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Government
of South Australia

Report

of the

Auditor-General

Annual Report

for the

year ended 30 June 2012

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Part C: State finances and related matters

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

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General enquiries regarding this report should be directed to:

Auditor-General
Auditor-General's Department
9th floor
State Administration Centre
200 Victoria Square
Adelaide SA 5000

Copies may be obtained from:
Service SA
Government Legislation Outlet
Ground Floor
EDS Building
108 North Terrace
Adelaide SA 5000

Website: www.audit.sa.gov.au

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Appendix

State finances and related matters

1 Introduction

The 2012-13 South Australian Budget was tabled in Parliament in May 2012. This commentary provides Audit observations and comments on aspects of the State's finances. In particular:

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

Limitation on audit analysis

Most of the audit analysis in this Report is based on data provided in the Budget Papers, particularly for the 2012-13 Budget, supplemented with information provided by DTF.

There are some limitations associated with the data when analysing results. These limitations include the following:

- The Audit commentary in this Report is based on a review of the Budget material and related information. It is not an audit in the same sense as work conducted to provide an audit opinion on financial statements. The Budget data are estimates and are unaudited.
- This review considers the estimated result for 2011-12. Past experience is that actual results have varied, sometimes substantially, from the estimated result.
- Classification changes occur from year to year in revenue and expense definitions that can affect the comparability of individual items across the time series. Such changes do not generally affect the net lending (borrowing) result. Budget Papers explain structural breaks in time series.

In Audit's view, these limitations are reasonable and do not invalidate the overall trend analysis from the Budget data.

2 Overview of State finances

2.1 Overview

This section provides a broad overview of matters that are, in my opinion, currently relevant to the State's public finances. Further commentary and details follow in later sections. Specific terms are used in reporting on public finances. The main terms and their meanings are provided in sections 3 and 4 of this Report. References to the Budget are to the Budget Statement, Budget Paper 3 unless otherwise stated.

2.2 Fiscal strategy

Each budget the Government sets out its fiscal strategy and its broader fiscal targets, together with performance against those targets.

The 2009-10 Budget was set against the backdrop of uncertainty as economies emerged from the global financial crisis. The crisis had a striking effect on the State's finances. Declining revenues, combined with higher infrastructure and operating spending, led to an operating deficit in 2008-09, the first in six years, and previously unbudgeted growth in net debt. The announced fiscal strategy was to return the State to sustainable surpluses in the medium-term. The 2009-10 Budget built on earlier savings measures and contained a range of budget improvement targets for which specific measures were to be identified in the 2010-11 Budget.

The fiscal strategy for the 2010-11 Budget was to establish and maintain sustainable surpluses. An operating deficit of $389 million was budgeted for 2010-11 with a return to initially small but growing surpluses. The Budget detailed significant budget improvement measures adopted from the then Sustainable Budget Commission's recommendations. These measures, and a moderation in infrastructure spending, were anticipated to return the Budget to surplus on both an operating and net lending basis by 2013-14.

The 2011-12 Budget reported that the Budget was prepared in an environment of deteriorating revenues, with taxation and GST revenues remaining significantly below estimates made prior to the global financial crisis, and those estimated in the 2010-11 Budget. A key fiscal strategy of the 2011-12 Budget was to re-establish and maintain sustainable operating surpluses. An operating deficit of $263 million was budgeted for 2011-12 and operating surpluses were projected from 2012-13 although at lower levels than in the previous Budget. The Budget also was not projected to return to net lending surplus until 2014-15, a year later than previously forecast.

The 2011-12 MYBR noted that global economic uncertainty had intensified beyond any expectations and had precipitated ongoing softness in the domestic economy, particularly the property and retail sectors. This has resulted in significant deterioration in the budget position since the 2011-12 Budget was released. Over the forward estimates, revenue was revised down by $1.1 billion and the net operating balance was not forecast to return to surplus until 2014-15, two years later than forecast in the 2011-12 Budget.

Given the global economic uncertainty and the significant impact on revenues, new fiscal targets were set by the Government as part of the 2011-12 MYBR.

2.2.1 New net operating balance target

In the 2011-12 Budget the Government had targeted at least a net operating surplus in the general government sector in every year. This has now changed to a net operating surplus by the end of the forward estimates. The 2012-13 Budget projects a return to a net operating surplus in 2015-16 ($512 million). Deficits are expected for each of the three years 2012-13 to 2014-15. The cumulative net operating deficit over the four years of the 2012-13 Budget is $1.148 billion. Further, the 2012-13 Budget projects net lending deficits over each year of the forward estimates, with the cumulative amount being $5.015 billion. This amount is impacted by the recognition of the new Royal Adelaide Hospital ($2.8 billion) in 2015-16.

