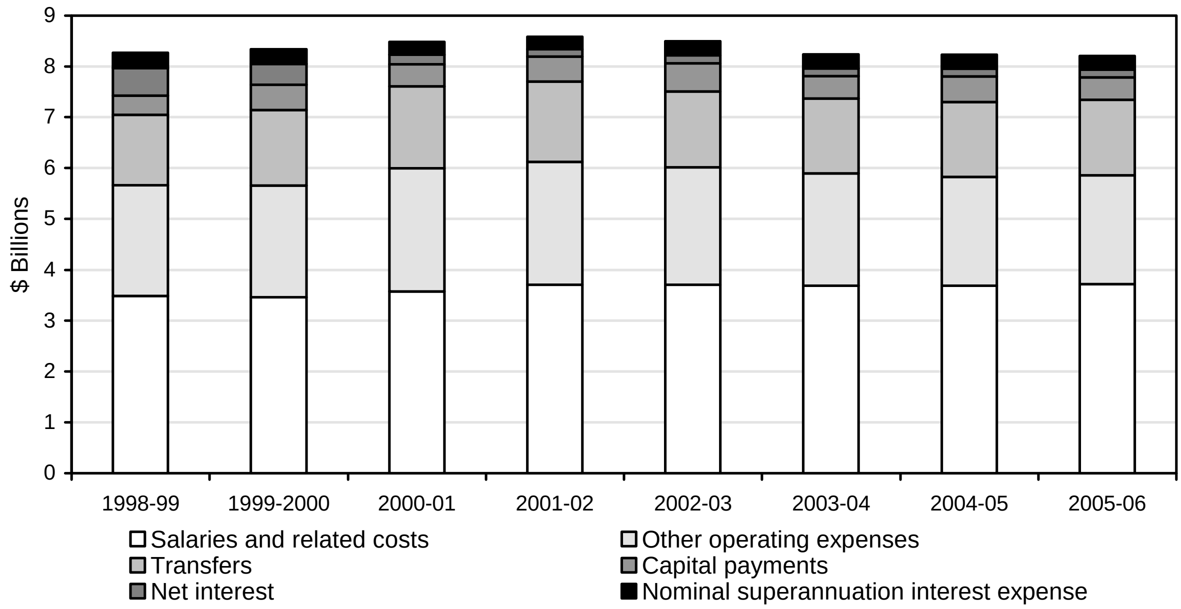
GFS - General Government Sector Expenses

	2001-02 Budget $'millions	2001-02 Estimated Result $'millions	Difference $'millions	Difference Percent
Employee expenses	3 583	3 705	122	3.4
Other operating expenses	2 182	2 418	236	10.8
Transfers	1 535	1 581	46	3.0
Total operating expenses	7 300	7 704	404	5.5
Capital payments	519	492	(27)	(5.2)
Net interest	143	145	2	1.4
Nominal superannuation interest expense	239	244	5	2.1
	8 201	8 585	384	4.7

Going forward, expenses are projected to decrease in real terms from 2001-02. Audit analysis indicates that this is against the trend for the four years to 2001-02 where expenses have increased in real terms. This suggests that managing the level of expenses will be essential to achieve set targets.

The following chart highlights the trends in expenses (in real terms) that have emerged since 1997-98. Data has been adjusted using deflators provided by DTF.

General Government Sector Expenses (Real) (a)



(a) Estimated June 2002 values

The chart shows total expenses are projected to decrease in real terms from $8.6 billion in 2001-02 to $8.5 billion in 2002-03.

The following discussion focuses on some of the major components that make up the total expenses.

7.2 EXPENSES BY TYPE

7.2.1 Salaries and Related Costs

7.2.1.1 Public Sector Wage Growth

Salaries and related costs ($3.7 billion in 2001-02) represent a very high proportion (43 percent) of the total current expenses. The 2002-03 Budget provides sums 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 major risk to the Budget is the outcomes from the enterprise agreements, which are due for renegotiation in the following timeframes:

Public service executives 1 July 2002
Medical officers 1 January 2003
Wages parity 1 October 2004
Police 1 July 2004
Nurses 1 October 2004
Teachers 1 October 2005

Given that a number of the agreements have been relatively recently finalised, the impact of agreements for the majority of employees should be known, and the Budget should reflect a reasonably accurate estimate of costs in the immediate years of the estimate period.

However, the Budget identifies that if wages and salaries for public sector employees increased by 1 percent more than is currently factored into the Budget then wage and salary expenditure would increase by approximately $38 million per annum.

7.2.1.2 Separation Packages

Separation payments continue to be a feature of workforce management with spending estimated to be $42 million over the next 12 months for the separation of approximately 600 employees. The $42 million is included within the employee expenses budget for 2002-03.

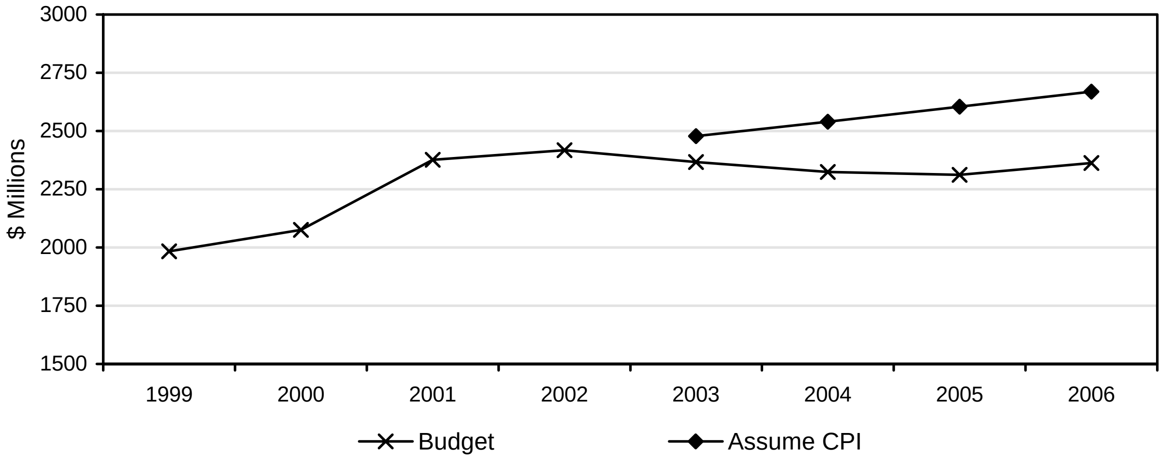
The budgeted costs for salaries and related costs include savings of approximately $16 million per annum commencing in the 2002-03 year relating to previous separation packages given.

7.2.2 Other Operating Expenses

Other operating expenses are estimated to be $2.4 billion for 2001-02, but are budgeted to fall by $51 million in nominal terms in 2002-03.

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 expenditure with an assumed increase from the 2001-02 year in line with the Consumer Price Index (CPI).

GFS - General Government Sector Other Operating Expenses



Based on this analysis the potential shortfall in the Budget would be:

	Based on CPI (2.5%) $'millions
2003	111
2004	216
2005	292
2006	307

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 savings targets that have been built into the 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. This matter is discussed in more detail later under the heading ‘7.2.7 - Savings’.

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:

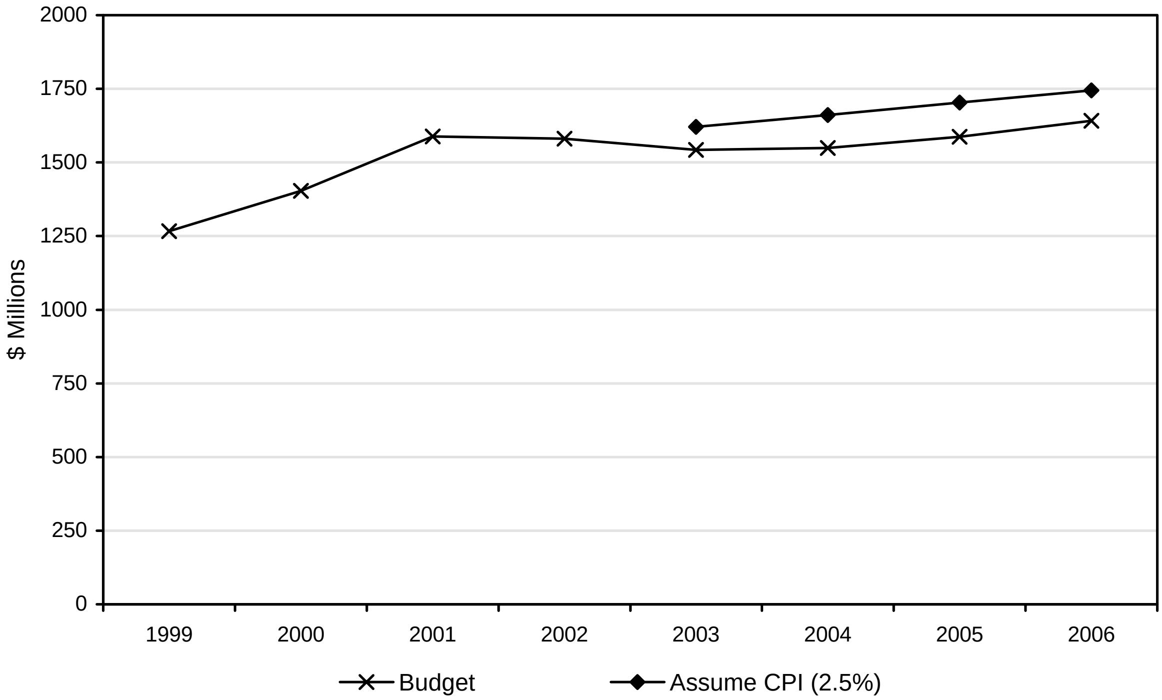
- appropriation for the South Australian Housing Trust and TransAdelaide;

- community service obligation payments to South Australian Water Corporation and ForestrySA;
- grants to non-government schools;
- grants to local government;
- grants to industry.

Transfer payments are estimated to be $1.6 billion for 2001-02, but are budgeted to fall by $38 million in nominal terms in 2002-03

Again, as was the case for other operating expenses, although it is difficult to determine with accuracy the ‘natural’ cost pressures within this expenditure line, the following graph compares the budgeted GFS General Government Sector transfer payments with an assumed increase from the 2001-02 year in line with the CPI.

GFS - General Government Sector Transfer Payments



Based on this analysis the potential shortfall in the Budget would be:

	Based on CPI (2.5%) $’millions
2003	78
2004	112
2005	116
2006	103

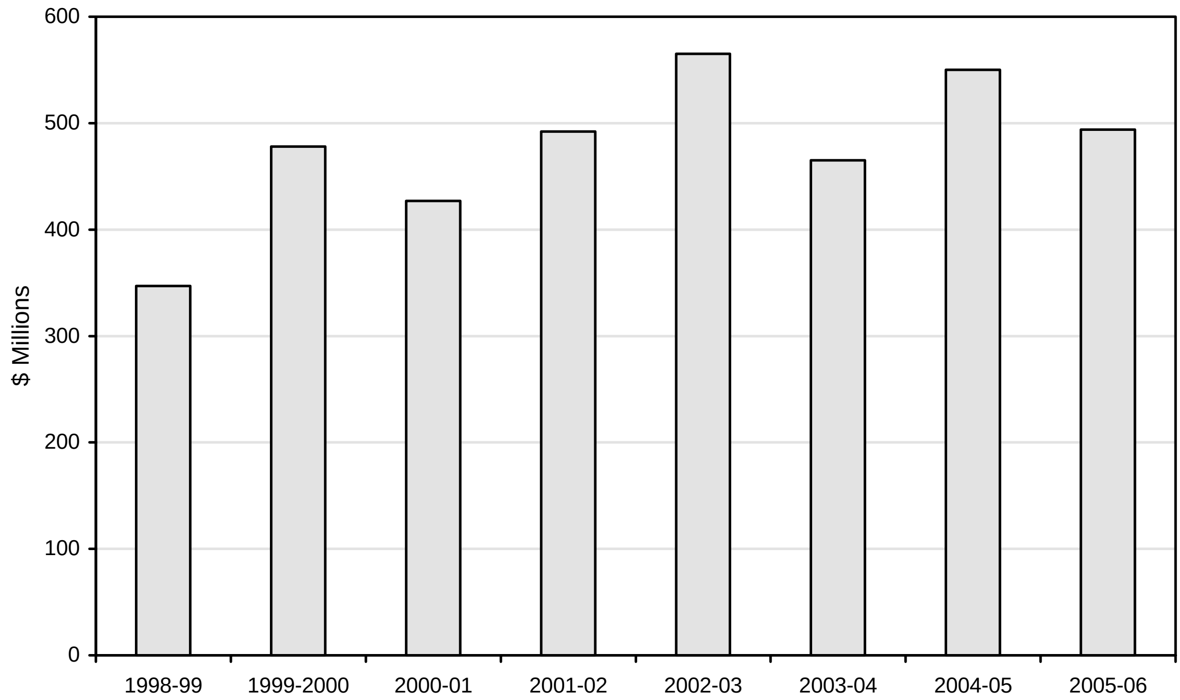
Again, the use of the CPI to inflate past expenditure may not be an accurate reflection of future costs, but highlights the importance of the savings target in the Government achieving its fiscal strategy.