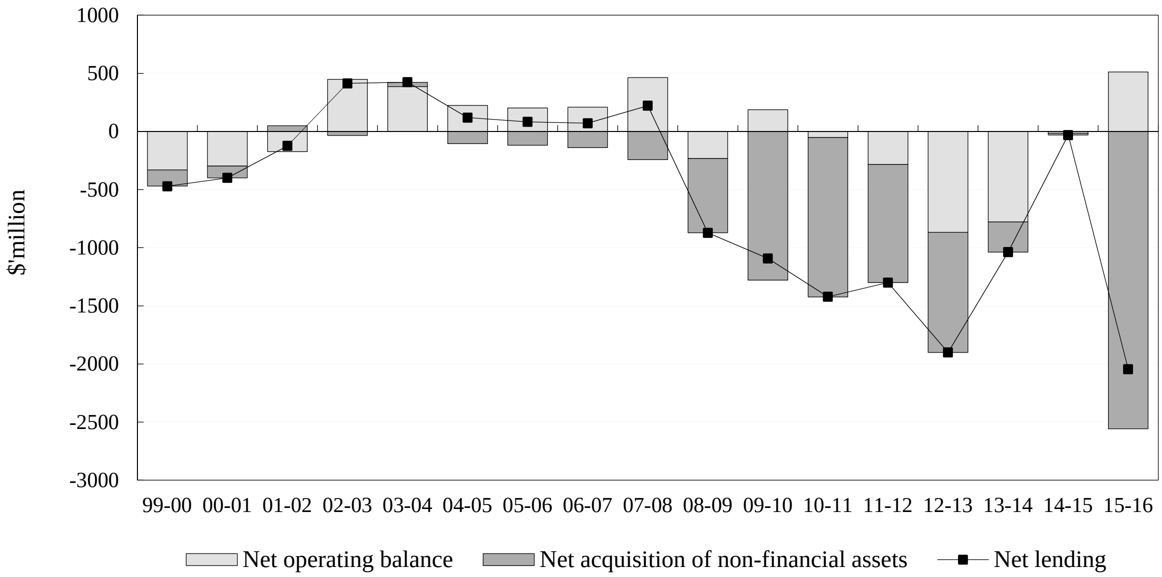
The 2012-13 Budget reinforced the adverse effect of ongoing weaker than expected economic conditions, particularly constrained household consumption and a very subdued property market. As a result tax and GST revenue growth were revised downward significantly from the projections in the 2011-12 Budget. For the period 2011-12 to 2014-15 taxation revenue was revised downward by $1.551 billion and GST revenue was revised downwards by $1.276 billion.

2.2.2 New debt fiscal target

The Government has also established a new debt fiscal target - a maximum ratio of general government net debt to revenue of 50%. This differs to a broader measure in previous years of net financial liabilities to revenue. Net financial liabilities include the present value of the unfunded superannuation liability, which can fluctuate significantly from year to year depending on the discount rate required to be used to calculate the liability.

Net debt is expected to increase from $4.3 billion in 2011-12 to $8.8 billion in 2015-16. Expressed as a percentage of revenue, this increases net debt from 27% in 2011-12 to 49.1% in 2015-16. The net debt increase reflects net lending deficits due to high levels of capital expenditure and net operating deficits. The following chart demonstrates the trend in net lending since 1999-2000 and expected trend over the forward estimates.

Chart 2.1 - General government sector net operating balance, net acquisition of non-financial assets[(a)] and net lending



(a) Net acquisition of non-financial assets included as negative amounts

Chart 2.1 shows the increased frequency of net lending deficits since 2008-09 reflecting:

- a significant capital expenditure program since 2008-09 (net acquisition of non-financial assets)
- expected significant net operating deficits for the period 2011-12 to 2013-14
- the recognition of the new Royal Adelaide Hospital asset in 2015-16.

2.2.3 The State credit rating

The securing and maintaining of a triple-A credit rating for the State has been used by the State Government as another target measure (indicator) of prudent management of risks to State finances.

South Australia's credit rating from Standard & Poor's was downgraded from AAA to AA+ following the release of the State Budget in May 2012. In early September 2012, Moody's also downgraded South Australia's credit rating.

Prior to this downgrade, South Australia had maintained a triple-A credit rating since September 2004.

At the time of the release of the 2012-13 State Budget, Standard & Poor's commented that the downgrade reflects:

- the State's weak budgetary performance and a debt burden higher than what was previously expected
- financial forecasts released in the 2012-13 Budget where revenues have deteriorated since the 2011-12 MYBR and savings measures are insufficient to offset the lower revenue.

Standard & Poor's also reiterated that the ratings on South Australia remain underpinned by the strong institutional framework benefitting Australian state governments, and the State's strong economy and financial management in an international context.