7.2.4 Capital Payments

Gross fixed capital formation in the 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.

GFS - General Government Sector 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 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 $20 million (in 2002-03) and $295 million (in 2005-06)

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.

7.2.5 Interest

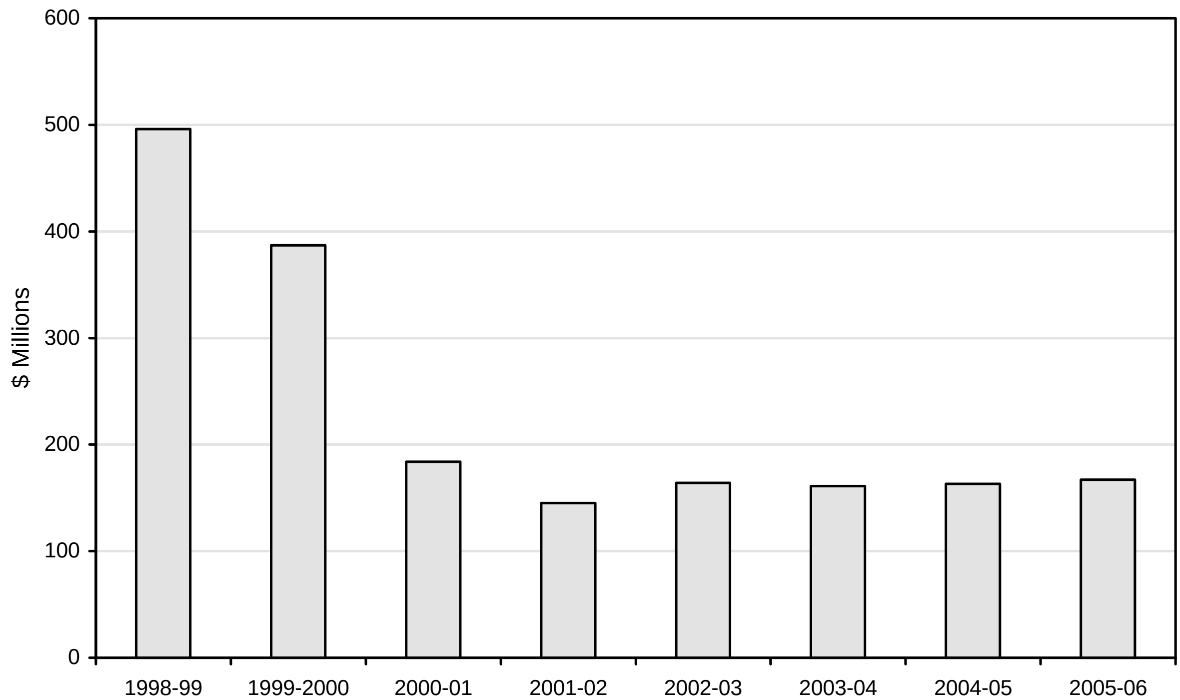
The impact of the interest expense on the State's finance has diminished greatly over the last few years as the full impact of assets sales has taken place, decreasing from $496 million in 1998-99 to an estimated expense of $145 million in 2001-02.

Although there is an anticipated small increase in net interest expense to $164 million in the 2002-03 Budget due to the impact of a small change in the Common Public Sector Interest Rate charged to the Treasurer by SAFA, the expense is expected to remain relatively unchanged over the forward period.

However, to put the reductions in perspective, it must be remembered that the reduction in interest expense has come at the cost of distributions from the assets sold to reduce public sector debt.

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

GFS - General Government Sector Net Interest Expense (Nominal)



Net debt for the General Government Sector is projected to increase slightly over the Budget forward estimate period with the potential for an increase in the net interest expense.

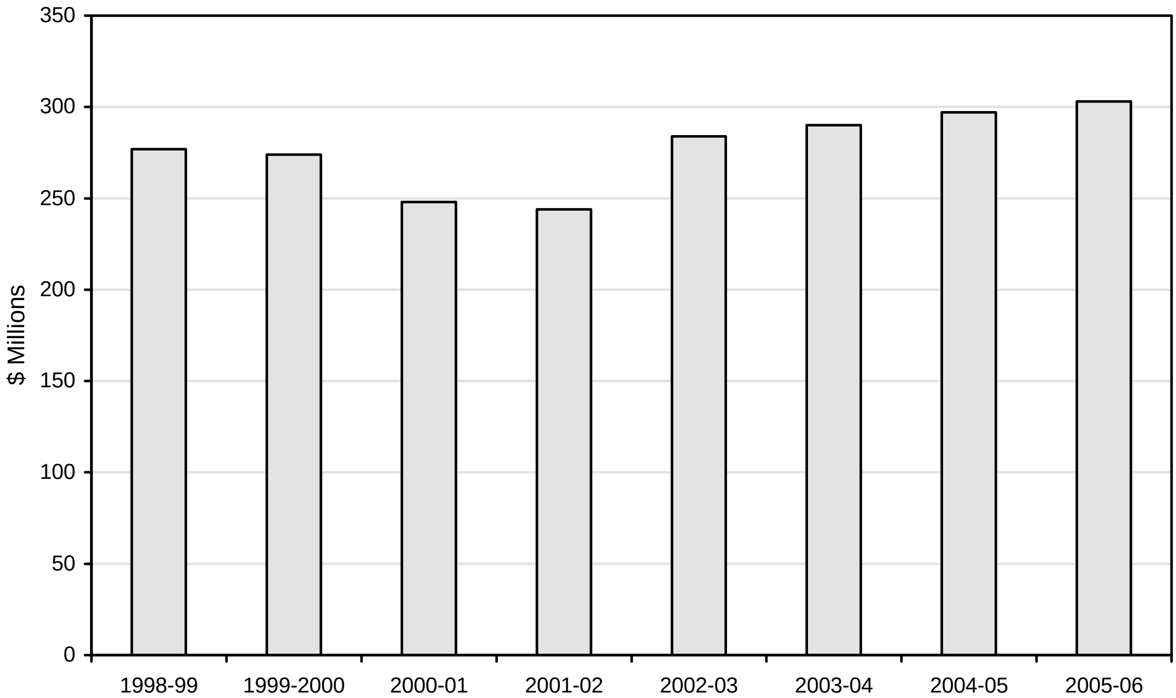
Further discussion in relation to debt movements is provided in the section under the heading '12 - Net Debt'.

7.2.6 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 that the unfunded liability for the defined benefits superannuation schemes is equivalent to any other debt that is recognised by including the nominal interest on the outstanding liability as part of expenses in the operating statement.

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

GFS - General Government Sector Nominal Superannuation Expense (Nominal)



The increases over the forward years recognises the increased liability due to recent falls in investment earnings, and the expected increases in the unfunded liability in the short term, notwithstanding the ongoing program to fully fund the liability over the next 30 years.

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

7.2.7 Savings

A number of times earlier in this Report recognition has been given to planned savings that have been included in the Budget Papers, and that form the basis of trying to achieve the long term fiscal strategy.

The Budget includes a number of savings that have been identified by agencies, based on either achieving efficiency or reducing particular services. This amount was supplemented with reductions in flexibility for future general cost pressures or new initiatives through the reductions in contingency provisions.

A summary of those savings that have been identified is:

Summary of Budget Savings

	2002-03 $'millions	2003-04 $'millions	2004-05 $'millions	2005-06 $'millions
Agency Cost Recovery/Revenue Measures	14	20	21	21
Agency savings measures	86	110	122	119
Commercial sector measures	12	12	14	18
Consultancy savings	11	11	11	11
ETVSP savings	16	16	16	16
Other	14	11	4	4
Contingency provisions	30	47	34	82
Reversal of previous Government decisions	13	17	18	16
	196	244	240	287

In addition, further expenditure reviews were commenced during 2001-02 in relation to the Education and Human Services portfolios. Reviews with respect to other areas have yet to be established.

These expenditure reviews are being conducted jointly between the Department of Treasury and Finance and officers of the departments under review. The Expenditure Review and Budget Cabinet Committee is overseeing the conduct of the reviews, with the expenditure review team reporting to the Committee through the Under Treasurer.

The outcome of the review of expenditures and the factors driving those expenditures will be the establishment of an agreed forward estimate methodology and revised budget estimates. The review will also identify any efficiencies and scope for re-prioritisation of activities.

The expenditure review process has been divided into three parts:

- Development of an understanding of the financial and other issues confronting the portfolio, involving a stocktake of activities and finances and identification of potential issues for further investigation.
- Investigation of those specific priority issues.
- An evaluation of the current forward estimates.

It is anticipated that the final reports for these initial reviews will be completed for consideration as part of next year's Budget process.

Coming out of both the initial savings measures identified above and any further savings identified as part of the expenditure reviews will be a monitoring process to ensure that those savings are achieved, and that there is no overspending in other areas. If the savings are not achieved, as demonstrated above, it is likely there will be considerable stress on the overall Budget outcome.

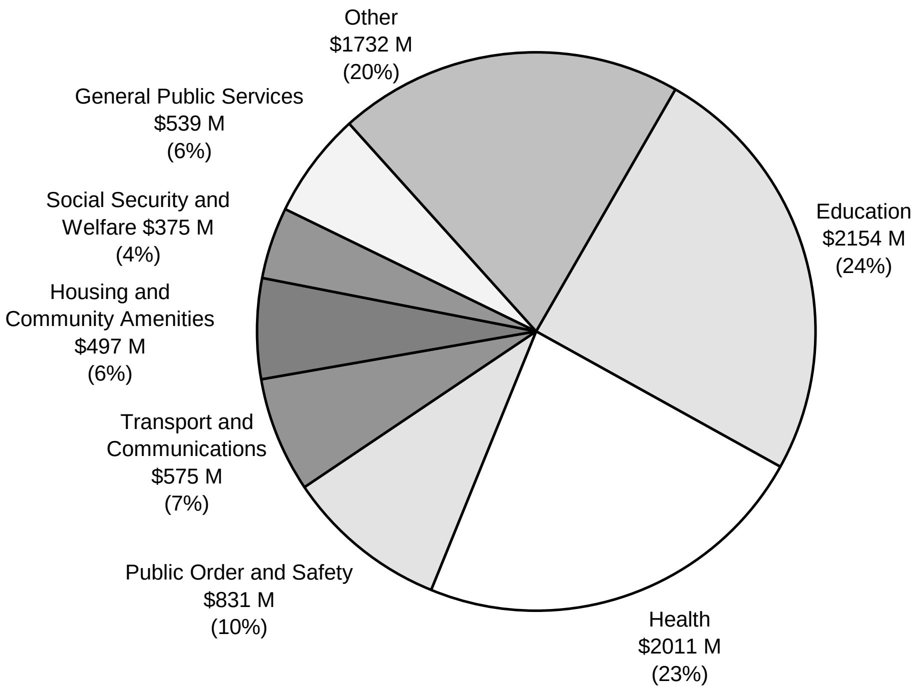
7.3 EXPENSES BY FUNCTION

The discussion on expenses up to now has focused on expenditure by type.

The GFS reporting framework also provides information on expenditure by its function. 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 demonstrates the extent to which the health and education sectors dominate the overall expenditure by the State.

GFS - General Government Sector Expenses by Function



It is evident from the chart that even though the Government have made commitments to increase spending in both the health and education areas, it is unlikely that the level of savings required to meet the fiscal target can be achieved without also making savings in those same sectors.

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.[28]

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

- ***GFS Data*** — which is the focus of the Budget Papers. On 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 South Australian Water Corporation, ForestrySA and TransAdelaide).[29]

- ***AAS 31 (Whole-of-Government Financial Statements) Data*** — which provides the only whole-of-government presentation of financial position. This commentary concludes the sections on the financial position as it relates to the 2000-01 year.

There are distinct differences in the presentation of these financial statements and advantages to using each set of data to analyse assets and liabilities.

The following briefly provides commentary concerning the two sets of data:

- GFS data for 2002 and 2003 for the General Government and Public Non-Financial Corporations Sectors is available at the date of this report, however, data for the Total Public Sector is unavailable. This, therefore, does not allow for a complete picture (in terms of the full details) to be formed as to what the State's estimated financial position will be at 30 June 2002 and 2003. In this regard the equity interest (net assets) of other sectors are included for each sector so the net overall position is reported.

- AAS 31 data includes asset revaluation increments made on non-current assets, where GFS data excludes revaluation revenue and expenses because they are outside the control of government.

- Unfortunately preparation of data on the AAS basis is such that data is not available for the 2001-02 year at the time of this Report. AAS 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 2001. Notwithstanding, references are made to highlight some of the differences in the presented positions.

---

[28] Budget Statement 2002-03, Budget Paper 3, Appendix A (as revised), includes the financial data in statements described as 'Balance Sheet'. This Report uses the title 'Statement of Financial Position'.

[29] Budget Statement 2002-03, Budget Paper 3, Appendix E details agencies within the respective sectors.

The following analysis has been performed with these limitations in mind and also uses amounts sourced from specific agencies' 2001-02 financial statements to assist in providing detail as relevant.

8.1.1 Key GFS measures

Three key GFS measures of the State's financial position are:

Net Worth — 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. This measure includes the effects of revaluations of non-financial assets.

Net Financial Worth — Net financial worth is a measure that is determined by total financial assets less total liabilities. It is a broader measure than net debt and captures changes in other liabilities and equity interests when observing trends and comparing between jurisdictions.

Net Debt — Net debt is calculated as financial liabilities less financial assets. It takes into consideration deposits held or on-hand, advances received or paid, investments, loans and placements and borrowings.

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

Data presented in the Budget Papers (Appendix A, Table A4 as revised) for the General Government Sector covers the full period of the forward estimates and is presented below.

GFS - General Government Sector Financial Position (Nominal Terms)

	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
	Actual	Actual	Estimated Result	Budget	Estimate	Estimate	Estimate
	$'million	$'million	$'million	$'million	$'million	$'million	$'million
Assets	24 529	24 371	24 770	24 660	24 842	25 090	25 550
Liabilities	12 082	9 583	10 512	10 569	10 761	10 964	11 310
Net Worth	12 447	14 788	14 258	14 091	14 081	14 126	14 240
Net Financial Worth	2 986	4 091	3 342	2 957	2 870	2 751	2 720
Net Debt	1 920	1 246	1 370	1 360	1 357	1 399	1 400

Of note is the expectation that:

- assets will decrease in 2002-03 and increase thereafter;
- liabilities will increase across the forward estimates;
- net worth (assets less liabilities) will decrease from 2000-01 to 2003-04 and increase thereafter as asset growth outstrips liability increases;
- net financial worth (financial assets less liabilities) will decrease for the full period of the forward estimates;
- net debt is estimated to increase over the forward estimate years.

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.

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

	1999-2000	2000-01	2001-02	2002-03
			Estimated	
	Actual	Actual	Result	Budget
	$'million	$'million	$'million	$'million
Assets	26 444	25 592	26 020	26 007
Liabilities	13 998	10 776	11 763	11 915
Net Worth	12 445	14 816	14 258	14 091
Net Financial Worth	(8 986)	(7 109)	(7 832)	(8 309)
Net Debt	4 355	3 223	3 408	3 459

This table highlights that:

- net worth and net financial worth are expected to decrease from 2000-01 to 2002-03.
- net debt is estimated to increase from 2000-01 to 2002-03.

Further detailed commentary on the statement of financial position, is provided, concentrating on the categories of data for:

- Assets
- Liabilities
- Net Worth and Net Financial Worth
- Net Debt.

9 ASSETS

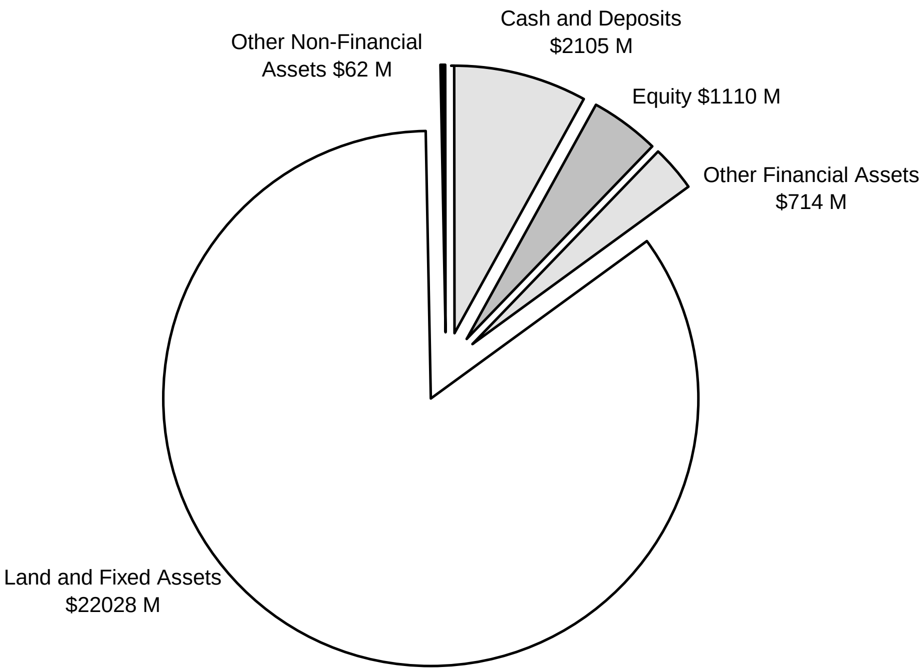
9.1 INTRODUCTION

Historic information shows that the State's financial position does not materially vary from year to year in the absence of major asset disposals. 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 2002 for the Non-Financial Public Sector.

GFS - Non-Financial Public Sector Assets at 30 June 2002 ($'millions)



Non-financial assets clearly represent the vast majority of State assets being 85 percent of the total. These assets are approximately evenly divided between the General Government and Public Non-Financial Corporations Sectors. The significance of this is that 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. The following tables set out details of financial assets in the General Government and Non-Financial Public Sectors.

9.2.1 GFS - General Government Sector Financial Assets

The following table provides available time series data for the General Government Sector.

GFS - General Government Sector Financial Assets (Nominal Terms)

	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
			Estimated				
	Actual	Actual	Result	Budget	Estimate	Estimate	Estimate
	$'million	$'million	$'million	$'million	$'million	$'million	$'million
Cash and Deposits	3 187	1 806	1 989	1 957	2 039	2 147	2 403
Equity	9 914	10 158	10 138	9 873	9 915	9 905	9 988
Other financial assets	1 967	1 709	1 726	1 696	1 676	1 663	1 638
Total financial assets	15 068	13 673	13 853	13 526	13 630	13 715	14 029
Increase (Decrease)		(1 395)	180	(327)	104	85	314

In terms of the preceding time series, the stand out item is the decrease of financial assets by $1.4 billion in 2000-01. This is a once off item relating to the application of proceeds from asset disposals in 1999-2000 toward the reduction of debt.

Total financial assets are expected to reduce from 2001-02 to 2002-03 and increase thereafter. The decrease for 2002-03 principally reflects the expectation that equity of the General Government Sector in SAAMC and SAFA will decrease by $324 million as a result of distributions back to the General Government Sector.

While there is an expected increase in non-financial assets in 2002-03, this increase is insufficient to cover the reduction in financial assets with a resultant expectation of a decrease in total assets for 2002-03. Further related comment on this point is made later in respect to non-financial assets.

9.2.2 GFS - Non-Financial Public Sector Financial Assets

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

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

	1999-2000	2000-01	2001-02	2002-03
			Estimated	
	Actual	Actual	Result	Budget
	$'million	$'million	$'million	$'million
Cash and Deposits	3 303	1 932	2 105	2 045
Equity	966	1 076	1 110	820
Other financial assets	743	658	715	741
Total financial assets	5 012	3 666	3 930	3 606
Increase (Decrease)		(1 346)	264	(324)

The trends revealed in the preceding table are consistent with that for the General Government Sector. This, in effect, indicates that there are no material trends from the Public Non-Financial Corporations Sector influencing the consolidated position.

9.2.3 Agency Financial Assets

South Australian Government entities have significant investments that are recognised in the State's financial position. These investments are held or managed by a number of agencies, including:

- 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 shows the major holdings of investment assets as at 30 June 2002 for the above named entities:

Investments held by Public Sector Agencies (a)

	Domestic Equities $'million	International Equities $'million	Fixed Interest $'million	Other Investments $'million	Total $'million
Funds SA (b)	1 737	1 623	481	1 341	5 182
MAC	199	110	810	92	1 211
SAICORP	42	31	58	-	131
SAAMC	-	-	-	1 189	1 189
SAFA	-	-	-	1 319	1 319
Total	1 978	1 764	1 349	3 941	9 032

(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 2002.

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

9.2.4 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 organisation specific investment strategies, which are ratified by the relevant organisations' 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 following table shows the movement in the All Ordinaries Index (ASX 100) and the Dow Jones Composite Index for the past 10 years and provides an indication of movements in equity prices over that period. The above organisations have diversified portfolios and hence have exposures to other countries' equity markets and investment instruments. For the purposes of this discussion, however, the following table shows the volatility of investing in equity markets and the differing annual returns that have been received in the past.

Movement in Share indexes (1993-2002) (a)

	ASX 100 Percent	Dow Jones Composite Index Percent
1992-93	6	11
1993-94	14	(3)
1994-95	(1)	15
1995-96	7	19
1996-97	23	34
1997-98	(3)	15
1998-99	8	18
1999-00	2	(6)
2000-01	3	1
2001-02	(2)	(14)
Average	**6**	**9**

(a) Movements have been calculated using the average monthly values.

The preceding results show that there have been average returns over this period of approximately 6 percent per annum on Australian equity markets and 9 percent per annum returns on the United States' markets. Within this time period, negative returns have also been incurred for three out of the 10 years, however, this has had minimal impact over the long term.

Poor investments 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'.

9.2.5 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.

Funds SA use derivative instruments to hedge approximately 33 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 does not hedge any 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.

The different risk management approaches and policies also take into account the extent of exposures respective organisations have. The earlier table of investments held in public sector agencies highlights that Funds SA has by far the greatest value of investments and exposures to international and domestic equity markets.

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 revaluation every three years. Valuation of public sector assets, particularly General Government Sector (Non-Commercial) Assets, is a subjective process. It is important to understand that 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

The following tables set out the non-financial assets for the General Government Sector.