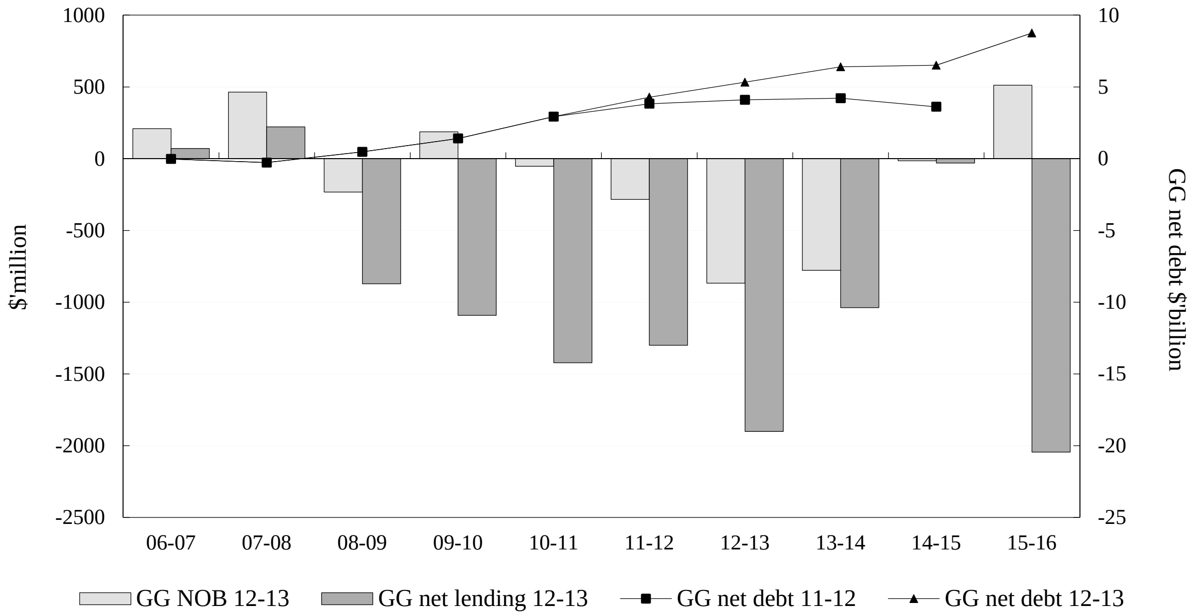
Standard & Poor's also indicated that downward pressure remains due to ongoing budgetary pressure associated with diminished revenues and increased expenditures. The rating could be lowered if revenue expectations were to be further revised downward, or if there was to be further weakening in the fiscal strategy and delivery of savings measures. In late September 2012 Standard and Poor's further downgraded South Australia's credit rating from AA+ to AA with a stable outlook.

Moody's commented that the ratings downgrade reflects the deterioration in the State's financial performance over the last several years as large and recurrent deficits have emerged, reflecting less robust revenue growth, while current expenditures have remained elevated and capital expenditures have reached record highs. Further, it highlighted that to meet its targets South Australia will have to exert resolute controls to counter pressure emanating from health care and wage expectations, which will likely require stronger fiscal resolve. In addition, it may need to intensify its focus on expenditure reductions should its relatively robust revenue assumptions prove unfruitful.

2.3 Changing financial position

The following chart shows changes occurring or anticipated in some of the key financial indicators over a 10 year period to 2015-16 for the general government sector.

Chart 2.2 – General government sector net operating balance (NOB), net lending and net debt



The chart highlights the seven year period from 2008-09 to 2014-15 where net operating deficits occurred or are expected for each year other than 2009-10. This reflects the impact of the global financial crisis and the ongoing global economic uncertainty and the budget policy dimensions for revenue and expense management set over recent years. A net operating surplus is projected in 2015-16, consistent with the new fiscal target of achieving a net operating surplus by the end of the forward estimates. The 2012-13 Budget relies on strengthening revenue growth rates in the last two years of the forward estimates for a consequent improvement in the net operating balance.

Net lending deficits (where revenues are less than operating and investment expenditure) are also incurred or projected for each of the years 2008-09 to 2015-16. As a consequence, net debt rises from a surplus cash position of $276 million in 2007-08 to peak at $8.8 billion in 2015-16. The 2015-16 year includes recognition of the new Royal Adelaide Hospital ($2.8 billion).

Net lending deficits are significantly influenced by capital investment spending decisions. Over $8 billion is spent or estimated to be spent on net acquisition of non-financial assets for the period 2008-09 to 2015-16. This includes $2.8 billion in 2015-16 associated with the recognition of the new Royal Adelaide Hospital.

The general government net debt 2011-12 line illustrates what was anticipated in the 2011-12 Budget. The 2012-13 Budget projects net operating results significantly lower than previously budgeted and net lending deficits that are higher than previously budgeted. Consequently, it is anticipated net debt will increase more than previously projected and is now expected to reach $6.5 billion (previously estimated at $3.6 billion) in 2014-15.

The chart also highlights that from 2012-13 to 2014-15, expected unfavourable outcomes related to revenue have had a significant impact through higher than previously expected net operating balance deficits and increasing net debt. There is little room for further unfavourable outcomes without increasing the risk of failing to meet forward estimate outcomes.

2.4 Operating Statement

2.4.1 Estimated results for 2011-12

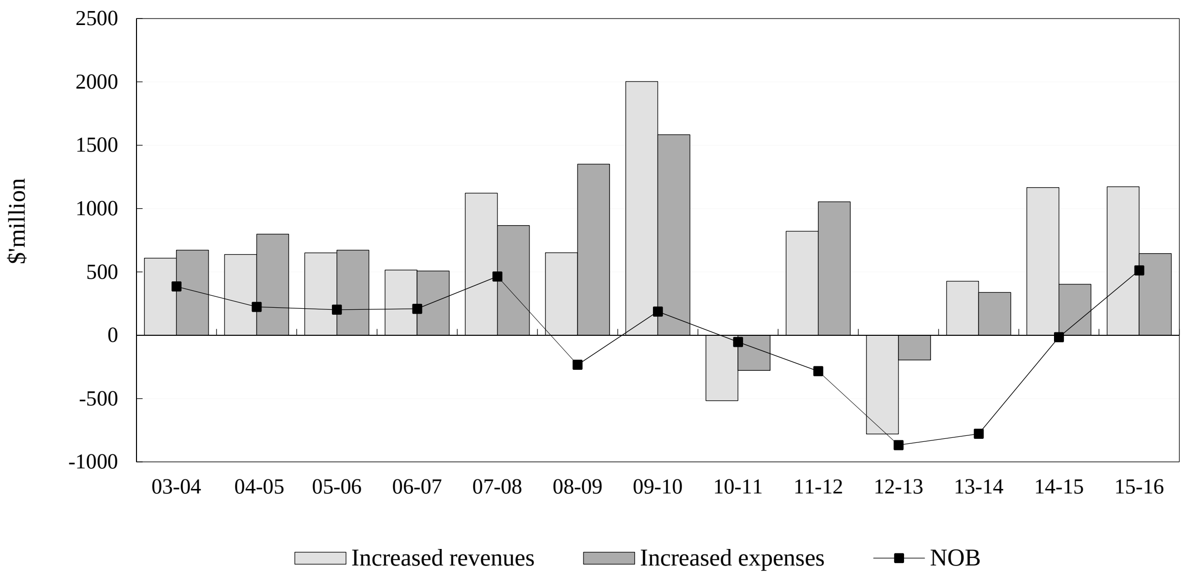
The 2012-13 Budget estimates a net operating balance deficit of $284 million compared to the budgeted deficit of $263 million.