GFS - General Government Sector Non-Financial Assets (Nominal Terms)

	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
			Estimated				
	Actual	Actual	Result	Budget	Estimate	Estimate	Estimate
	$'million	$'million	$'million	$'million	$'million	$'million	$'million
Non-financial assets	9 461	10 697	10 916	11 134	11 211	11 375	11 521
Increase		1 236	219	218	77	164	146

The table highlights the expected continuous increase in non-financial assets over the forward estimates.

The following table shows the main variations in non-financial assets for the period 2001-02 to 2005-06.

	2001-02 Estimated Result $'million	2002-03 Budget $'million	2003-04 Estimate $'million	2004-05 Estimate $'million	2005-06 Estimate $'million
Opening Balance	10 697	10 916	11 134	11 211	11 375
Add: Gross fixed capital formation	492	565	465	550	494
Less: Depreciation	386	388	394	393	397
Add: Net revaluation increments	43	48	2	0	41
Add: Ports Corp transfers	43	0	0	0	0
Other	27	(7)	4	7	8
Closing Balance	10 916	11 134	11 211	11 375	11 521

The table highlights that the main changes in asset value reflect net acquisitions (gross fixed capital formation less depreciation). Revaluations and transfers between sectors account for the majority of other movements from year to year.

As mentioned previously, physical asset amounts tend to stay relatively stable from year to year. The main increase in 2000-01 related to an asset revaluation done on the State's road network assets, which resulted in an net increase in total assets of approximately $1.1 billion. Revaluations for the State's other major infrastructure (water, sewerage and drainage systems) are not required until the financial year ending 30 June 2003.

Assets are estimated to increase by $218 million in 2002-03. As previously noted, this compares to a budgeted decrease in financial assets of $327 million for that period reflecting distributions from SAAMC and SAFA. In effect this indicates that the distributions from SAAMC and SAFA are in part being applied to meet recurrent expenses rather than asset acquisition.

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

The following tables set out the non-financial assets for the Non-Financial Public Sector.

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

	1999-2000 Actual $'million	2000-01 Actual $'million	2001-02 Estimated Result $'million	2002-03 Budget $'million
Non-financial assets	21 431	21 925	22 090	22 401
Increase		494	165	311

The table highlights the expected increase in non-financial assets over the three years to 2002-03. The lower growth for 2001-02 is as a result of the finalisation of disposal of ports and racing assets during the early part of 2001-02.

Over the past three years to 2001-02 there have been significant changes made to the State's infrastructure base with the disposal of the State's electricity and ports infrastructure to the private sector. These large decreases are shown through the fall in infrastructure assets as reported in AAS 31 Whole-of-Government Statements. The majority of the proceeds received from these disposals was used to repay State debt and other obligations resulting in a restructure of the financial position for the State (lower physical revenue producing assets and offsetting lower debt) and lower future interest expense obligations with a corresponding forgoing of revenues from those assets.

The effects of the asset disposals are not apparent in the table for the Non-Financial Public Sector because of the large increases reported for the General Government Sector from the first time recognition of assets and revaluations.

9.3.4 Total Net Acquisition of Non-Financial Assets

The following table sets out estimates data for the General Government Sector net acquisition of non-financial assets for the Budget years.

GFS - General Government Sector Net Acquisition of Non-Financial Assets

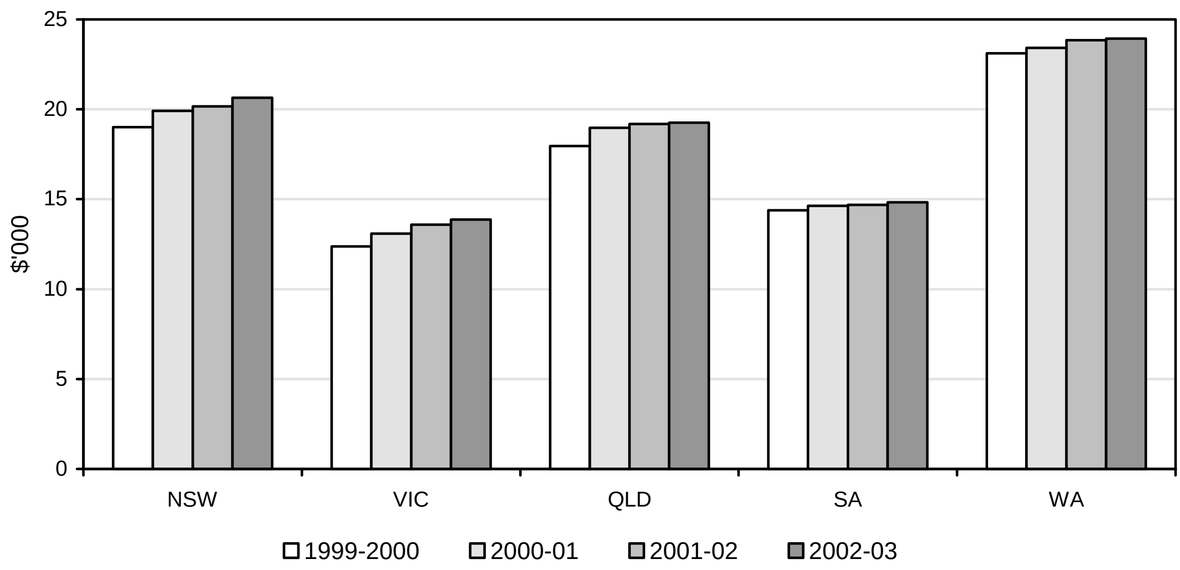
	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
			Estimated				
	Actual	Actual	Result	Budget	Estimate	Estimate	Estimate
	$'million	$'million	$'million	$'million	$'million	$'million	$'million
Total Net Acquisition of Non-Financial Assets	140	102	108	179	74	157	97

The table indicates that net acquisition of non-financial assets is expected in each year although fluctuating across the forward estimates. Depreciation expense is consistent over the forward estimates. The larger growth expectations in 2002-03 and 2004-05 simply reflect projected spending provided in the Budget.

9.3.5 Comparison 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



9.3.6 Private Public Partnerships (PPP)

Non-financial assets can be acquired directly by the Government or by various methods through the private sector. Depending on the arrangements in place, assets may or may not be recognised as being owned by the Government.

PPP is a government initiative that commenced in 2001 (the 2001-02 Budget indicated an intention to investigate the possibility of using public-private partnerships (Partnerships SA) for the provision of some capital projects) with the objective of contracting with the private sector to assist with the development of infrastructure and for the provision of services.

The new Government has indicated in the Budget Papers its intention to pursue partnership opportunities with the private sector.[30]

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.

Detailed guidelines have recently been released detailing the principles applying to these arrangements.[31]

A number of projects have to date been investigated for their feasibility for being delivered as PPPs during 2001-02, including the development of a new:

- Science and Technology Centre
- State Swimming Centre
- Adelaide Women's Prison.

Monies were also approved to evaluate the feasibility of upgrading a number of police stations around the State.

Total monies approved from the contingency provision in 2001-02 for all the above feasibility studies totalled $0.4 million.

---

30 Capital Investment Statement 2002-03, Budget Paper 5, p. 2.

31 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.

The Government has indicated that rigorous analysis of any public-private partnership will be undertaken to ensure that the Government will receive better value for money from such an arrangement than from developing infrastructure by conventional means.

Any projects successfully implemented under Partnerships SA are not likely to be included in capital expenditure. To the extent that new services are provided to the Government by the private sector, a cost will be reflected in current expenses.

9.3.7 Some Observations on PPP and Procurement Generally

In the context of the discussion on the State's finances, the following observations are made with respect to the new focus being given to PPP's.

Firstly, I am aware that in the past, for some transactions under consideration, there has been particular focus given to the accounting treatment of the transaction, in particular whether it would be on or off balance sheet. Although Audit understands that the desire to reduce debt and achieve a particular credit rating has been a fiscal imperative, it is important that such decisions do not end up driving the transaction, and take away from the more important objective of value for money and proper risk allocation. The question of the accounting treatment of a transaction should be driven by the allocation of risk in the particular circumstances, and not the other way around.

In my view, there is a risk that this issue will continue to exist, with the primary fiscal target set by the Government being the GFS net lending (borrowing), a measure that includes the up-front capital cost of an asset purchased by government.

Secondly, criticisms are often aimed at these types of transactions relating to the locking in of costs over a long period, and the detrimental effect they have on future State finances. Whilst I agree that this can be an issue, it can also reflect on the lack of recognition of the long-term consequences of any capital procurement process, whether it is by the Government directly or by the private sector on its behalf. If the Government purchases an asset there should be a:

- full understanding of the service being provided and the options for its delivery;
- long-term commitment to the proper exploitation and maintenance of that asset over its entire life.

It is the failure to do these things that can have a detrimental effect on the State's finances.

It should be expected that the discipline that is applied (or should be applied) at the beginning of a PPP process should be the same for any service provision relating to a long-term asset, with proper recognition given the full life-cycle costs. This is consistent with the Project Initiation Process document issued by the Department for Administrative and Information Services.

10 LIABILITIES

10.1 INTRODUCTION

In the 1998-99 Budget, the previous Government set out a four-year financial plan. Two key elements of the strategy outlined in that plan were continuing real reduction in net debt and the elimination of unfunded superannuation liabilities by 2024 (subsequently extended to 2034). A major asset sales program announced in February 1998 was the basis of achieving a significant real rate of debt reduction.[32]

The 2002-03 Budget has set out a number of fiscal principles relevant to the State's liabilities. Specifically,

- ***Fiscal Target*** — to achieve on average balanced budgets in the General Government Sector

- ***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 an AA 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).

The Budget also states that:

> *These fiscal principles reflect a commitment to containing the public sector's level of liabilities by ensuring no growth in 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.*[33]

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.

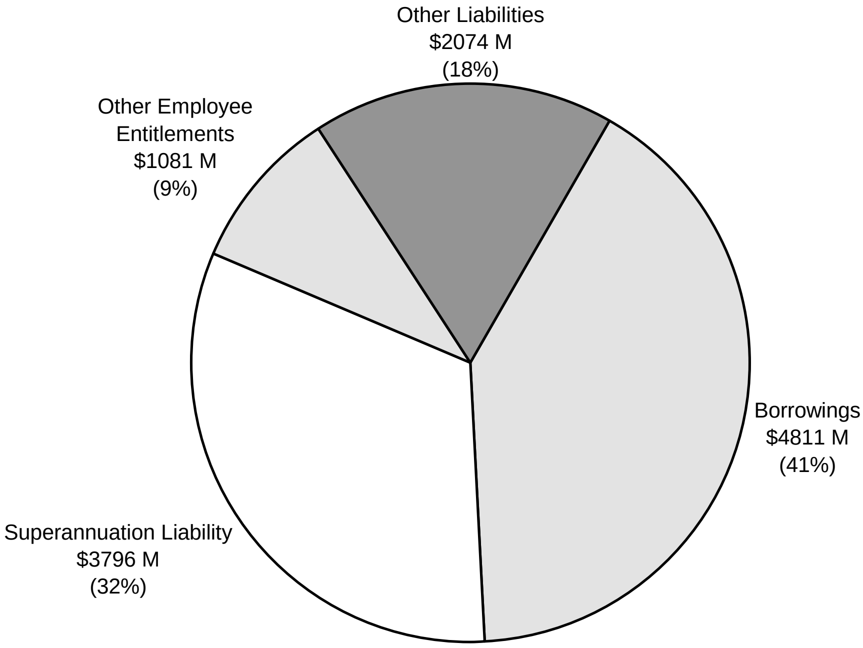
The following chart shows the estimated composition of liabilities of the State as at 30 June 2002 for the Non-Financial Public Sector.

---

32 Budget Statement 1998-99, Budget Paper 2, p. 1-1.

33 Budget Statement 2002-03, Budget Paper 3, p 2.3.

GFS - Non-Financial Public Sector Estimated Liabilities at 30 June 2002 ($’millions)



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

10.2 ANALYSIS OF LIABILITIES

10.2.1 GFS - General Government Sector Liabilities

GFS - General Government Sector Liabilities (Nominal Terms)

	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
			Estimated				
	Actual	Actual	Result	Budget	Estimate	Estimate	Estimate
	$’million	$’million	$’million	$’million	$’million	$’million	$’million
Borrowing	5 140	3 123	3 492	3 457	3 515	3 633	3 846
Superannuation	3 482	3 242	3 778	3 864	3 949	4 032	4 110
Other employee entitlements	901	983	1 025	1 052	1 080	1 094	1 111
Other	2 559	2 235	2 217	2 196	2 217	2 205	2 243
Total Liabilities	12 082	9 583	10 512	10 569	10 761	10 964	11 310
Increase (Decrease)		(2 499)	929	57	192	203	346

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

This table highlights the expected growth in total liabilities over the period of the forward estimates, with all categories showing some increase in nominal terms.

10.2.2 GFS - Non-Financial Public Sector Liabilities

The following table shows trends in liabilities for this sector.

	1999-2000	2000-01	2001-02	2002-03
			Estimated	
	Actual	Actual	Result	Budget
	$'million	$'million	$'million	$'million
Borrowing	6 668	4 386	4 811	4 835
Superannuation	3 556	3 262	3 796	3 883
Other employee entitlements	974	1 055	1 081	1 108
Other	2 800	2 073	2 074	2 089
Total Liabilities	13 998	10 776	11 762	11 915
Increase (Decrease)		(3 222)	986	153

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

This table also highlights the expected growth in total liabilities over the period under review. The major increase in 2001-02 is due to superannuation liabilities that are estimated to increase $621 million over the two years to 2002-03.

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. It is not a physical reduction as in the case of debt retirement.

As announced in the 1999-2000 Budget, the target with respect to fully funding superannuation liabilities was extended from 2024 to 2034. This extension allowed for a recurrent outlay saving of $55 million per annum in terms of cash-based reporting.

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 scheme, 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 2002, the estimated unfunded liability is $3.8 billion. Under these schemes, poor or negative investment returns on funds invested will result in increased expenses to the Government which are required to be paid from the General Government Sector.

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 scheme of unfunded liabilities.

10.3.3 Unfunded Superannuation Liability at 30 June 2002

The following table sets out the major elements that comprise the movement for unfunded superannuation liabilities from 30 June 2001 to 30 June 2002.

Change in Unfunded Superannuation Liabilities

		$'million	**$'million**
Opening Balance June 2001			3 249
Add:	Notional interest	244	
Less:	Past service payments	(122)	
Less:	Ports Corp proceeds	(90)	
Add:	Shortfall in earnings against assumed	410	
Add:	Half-yearly CPI	39	
Add:	Difference between actual experience and assumed	54	
Closing Balance June 2002			3 784

The estimated unfunded superannuation liability as at 30 June 2002 is $3.8 billion. This is an increase of $535 million from 30 June 2001, and is due mainly to a significant fall in investment earnings from assets managed by Superannuation Funds Management Corporation of South Australia (Funds SA) during the year. The fall was due principally to negative returns on international and domestic equities (shown as shortfall in earnings against assumed) that comprise a large proportion of superannuation assets.

This increase outweighs the reduction in the unfunded liability for the previous year ending 30 June 2001 of $294 million, which was due mainly to the estimated liability being reduced by $619 million based on the triennial actuarial review completed as at 30 June 1999. The significant movement in the liability amounts shows the inherent volatility of the liability amount and the influence that assumptions such as investment earnings has on the estimated amount.

The commitment to fully fund unfunded liabilities was reaffirmed by the Government in the 2002-03 Budget Papers, with the position as at 30 June 2002 remaining consistent with the plan to eliminate unfunded superannuation liabilities by 2034. Additional payments will be required, however, to compensate for reduced earnings in 2001-02 to remain on target. All other things being equal - out performance in any year may provide an ongoing benefit to future Budget results.

10.3.4 Analysis of June 2002 Unfunded Superannuation Liability

A net increase of $385 million in superannuation liabilities in 2001-02 was expected compared to the numbers published in the 2001-02 Budget. This increase is primarily a result of lower returns on investments than those initially budgeted for. The assumed investment earnings in the 2001-02 Budget for the year ending 30 June 2002 was 7.5 percent, where the revised estimated earning rates used this year were as follows:

- negative 3.7 percent for all superannuation scheme assets;
- negative 4.0 percent for defined benefit scheme assets only.

This shortfall in actual earnings contributed $410 million to the increase in the unfunded liability amount.

Other factors that contributed to the increase in 2001-02 were the incorporation of current membership data into actuarial models such as salary growth and mortality rates. This was partially offset by the application of $90 million to Funds SA to reduce past service unfunded superannuation liabilities. This one-off payment was received from a portion of the proceeds from the disposal of the South Australian Ports Corporation.

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:

• Return on Investments	7.5 percent per annum
• Inflationary salary increases	4.0 percent per annum
• CPI increases	2.5 percent per annum

As stated above, the assumed rate of return on assets in the 2001 triennial review was 7.5 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 table shows investment returns over the past 10 years for the State's defined benefit superannuation schemes.

Return on Defined Benefit Assets (1992 - 2002)

	SA Pension Scheme Percent	SA Lump Sum Scheme Percent
1992-93	11.90	9.40
1993-94	3.20	3.60
1994-95	5.00	6.20
1995-96	7.20	7.20
1996-97	20.71	20.63
1997-98	12.86	12.80
1998-99	9.54	9.53
1999-2000	17.03	17.06
2000-01	3.21	3.23
2001-02	(5.30)	(5.32)
Average	8.54	8.43

Over the period examined, on average, investment returns exceeded the budgeted investment-earning rate. Investment returns of other state superannuation schemes are not significantly different over comparative years and have also reached their target rate of return.

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 details the asset mix that was held as at 30 June 2002. The high percentage of domestic and international equities held partly explains the negative investment earning results for 2001-02. For a discussion on the risks involved with this investment strategy, refer to the Superannuation Funds Management Corporation of South Australia (Funds SA) in Part B of this Report.

Funds SA Asset Allocation as at 30 June 2002

Asset Mix	30-Jun-02 $'million	30-Jun-02 Percent
Australian Equities	1 737	34
International Equities	1 623	31
Property	524	10
Inflation Linked Securities	620	12
Fixed Interest	481	9
Cash	198	4
	5 183	100

10.3.6 Superannuation Funding

In 2002-03, total superannuation funding is budgeted to be a significant part of cash outlays. Payments comprise amounts paid from the non-commercial sector 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 from the non-commercial sector, the amounts paid as benefits so as to obtain consistent measures, over time, of the net contribution by the non-commercial sector to the funding of superannuation liabilities currently accruing or which have accrued in the past. The following table has been prepared with this in mind.

Superannuation Funding from Non-Commercial Sector

	(1) Total Funding $'million	(2) Benefits Paid (a) $'million	(3) Net Contribution Liabilities (b) $'million	(4) Real (June 2002) Terms (c) $'million
1993-94	545	280	265	302
1994-95	583	284	299	334
1995-96	595	285	310	347
1996-97	459	270	189	207
1997-98	423	282	141	153
1998-99	566	308	258	282
1999-2000	498	319	179	189
2000-01	324	368	(44)	(45)
2001-02 Budget	434	364	70	70
2001-02 Estimated result	527	377	150	150
2002-03 (d)	534	398	136	132
2003-04 (d)	548	423	125	119
2004-05 (d)	562	450	112	104
2005-06 (d)	577	479	98	89

(a) Met from non-commercial sector in 1993-94 and from the Superannuation Funds Management Corporation (Funds SA) in subsequent years. Does not include benefits paid from employees' contributions.

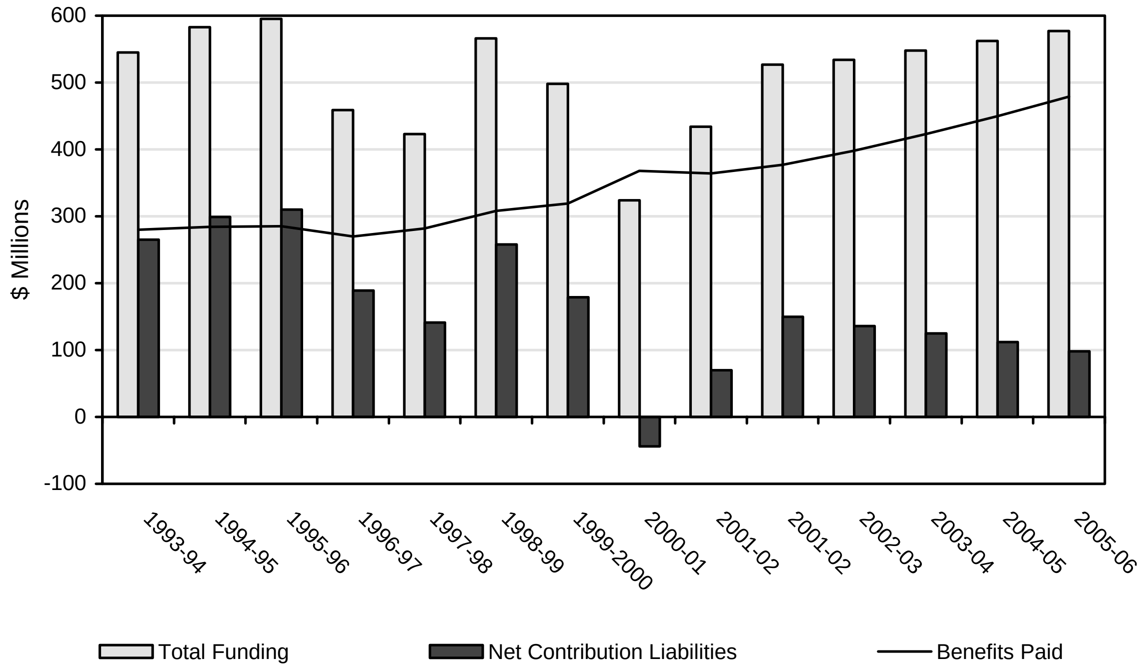
(b) Net contribution to past and currently accruing liabilities, that is, column (1) minus column (2).

(c) Deflators as provided by the Department of Treasury and Finance.

(d) Estimates/projections included in the 2002-03 Budget.

The following chart shows the trends in total funding, benefits paid and net superannuation contributions in real terms over the period of the table.

Superannuation Benefits and Contributions (Real) **(a)**



(a) Estimated June 2002 values

It will be seen that:

- in real terms total funding for superannuation is now expected to increase over the period reviewed;
- benefit payments increase over the forward estimate period resulting in decreasing net contributions to funding of superannuation liabilities currently accruing or which have accrued in the past. Benefit payments for the major schemes (State and Police) are currently estimated to peak in 2018-19.

The preceding data show the current position and is influenced by the payments made to meet the unfunded superannuation liability and the pattern of benefit payments.