The net lending deficit is estimated to be $1300 million, compared to the budgeted amount of $1252 million. The general government sector is estimated to have net debt of $4282 million at the end of 2011-12.

2.4.2 Budget forecasts 2012-13 to 2015-16

Chart 2.3 shows annual increases in revenues and expenses since 2003-04 compared to annual changes estimated for the four years of the 2012-13 Budget together with each year's net operating balance.

Chart 2.3 – Annual change in general government sector revenue, expenses and net operating balance (NOB)[(a)]



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

As shown, in the five years to 2007-08, annual increases in revenues and expenses were reasonably consistent and the net operating surpluses were achieved over the period. The global financial crisis affected 2008-09 and a net operating deficit was incurred. The annual movements from 2008-09 to 2011-12 are influenced by changes in Commonwealth funding, including stimulus grants, which peaked in 2009-10. Funding from the Commonwealth's Nation Building – Economic Stimulus Plan concluded in 2011-12.

The chart shows that for the four years of the 2012-13 Budget revenues are estimated to reduce in 2012-13 before improving significantly in the last two years of the forward estimates. Excluding the 2009-10 year where large Commonwealth stimulus grants were received, the revenue increases expected in the 2014-15 and 2015-16 years are the highest of any year on the chart. These revenue increases reflect expectations of a return to normal historical growth trends (see chart 2.8 in this chapter) and come off a base of significant revenue write-downs from previous budgets.

Chart 2.3 also highlights the expenditure restraint anticipated over those four years compared to earlier years. The projected net operating surplus for 2015-16 of $512 million is the highest of any year on the chart.

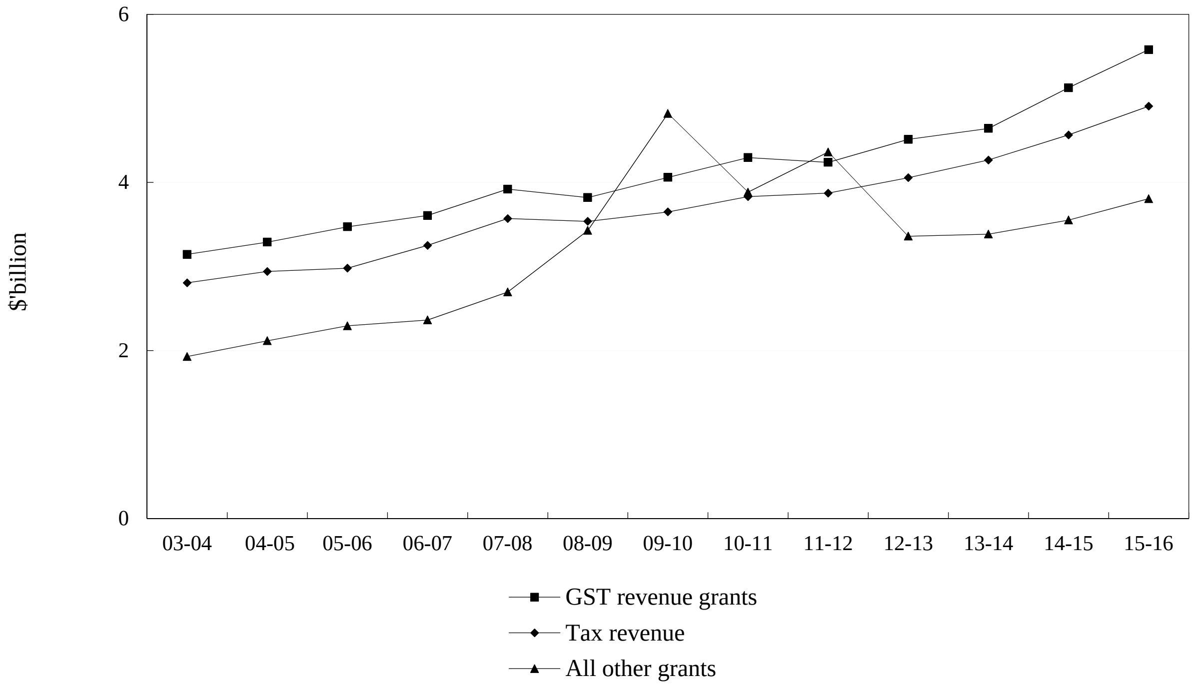
2.4.3 Revenue forecasts 2012-13 to 2015-16

There were significant temporary compositional changes in revenues following the global financial crisis. Immediate and large reductions in GST revenue grants and taxation revenue were offset by Commonwealth economic stimulus and other nation building funding to the states. Further, the crisis coincided with major changes in the Commonwealth's financial relations with the states. This resulted in other changes in timing and composition of Commonwealth revenues.