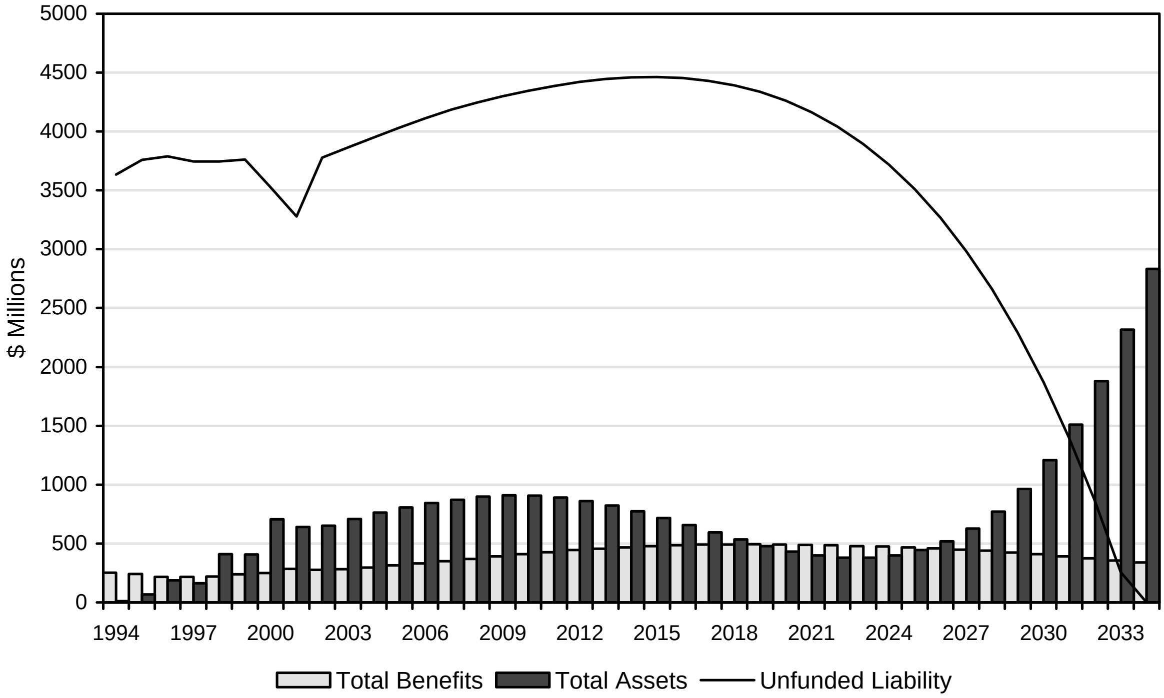
The reduction in the level of total payments for superannuation including the extension of the timeframe to fund superannuation liabilities to 2034 and the actuarial assessment reducing the estimated total liability, have enabled reductions in estimated future payments and provided additional room for spending in other areas, while staying within total cash-based outlay projections. This has been offset by revisions effected in the 2002-03 Budget to compensate for the negative superannuation returns that occurred in 2001-02, resulting in increased contributions over the forward estimates.[34] This will continue to meet the policy of fully funding the superannuation liability by 2034.

[34] Budget Statement 2002-03, Budget Paper 3, Table 3.20.

10.3.7 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 2014-15. It is estimated that benefit payments will peak in 2018-19.

It is also apparent that 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 table shows the value of Non-Financial Public Sector liabilities estimated for the four years to 2002-03.

GFS - Non-Financial Public Sector Other Liabilities

	1999-2000 $'million Actual	2000-01 $'million Actual	2001-02 $'million Estimated Result	2002-03 $'million Budget
Other employee entitlements	974	1 055	1 081	1 108
Other	2 800	2 073	2 074	2 089
Total Liabilities	3 774	3 128	3 155	3 197
Increase (Decrease)		(646)	27	42

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 $704 million for 2001-02 and $724 million in 2002-03. 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 $195 million for 2001-02 and $195 million in 2002-03;
- outstanding claims for South Australian Government Captive Insurance Corporation (SAICORP) estimated at $172.1 million for 2000-01 and $172.5 million in 2001-02. 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 $63 million at 30 June 2002 ($74 million in 2001). Details of SAICORP's operations are included in the Part B of this Report.

10.5 CONTINGENT LIABILITIES

As reported in the Budget Papers[35] 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;
- the amount of the liability cannot be measured reliably;
- there is significant uncertainty as to whether an obligation presently exists.

[35] Budget Statement 2002-03, Budget Paper 3, p 6.5.

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 2001 were valued at $1.9 billion. This is at nominal values without adjustment for the probability of actual liabilities occurring.

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 CONCERNING THE MEASURES AND RATIOS

Before considering the measures and related ratios, 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

The following table sets out the trends in net worth and the net financial worth for the General Government Sector.

GFS - General Government Sector Net Worth and Net Financial Worth (Nominal Terms)

	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	
			Estimated					(Decrease)
	Actual	Actual	Result	Budget	Estimate	Estimate	Estimate	Over Last
	$'million	$'million	$'million	$'million	$'million	$'million	$'million	4 years
Net Worth	12 447	14 788	14 258	14 091	14 081	14 126	14 240	
Increase (Decrease)		2 341	(530)	(167)	(10)	45	114	(18)
Net Financial Worth	2 986	4 091	3 342	2 957	2 870	2 751	2 720	
Increase (Decrease)		1 105	(749)	(385)	(87)	(119)	(31)	(622)

The table highlights that:

- net worth is forecast to decrease $167 million in 2002-03 and rise again in the two years 2004-05 and 2005-06 with a net reduction over the forward estimates period of $18 million;
- net financial worth is forecast to decrease annually over the forward estimates period with a total decrease of $622 million over the four years to 2005-06.

The main reason for the trends shown in the tables is the budgeted decrease in equity in SAAMC and SAFA in 2002-03 and the increase in unfunded superannuation liabilities and the persistent net borrowing result over the forward estimates period. Growth in unfunded superannuation liabilities is not estimated to peak until 2014-15.

11.4 NET WORTH PER CAPITA

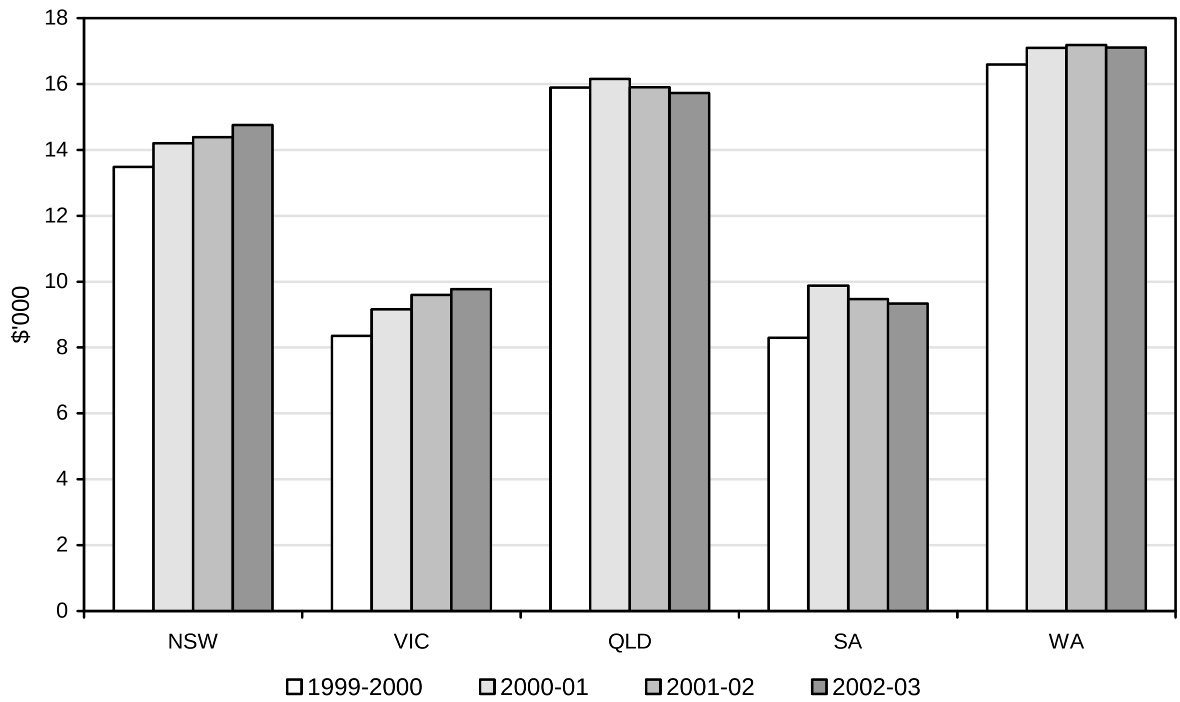
General Government Sector net worth is calculated as total assets (physical and financial) less total liabilities (debt, superannuation, other) and therefore highlights the net change in these items.

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 the mainland States.

GFS - General Government Sector Net Worth per Capita



The chart shows the decrease in net worth in 2001-02 and 2002-03 in this State.

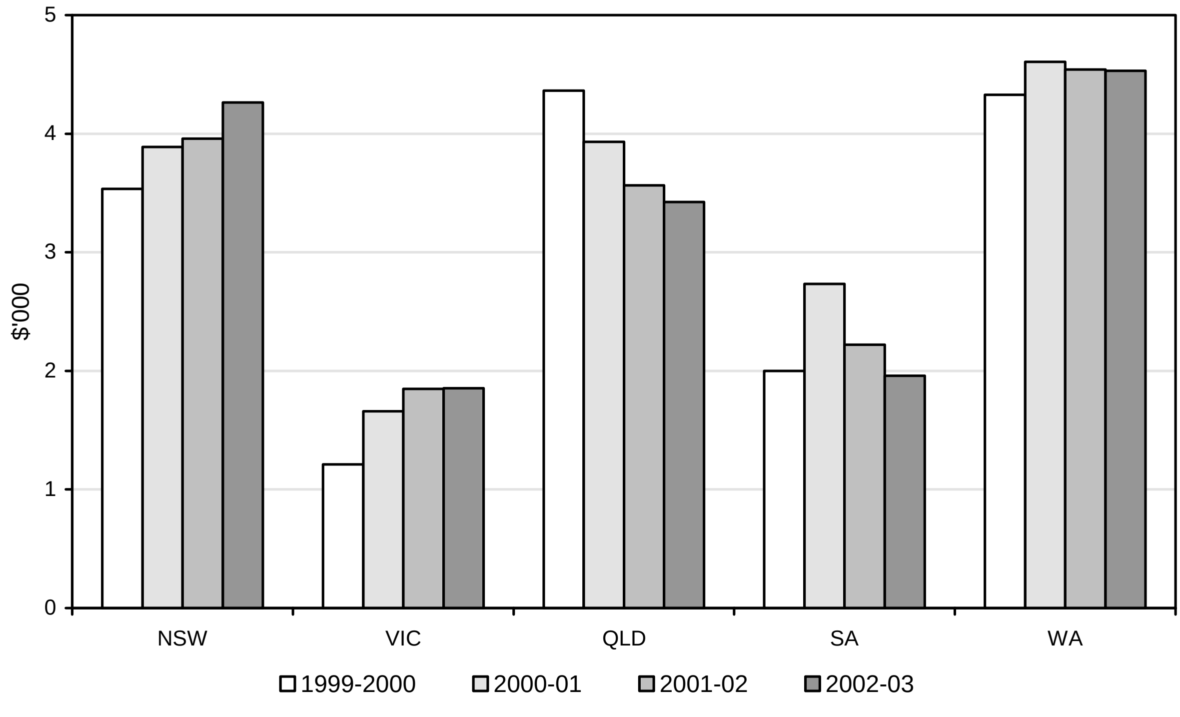
The positions of South Australia and Victoria stand out. Differences arising between the states reflect the histories of policy decisions made and financial outcomes. More particularly, South Australia and Victoria suffered major losses in relation to financial institutions that severely eroded their 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. The differences between the high and the low are very significant and for example for South Australia to reach the average of the other four States for 2001-02 would require additional net assets in the order of $7.1 billion.

11.5 NET FINANCIAL WORTH PER CAPITA

The following chart plots Budget data for the mainland States.

GFS - General Government Sector Net Financial Worth per Capita



The results are consistent with the trends for net worth. The Budget Papers[36] indicate that the improvement in South Australia's financial net worth in 2000-01 is a result of an accounting gain on disposal of the electricity assets and the beneficial impact of superannuation asset earnings in 1999-2000. The fall projected for 2001-02 for South Australia is due to projected increases in borrowings and superannuation liabilities. As for net worth, the further fall in 2002-03 primarily reflects the reduction in equity in SAAMC and SAFA.

---

[36] Budget Statement 2002-03, Budget Paper 3, p 6.5.

For South Australia to reach the average of the other four States for 2001-02 would require additional net financial assets in the order of $1.8 billion.

11.6 THE POSITION RELATIVE TO OTHER STATES

The data suggests that having achieved some improvement in financial indicators in 2000-01, South Australia remains significantly below the average in terms of the financial strength ratios for four major States. This emphasises the need for the State to maximise the efficiency with which it uses its existing resources and for strict risk management processes in protecting against the incurrence of large liabilities in the future.

It is noted that the disposal of the State’s electricity infrastructure and subsequent repayment of State debt has had a minimal impact on the above ratios. Although this is the case, the State’s reduction of its previously large debt burden should assist it in forward years through lower interest payments and reduced financial risk.

12 NET DEBT

12.1 INTRODUCTION

A major element of the State's liabilities is net debt. This section examines trends in net debt of the State and includes:

- a range of debt measures and indicators that assist in monitoring the position in relation to debt management in past and future years;
- commentary on factors that have influenced, or are influencing the level of State borrowings;
- discussion on debt management of the State's borrowings with external bodies.

The net debt figures referred to in the Budget Papers and this Report are based on Australian Bureau of Statistics (ABS) Government Finance Statistics (GFS) definitions. Further, the figure in focus relates to the net debt of what is referred to as the Non-Financial Public Sector that is comprised of all public sector entities except for Public Financial Corporations such as the South Australian Government Financing Authority (SAFA).

12.1.1 Definition of Net Debt

Net debt is calculated as financial liabilities less financial assets. It takes into consideration deposits held or on-hand, advances received or paid, investments, loans and placements and borrowings.

12.1.2 Major Influences and Recent History

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 2002 net debt of the Non-Financial Public Sector is estimated to be $3.4 billion (7.5 percent of South Australia's Gross State Product). This is now lower than the balance of unfunded superannuation liabilities, which is estimated to be $3.8 billion at 30 June 2002.

Net debt is projected to steadily decrease in real terms over the period of the 2002-03 Budget to 2005-06 although in nominal terms it grows over the year to 2002-03.

12.1.3 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 is linked with the GFS accrual numbers in that a reduction in GFS accruals is generally reflected by a reduction in the indebtedness of the Treasurer.

12.2 CURRENT FISCAL STRATEGY AND NET DEBT

12.2.1 Debt Strategy to 2001-02

In the 1998-99 Budget, the Government set out a four-year financial plan. One of the key elements of the strategy outlined in that plan was the continuing real reduction in net debt. A major asset sales program announced in February 1998 was the basis of achieving a significant real rate of debt reduction.

In June 1999 Parliament passed legislation enabling the lease or sale of publicly owned electricity assets, the largest public sector asset disposal in the State's history. The legislation required the net proceeds from the disposal to be used for debt retirement. This resulted in $4.9 billion being used to retire debt of the State and lower recurrent interest payments by the State over the long term.[37]

12.2.2 Current Fiscal Strategy and Net Debt Projections

With this lower debt level and associated interest payments, announced as part of the 2002-03 Budget fiscal strategy, is a new long-term strategy underlying future Budgets that includes the goal of achieving, on average, zero net borrowings in the General Government Sector.[38] This strategy and other announced fiscal principles are consistent with maintaining no growth in debt. The strategy is, however, not expected to be achieved until after the end of the current parliamentary term.

Importantly, the fiscal principles adopted for the 2002-03 Budget 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.

The net debt data for the General Government Sector is as follows:

GFS - General Government Sector Net Debt (Nominal Terms)

	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
			Estimated				
	Actual	Actual	Result	Budget	Estimate	Estimate	Estimate
	$'million	$'million	$'million	$'million	$'million	$'million	$'million
Net Debt	1 920	1 246	1 370	1 360	1 357	1 399	1 400
Increase (Decrease)		(674)	124	(10)	(3)	42	1

The forward year net debt data for the Non-Financial Public Sector is projected to be as follows:

GFS - Non-Financial Public Sector Net Debt (Nominal Terms)

	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	Increase
			Estimated					(Decrease)
	Actual	Actual	Result	Budget	Estimate	Estimate	Estimate	Over Last
	$'million	$'million	$'million	$'million	$'million	$'million	$'million	4 Years
Net Debt	4 355	3 223	3 408	3 459	3 433	3 348	3 279	
Increase (Decrease)		(1 132)	185	51	(26)	(85)	(69)	(129)

[37] 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.

[38] Budget Statement 2002-03, Budget Paper 3, p 2.4.

Based on these projections, there is an increase in net debt in 2002-03 and subsequent annual decreases through to the end of the period of the estimates.

Net debt is estimated to reduce by $129 million over the four years to 2005-06.

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.

There are a variety of measures and indicators in relation to debt burden that are generally accepted. The measures and indicators included in this section of the Report encompass:

- net debt - nominal and real terms;
- ratios relating to debt affordability and debt servicing.

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 $5.7 billion. Forward projections show that net debt is projected to rise in real terms in 2002 but reduce in real terms from then to $3 billion.

South Australian Public Sector Net Indebtedness 1997 to 2006

	Nominal Prices $'million	Real Terms (a) $'million	Per Capita (Real Terms) $'million	Percentage of GSP Percent
New Series				
1997	7 946	8 713	5 880	20.6
1998	7 589	8 231	5 521	19.0
1999	7 720	8 446	5 634	19.5
2000	4 355	4 599	3 052	10.5
2001	3 223	3 279	2 164	7.5
2002 (b)	3 408	3 408	2 239	7.5
2003 (c)	3 459	3 365	2 201	7.2
2004 (c)	3 433	3 260	2 124	6.8
2005 (c)	3 348	3 100	2 012	6.3
2006 (c)	3 279	2 962	1 916	5.8

(a) Estimated June 2002 values

(b) Estimated result

(c) Projections

12.3.3 GFS - General Government and Public Non-Financial Corporation Sectors Net Debt

Total net debt of the two sectors of the Non-Financial Public Sector for the seven years 2000 to 2006 is set out in the following table.

GFS - General Government and Public Non-Financial Corporation Sectors Net Debt (Nominal Terms)

	1999-2000	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06
			Estimated				
	Actual	Actual	Result	Budget	Estimate	Estimate	Estimate
	$'million	$'million	$'million	$'million	$'million	$'million	$'million
General Government	1 920	1 246	1 370	1 360	1 357	1 399	1 400
PNFC	2 435	1 977	2 038	2 099	2 076	1 949	1 879
Total Net Debt	4 355	3 223	3 408	3 459	3 433	3 348	3 279

The reduction in net debt in 2000-01 was $674 million for the General Government Sector and $458 million for the Public Non-Financial Corporation Sector (debt of the former electricity businesses disposed of in 2000-01).

Over the forward estimates net debt remains relatively stable for the General Government Sector increasing by a small amount. Net det of the Public Non-Financial Corporations, however, decreases over the period after an increase in 2002-03.

Most debt resides with the Public Non-Financial Corporation Sector. The main holders of debt in that sector are South Australian Water Corporation, the South Australian Housing Trust and TransAdelaide. Of these South Australian Water Corporation is a commercial business servicing its debt from business revenues.

12.3.4 Net Debt and Deficits

While the focus is no longer on the cash-based results of the non-commercial and commercial sectors, the past detailed reconciliation of movements in net debt remains useful. The following assists to understand movements in net debt.

The primary factors that influence the net debt figure are:

- the annual surplus/deficit - a surplus will reduce debt and a deficit increases debt;
- asset sales - can affect net debt by exchanging physical assets for cash.

These are stated separately because of the Government's practice of presenting the annual surplus/deficit exclusive of asset sales. Audit believes this practice to be useful in understanding underlying and sustainable public sector financial operations.

The following table is designed to aid an understanding of the relationship between the net debt figures and the annual cash-based Budget results as published:

Reconciliation of Debt and Deficits (a)

	(1) Net Debt Level at End of Year (b) $'million	(2) Change in Debt in Year (a) $'million	(3) Non-Commercial Deficit $'million	(4) Commercial Sector Deficit $'million	(5) Sale of Government Businesses $'million	(6) Other Factors (c) $'million
1996-97	7 946	-	-	-	-	-
1997-98	7 589	-357	-149	43	-147	-104
1998-99	7 720	131	133	-71	-	69
1999-2000	4 355	-3 365	60	37	-3 671	209
2000-01	3 223	-1 132	39	37	-1 240	32
2001-02 (d)	3 408	185	321	64	-17	-184
2002-03 (e)	3 459	51	-50	65	-	36
2003-04 (e)	3 433	-26	-92	7	-	60
2004-05 (e)	3 348	-85	-48	-66	-	29
2005-06 (e)	3 279	-69	-83	-48	-	62

(a) Total of columns (3) to (6) equals column (2) (-) means a surplus

(b) Nominal prices

(c) 'Other Factors' includes items such as changes in levels of unpresented cheques, effects of differences in classification of certain advances

(d) Estimated result

(e) Projections

The table highlights that sale of government businesses has contributed $5.1 billion to reducing the total of net debt.

Importantly, in the period these sales were occurring net debt reduced by $4.5 billion from $7.9 billion in 1996-97 to $3.4 billion in 2001-02. It is apparent therefore that other factors have increased net debt over that same period by $537 million.

The projected improvements over the period 2001-02 to 2005-06 will therefore go against the trend of previous periods. The matter of management of this task has been discussed in section 5 'Statement of Financial Performance'.

12.3.5 Debt Affordability and Servicing

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

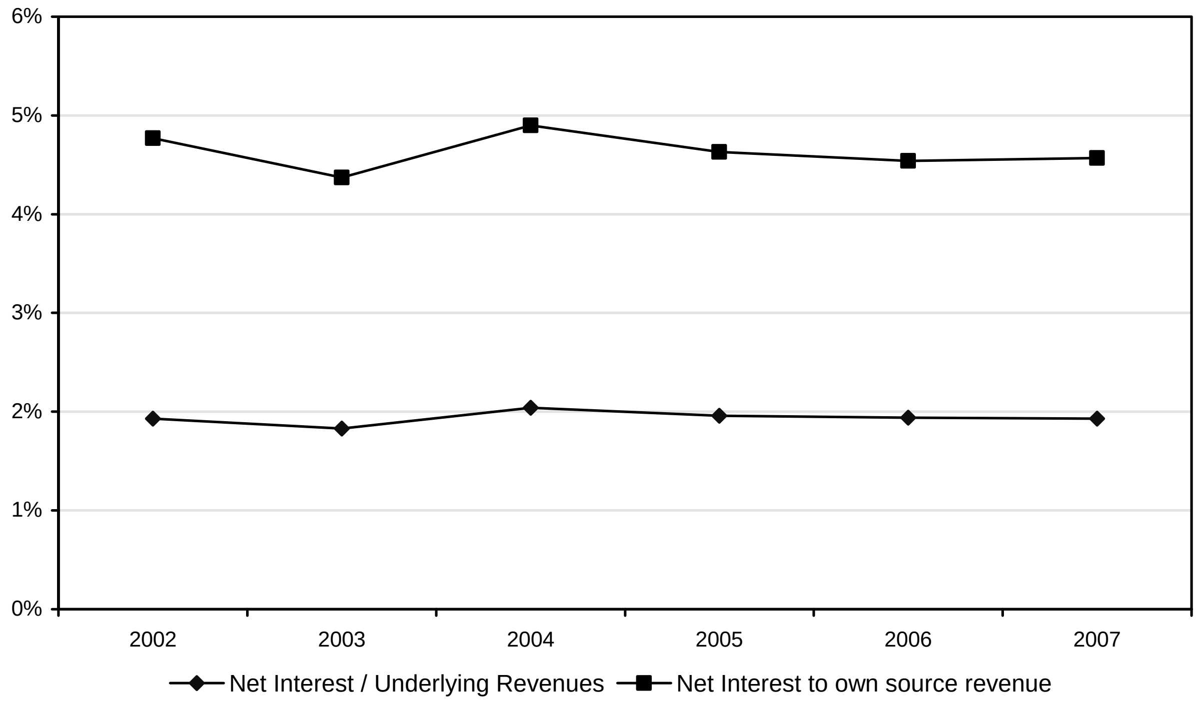
12.3.5.1 Net Interest Expenses to State Revenues

The following indicators, using the General Government Sector, 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.

Debt Affordability Ratios



The chart shows that:

- net interest expenses make up a very low proportion of total underlying revenues;
- over the forward estimates, net interest expenses are to remain stable in comparison to general increases in total revenues with only slight fluctuations with own source revenues.