Expected reductions in GST revenue grants and taxation revenue in the 2012-13 Budget are far more significant than what was expected in previous budgets. This has had a major impact on the net operating balance and net debt projections. Further, these reductions are not offset by Commonwealth economic stimulus funding, as was the case in the wake of the 2008-09 global financial crisis.

Chart 2.4 shows expected trends for the major revenue items in the 2012-13 Budget against the experience of the nine years to 2011-12.

Chart 2.4 – General government sector Commonwealth grants and taxation revenue



The chart highlights the impact of the global financial crisis and ongoing global economic uncertainty over the period 2008-09 to 2011-12. Over this period there were two breaks in trend where:

- GST revenue grants and taxation revenue fell in 2008-09
- GST revenue grants are expected to fall in 2011-12 and taxation revenue is expected to increase marginally.

Both GST revenue grants and taxation revenue streams are now estimated to grow annually, in real terms, over the forward estimates on the assumption that economic growth will improve over the forward estimates period. An analysis of these revenue streams against the historical average growth rates is provided later in this chapter under section 2.6.1 (See in particular chart 2.8 in this chapter).

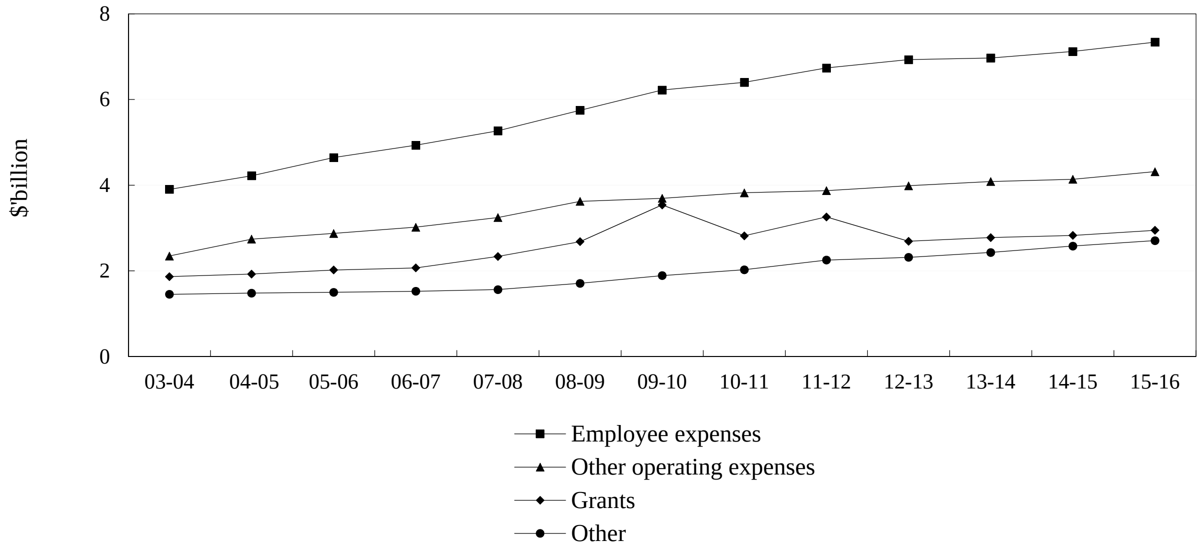
All other grants, principally other Commonwealth grants, increased markedly in the period 2008-09 to 2010-11 mainly due to the Commonwealth Government's Nation Building – Economic Stimulus Plan and Nation Building Plan for the Future capital grants. Grants remained high in 2011-12 mainly reflecting the timing of Commonwealth capital grants for major water, road and rail infrastructure projects. Other Commonwealth grants reduce in 2012-13 reflecting payment profiles agreed with the Commonwealth. Importantly, these monies are required to be spent on projects and are not available as general purpose revenue. Some of these grants are on-passed to recipients as grant expenses or are used for specific capital spending programs.

One aspect of public interest is the Olympic Dam expansion project. The 2012-13 Budget mentions that the economic impact of the construction phase of the Olympic Dam expansion project has been factored into revenue estimates. DTF has advised that a total of $43.9 million has been included in the 2012-13 Budget across the forward estimates in taxation revenues relating to the impact of the Olympic Dam expansion project. The majority of this is included in payroll tax revenue.

2.4.4 Expense forecasts 2012-13 to 2015-16

Chart 2.5 shows trends expected for total expenses in the 2012-13 Budget split into four main categories, against the experience of recent years.

Chart 2.5 – General government sector expenses

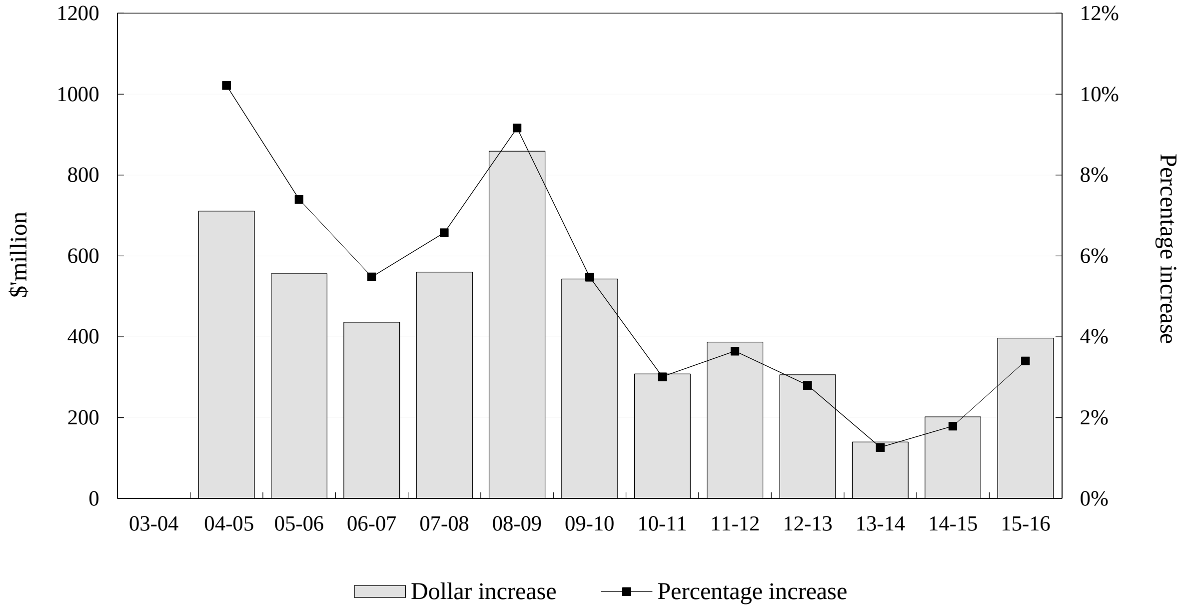


All categories of expenses, except grants, are estimated to increase in 2011-12 and beyond. The decrease in grant expenses is largely associated with Commonwealth grant revenues discussed above. These grant expenses reduce in line with related grant revenues.

The challenging dimension of expenditure restraint underlying the 2012-13 Budget is illustrated by the estimated annual movements in the two main expenditure items of the Budget, employee expenses and other operating expenses. These two items combined represent 68% of expenses for 2012-13, a proportion that is consistent with most years.

Chart 2.6 shows the annual movements projected for employee expenses and other operating expenses for the four years to 2015-16 are below all of the previous eight years' experience other than 2010-11.

Chart 2.6 – Annual change in employee and other operating expenses



Integral to the expenditure restraint is achieving savings initiatives built into the forward estimates from both previous budgets and the current Budget. As commented previously, achieving these expenditure targets is a major task and therefore another risk to the current budget strategy.

2.4.5 Net acquisition of non-financial assets

For 2011-12 net acquisition of non-financial assets (the balance of purchases of non-financial assets less sales of non-financial assets and depreciation) is estimated to be $1 billion, in line with budget. Net acquisition of non-financial assets for 2012-13 is also budgeted at $1 billion.

Purchases of non-financial assets in 2012-13 are expected to be $2.1 billion and this reduces to $1 billion through to 2014-15. Purchases increase significantly in 2015-16 due to the recognition of $2.8 billion associated with the new Royal Adelaide Hospital.

For the general government sector, sales of non-financial assets are expected to peak at $408 million in 2011-12 and reduce to $35 million in 2015-16.

For the NFPS, the estimated sales in the forward estimates include, amongst other things, proceeds from the forward sale of up to three harvest rotations for ForestrySA plantations and a proposed sublicence giving the right to operate the SA Lotteries' brands and products for a defined period of time. These are discussed in section 2.6.7.2.