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 $3.3 billion or 46 percent in the balance of the Indebtedness of the Treasurer to SAFA from $7.2 billion at 30 June 1999 to $3.9 billion as at 30 June 2002. These amounts are published annually in the Treasurer's Statements.[39]

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 previous Report. Last year 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 2001-02 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.

39 Report of the Auditor-General for the year ended 30 June 2002, Part B, Volume III, 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 funded 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 2001, and the following commentary has therefore been kept purposely brief.

The following summarises the financial position for the three financial years 1998-1999 to 2000-01.

AAS 31 (Whole-of-Government Financial Statements) Financial Position Data (Nominal Terms)

	1999	2000	2001
	$'million	$'million	$'million
Assets			
Cash and investments	6 009	7 577	4 988
Superannuation assets	3 996	4 916	5 175
Physical assets	22 825	20 817	21 934
Other	4 254	3 587	2 198
TOTAL ASSETS	37 084	36 897	34 295
Liabilities			
Unfunded superannuation	3 909	3 543	3 262
Borrowings	13 243	11 173	6 992
Employee entitlements	1 028	1 024	1 108
Superannuation liabilities	3 945	5 117	5 300
Other	4 476	4 111	3 347
TOTAL LIABILITIES	26 601	24 968	20 009
NET ASSETS	10 483	11 929	14 286

Of note here is the:

- decrease in total assets and total liabilities due to the disposal of the State's electricity assets and the consequent retirement of debt (borrowings);
- increase in net assets over the two years to 2000-01. This was due to profit realised from the disposal of electricity assets, a material revaluation of the road network and first time recognition of non-prescribed health service assets.

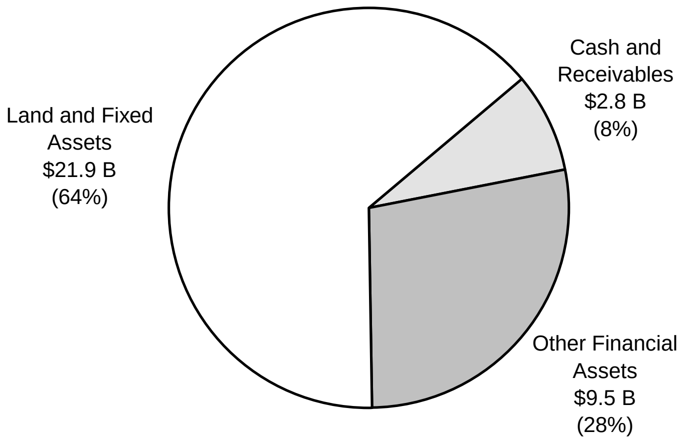
These movements mirror changes reported under the GFS methodology earlier in the Report.

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 not all that dissimilar from interstate jurisdictions, where similar trends are noted.

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

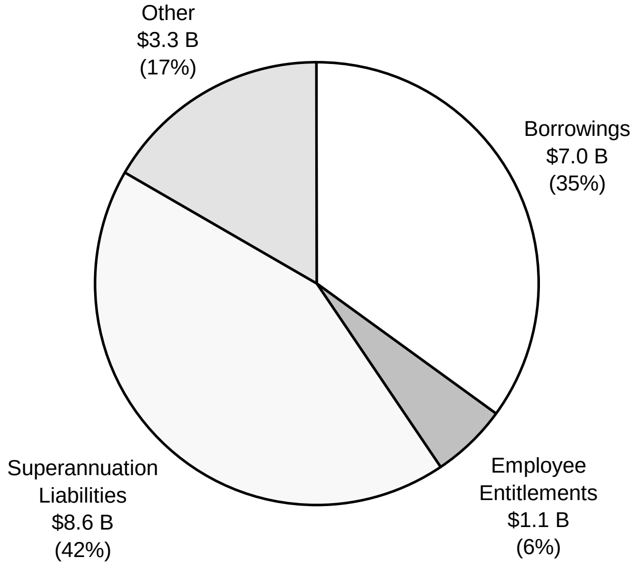
Composition of Total Assets as at 30 June 2001 ($'billion)



13.2 WHOLE-OF-GOVERNMENT LIABILITIES

The following table shows the Government's reported liabilities on a AAS 31 Whole-of-Government basis as at 30 June 2001. The table shows that borrowings and unfunded superannuation liabilities are the most significant liabilities. These make up 77 percent of the total liabilities as shown below.

Composition of Total Liabilities as at 30 June 2001 ($'billion)



14 BUDGET PREPARATION AND PERFORMANCE MONITORING

14.1 INTRODUCTION

For a number of years I have reported on government reforms that were originally referred to as the Government Management Framework (GMF). Although the GMF as a formal framework is now not part of the current vocabulary in public sector management it is recognised that a number of initiatives and principles arising from the GMF are still continuing to be pursued.

In particular, activity continues on the ongoing implementation of the budget reform process. The aim of the budget reform process was stated as helping the Government deliver, through better information for decision-making and, clearer managerial authority and accountability:

- improved services;
- value for money;
- sound State finances.

As a result, considerable effort had gone into the budget reforms to develop a process whereby the Budget is developed within a proper planning framework that sees that planning 'drives the budget'.

This framework identified a number of elements in the planning process, including:

- ***government outcomes*** — the target outcomes for all government services;
- ***priority areas and initiatives*** — providing a strategic plan for the budget process;
- ***portfolio outputs*** — describes the service to be provided by the portfolio;
- ***portfolio outcomes*** — the benefits that users of government services can expect.

The communication of the result of this planning process to the community is principally through the Budget Papers.

The focus of this section of the Report is to update a number of observations regarding the status of the budget reforms, particularly having regard to the ideals of the GMF from which they were originated. In doing so the commentary identifies a number of outstanding issues relating to:

- outcomes
- outputs
- financial reporting.

14.2 OUTCOMES

One of the key objectives of the reform process was to ensure that the Government's strategic priorities drive agency planning, operations and budgeting. In last year's Report I noted that there was clear evidence that there were formal mechanisms that documented this, including the internally prepared 'Ministerial Priority Outcomes' (the Green Book) and the published 'Directions for SA' document.

The Government's Budget Papers prior to 2002-03 recognised government outcomes as the highest level objectives for each service provided by a portfolio. No reference is made to outcomes in the 2002-03 Budget Papers.

DTF have advised that:

> *… the outcomes presented in the 2001-02 Portfolio Statements were those identified in the previous Government's "Directions for South Australia" document. References to this material were therefore removed from the current Government's 2002-03 Budget Papers.*
>
> *On 15 April 2002 it was determined that, with regard to the Portfolio Statements for the 2002-03 Budget, there would be no changes to the existing outputs and performance indicators presented in the previous Budget papers. This was on the basis that the Government would need to consider its position on outputs and outputs statements in the 2003-04 Budget.*

14.3 OUTPUTS

14.3.1 Key Performance Indicators (KPIs)

A significant part of the budget reform process was the recognition of outputs, and the development of key performance indicators (KPIs) that demonstrated an agency's success or otherwise in achieving those outputs.

Output KPIs were first developed for the 1999-2000 Budget and were in their formative stages, with a view to refining them in future years. It was anticipated that significant work would be undertaken in further refining the KPIs and making them a core management philosophy throughout agencies. The main areas that had required further work, as noted in my 1999 Report, were:

- the robustness of output KPIs and how well they address the qualitative criteria of relevance, focus, clarity, auditability (reliability) and decision-usefulness;
- to what extent the culture of performance orientation has permeated agencies' internal management practices;
- the finalisation of the performance management model, encompassing performance reporting, validation, use of performance information in the budget process, etc.

Although improvements were continuing to be made, last year I reported that significant gaps still remained. The non-financial nature of most output measures are such that they are often difficult to identify and measure. As a result it is expected that they would take some time to develop and refine to the stage where they provide an accurate picture of the achievement of the desired output.

14.3.2 Continuous Improvement of Output Measures

During 2000-01 DTF commenced a review of outputs and measures reported in Portfolio Statements across the public sector. In particular, the DTF began working with two agencies on improving their outputs and measures. Audit was advised that the aims of the review included the attempt to resolve the following issues in relation to outputs:

- Consistency with agency internal reporting.

- Comprehensive coverage of output recognition and measurement.
- Data integrity issues.

Although it could be argued that the scope of such reviews is more properly undertaken by agencies themselves, in my view, given the integration of outputs into the budget process, and the need to ensure their consistency across agencies, there needs to be continued coordination and leadership by the DTF to ensure ongoing improvement in this area of budget reform.

DTF have advised that in relation to 2001-02:

> *Portfolios have continued with the development of improvements in their outputs and performance indicator frameworks. DEH, Justice and DHS have all worked through and developed substantial revisions to their output and performance indicator frameworks.*
>
> *At this point Treasury and Finance is giving further consideration to the content and structure of the Portfolio Statements and to reporting requirements for performance indicators by agencies.*

Audit will continue to monitor the effort of the DTF and agencies to improve output measures across government.

14.3.3 Accountability for Output Performance

The output KPIs prepared as part of the budget process are reported in the Portfolio Statements that form part of the 2002-03 Budget Papers. The Portfolio Statements are seen as a key element of the accrual-output budgeting approach as they outline financial and non-financial information about the services provided to and on behalf of the community by each portfolio.

The information in the Portfolio Statements with respect to output indicators includes the estimated year end result (as the Budget Papers are tabled prior to the finalisation of actual data), together with the target result for the following year.

While this level of disclosure may be appropriate in the context of the Budget documents, accountability of agencies for outputs is not being achieved because:

- there is no requirement for the publishing of results against budgets for the same period;
- actual outputs (as opposed to estimated) are not required to be published.

The absence of the requirement to report on these matters is, in my view, inconsistent with the aims of the reform process, the objectives of which included improving the accountability of public sector operations, and ensuring the public sector accounts for resources in terms of the services it provides.

As noted above, the Government is considering its position on outputs and outputs statements for the 2003-04 Budget.

In the meantime I continue to recommend that consideration should be given to developing a reporting regime for output measures. Such a regime could be implemented, for example, through a requirement for such information to be included in agency annual reports, or by a reporting mechanism in the format of the Budget Portfolio Statements following the completion of the financial year.

14.3.4 Sound State Finances

As mentioned, one of the aims of the budget reform process was sound State finances. In the course of preparing the 2002-03 Budget the Government has seen the need to establish a detailed expenditure review process to facilitate a better understanding of the State's financial commitments and prepare for the 2003-04 Budget.

The need to establish a review process suggests, in my view, inherent weaknesses in the budget process, notwithstanding reform has been in progress over four years.

I will be seeking further details on the Budget process and related financial controls in the next year.

14.4 FINANCIAL REPORTING

In last year's Report I noted that progress was made by the DTF towards monthly whole-of-government financial reporting. It was, however, evident that there was still considerable work to do to improve on that progress. In particular, Audit noted that there was a need to improve the:

- process for the collection and consolidation of data;
- quality of data, as considerable work is required to be undertaken on initial information supplied by agencies;
- timeliness of reporting the information generated, as it was taking approximately 10 weeks to prepare monthly reports;
- reporting regime, as reports are currently only provided to the Treasurer.

Given the complexity of the task and the need for the improvements identified, there needed to be, in my view, continued coordination and leadership by the DTF to ensure that relevant, accurate and timely information is available to Executive Government to allow it to monitor government finances.

Earlier in this Report I have noted the extent to which control over government expenditure was absolutely fundamental if the Government's fiscal strategy was to be achieve. Not only does the Budget look to contain expenditure, it has also included significant savings to achieve the budgeted outcomes.

Although work undertaken by Audit during the course of 2001-02 identified that there had been improvements in the internal financial reporting of the State's finances, it has still not progressed to a stage where it can provide complete and accurate information in a timely manner for the critical review of whole-of-government progress against the Budget.

The continued improvement of internal management reporting on the State's finances will, in Audit's view, be a critical issue for DTF.

General Index to Part A

States Finances and Related Maters:
Some Audit Observations