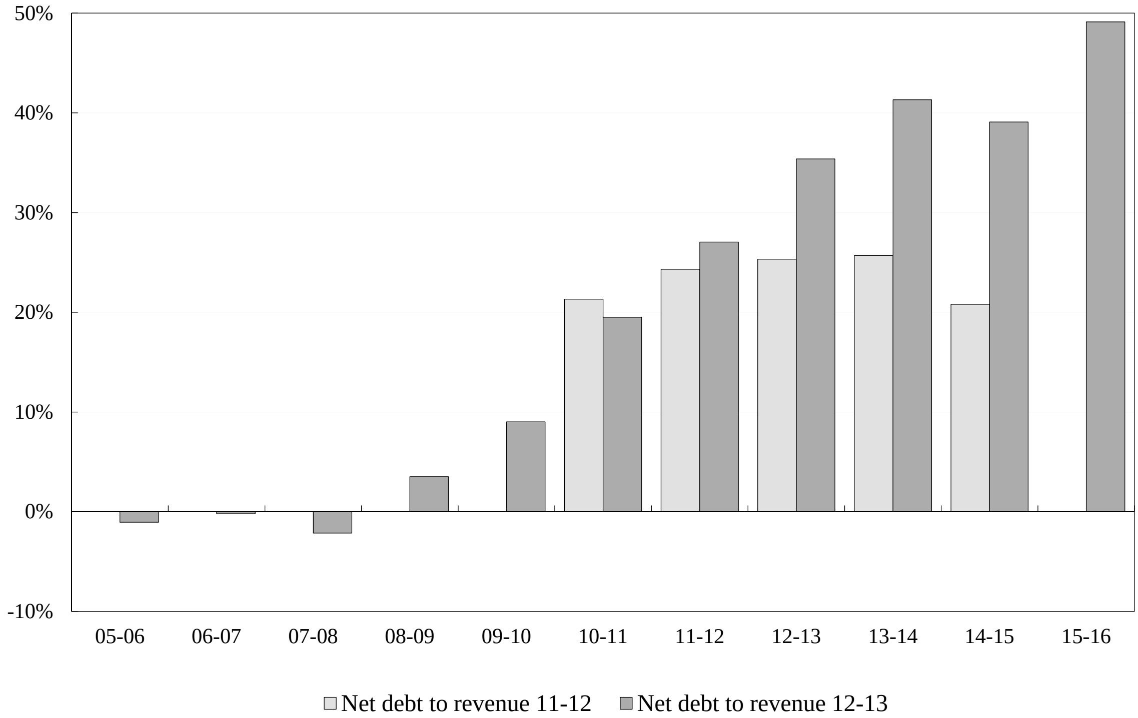
2.4.6 Ratios of net debt to revenue

As highlighted earlier, one of the Government's fiscal targets is to achieve a level of general government net debt that remains affordable over the forward estimates – equating to a maximum ratio of net debt to revenue of 50%. This is a new fiscal target established as part of the 2011-12 MYBR.

The Government previously had a fiscal target to achieve net lending outcomes that ensure the ratio of net financial liabilities to revenue continues to decline towards that of other triple-A rated states. However, this was replaced with a more specific net debt to revenue measure due to the volatility of the present value of the unfunded superannuation liability, which formed part of net financial liabilities. The broader net financial liabilities to revenue ratio is further discussed in section 10.3.1 of chapter 10 of this Report.

Chart 2.7 shows the ratio of net debt to revenue for recent years and for the 2011-12 and 2012-13 Budgets.

Chart 2.7 – General government sector ratio of net debt to revenue Budget comparisons



The chart shows that the ratio of net debt to revenue was projected to increase in the 2011-12 Budget, peaking in 2013-14. Movements in the ratio reflect the operating deficits expected and the capital expenditure program, financed in part by borrowings.

The 2012-13 Budget projects that net debt will rise higher than was previously estimated in the 2011-12 Budget. Consequently the ratio of net debt to revenue is significantly higher than previously budgeted. The ratio peaks in 2015-16 at 49.1% as a consequence of the recognition of the new Royal Adelaide Hospital.

The 2015-16 projected ratio is almost at the maximum of 50% established by the Government's new fiscal target and any further deterioration of the budget position over the forward estimates would place the expected achievement of this fiscal target in 2015-16 at risk. The risks to the budget are discussed further at section 2.6 of this chapter.

2.4.7 Interstate comparison

Section 10 of this Report includes comment on 2012-13 Budget comparisons for key budget aggregates across jurisdictions. In 2012-13, South Australia, New South Wales, Tasmania and Queensland are forecasting general government sector net operating balance deficits. Victoria and Western Australia have budgeted net operating surpluses. South Australia and New South Wales are predicting net lending deficits (borrowing) up to 2015-16. The other states expect to return to net lending surpluses in 2014-15 or 2015-16. Most jurisdictions are budgeting to invest significant funds into infrastructure projects.

2.5 Non-financial public sector Balance Sheet[1]

The State's Balance Sheet is expected to strengthen marginally over the four years of the 2012-13 Budget as measured by net worth. This is the combined effect of a rise in the value of non-financial assets, due to projected valuation increases and asset acquisitions, offset by increases in net financial liabilities.

Net financial worth deteriorates over the forward estimates by almost $5 billion due primarily to the growth in borrowings.

Net worth is estimated to add $0.8 billion over the forward estimates to reach $39 billion by 2015-16.

2.5.1 Assets

Total assets are expected to increase over the forward estimates from $64.1 billion in 2011-12 to $69.6 billion by 2015-16. There is a large increase in 2015-16 due to the recognition of the new Royal Adelaide Hospital ($2.8 billion).

Net acquisitions (purchases less depreciation and asset sales) increase non-financial assets by $1.5 billion in 2011-12 and add a further $2.9 billion through to 2015-16. Revaluations in the PNFC sector are also estimated to add substantially to non-financial assets.

Total financial assets are expected to be $2.6 billion in 2011-12, falling to $2.4 billion in 2015-16. This reduction is primarily due to the movement in investments in other public sector entities under the equity category of financial assets.

1 Balance Sheet data is for the NFPS unless otherwise stated due to the high value of non-financial assets in PNFCs.

Investments in other public sector entities represent the value of the Government's interest in PFCs including the Motor Accident Commission (MAC) and WorkCoverSA.

MAC reported a comprehensive loss result for the year of $34 million, compared to a comprehensive profit result of $193 million in 2010-11. This was primarily due to an increase in the outstanding claims liability and reduced revenue from investment activities. The Commission's statutory solvency level, calculated in accordance with a formula determined by the Treasurer, deteriorated to 100.8% (103.6%) of the target level of solvency. As at 30 June 2012 the Commission had net assets of $397 million ($431 million).

WorkCoverSA reported a comprehensive loss result of $437 million in 2011-12. This compares to a comprehensive profit result of $30 million in 2010-11. The significant deterioration in the comprehensive profit was mainly due to an increase in the outstanding claims liability. This contributed to a deterioration in its funding ratio to 59.2% from 64.8%, compared to its approved target funding range of 90% to 110%. As at 30 June 2012 WorkCoverSA had a net liability position of $1389 million ($952 million).

Lower discount rates required to be used in the calculation of the outstanding claims liability have significantly contributed to the increase in the liability for both MAC and WorkCoverSA.

2.5.2 Liabilities

Borrowing is a major component of liabilities over the period of the forward estimates. Net debt, mainly borrowings less cash and deposits, is estimated to rise by $1.9 billion to $8.4 billion at 30 June 2012 and to $13 billion by 2015-16. The general government sector net debt is estimated to increase to $4.3 billion at 30 June 2012 rising to $8.8 billion by 2015-16. In 2015-16 net debt will include the effect of accounting for the new Royal Adelaide Hospital discussed further in section 2.6.7.1.

The other major component of liabilities, unfunded superannuation liabilities, is estimated to be $11.9 billion for the year to 30 June 2012, an increase from the 2011-12 budgeted expectation of $8.7 billion. The increase is mainly due to changes in discount rates required to be used for the liability valuation calculation. Unfunded superannuation liabilities are valued at points in time by discounting future superannuation benefit payments by a discount rate that reflects the risk-free interest rate consistent with the requirement of prevailing AASs. A discount rate of 4% was used for the estimate as at the 2012-13 Budget, compared with 5.6% for the 2011-12 Budget. A 1% reduction in the discount rate is estimated to increase the superannuation liability by $2.5 billion.

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

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

2.6 Risks and management tasks for the 2011-12 Budget

It has been mentioned earlier that the stated fiscal strategy of the 2012-13 Budget is to achieve a net operating surplus by the end of the forward estimates. Similar to the 2011-12 Budget, key elements to the success of the 2012-13 Budget will be achieving estimated real growth in major revenue items, realising expenditure restraint arising from previously announced and current budget measures and achieving the estimated value of proposed asset sales.

Audit sought DTF's view of which areas of the Budget are considered to be the highest risks and any specific monitoring measures. DTF responded that the major risks to the fiscal outlook are set out in chapter 6 of the 2012-13 Budget Statement (Budget Paper 3). These include: the impact of economic activity on household spending patterns and demand for housing, which impact on GST and property taxation; expenditure risks such as higher than expected wage increases, cost escalations on capital projects and activity growth in hospitals and schools; and changes in Commonwealth policy.

This section discusses some of the risks to achieving the Budget estimates. The values ascribed to some risks are from the Budget Papers[2] which explain and illustrate the effect of many of the Budget risks.

Integral to any budget is the quality of data, which by its nature, is based on estimates, assumptions and targets. Processes supporting the data preparation are a vital element in the integrity of the Budget.

Audit requested confirmation from DTF that the 2012-13 Budget estimates are based on data submitted by agencies and details of the processes adopted by DTF to ensure the integrity and reasonableness of this data for use in the preparation of the Budget. DTF responded that the 2012-13 Budget estimates are based upon information submitted by agencies throughout the year relating to the following processes:

- Cabinet decisions
- carryovers
- impacting and non-impacting data adjustments
- mid-year review adjustments
- 2012-13 Budget measures.

Agencies submit data to DTF via DTF's Budget and Monitoring System to update their budget estimates. This data is subject to a range of integrity checks to ensure the correct application of accounting principles and that it is consistent with the relevant decisions of government. Quality assurance reports have been developed to aid in the detection of common problems associated with the data provided.

In addition, Audit sought details of the key assumptions and adjustments made in quantifying the forward estimates figures for 2013-14 to 2015-16. DTF responded that the forward estimates figures are calculated by consolidating approved budgets for individual government agencies. These incorporate government policy decisions and parameter variations relating to the operations of agencies, such as the quantity of services provided.

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[2] Budget Statement 2012-13, Budget Paper 3, chapter 6.

In estimating revenue items, DTF may apply some assumptions. These assumptions are outlined in chapter 3 of the Budget Statement, Budget Paper 3.

2.6.1 Net operating balance

The 2012-13 Budget estimates net operating deficits for the period 2011-12 to 2014-15. The cumulative value of the operating deficits over this period is $1.944 billion. The budget is expected to return to a surplus of $512 million in 2015-16.

Table 2.1 shows the impact of the global financial crisis and the Government response to ongoing global economic uncertainty by tracking how net operating result estimates have changed since the 2008-09 Budget, which was presented before the crisis.

Table 2.1 – Comparison of estimated net operating results between budgets

	2008-09 $'million	2009-10 $'million	2010-11 $'million	2011-12 $'million	2012-13 $'million	2013-14 $'million	2014-15 $'million	2015-16 $'million
NOB 2008-09 Budget	160	356	434	424				
NOB 2009-10 Budget	*(233)	(304)	78	96	304			
NOB 2010-11 Budget		*187	(389)	55	216	370		
NOB 2011-12 Budget			*(53)	(263)	114	80	655	
NOB 2012-13 Budget				*(284)	(867)	(778)	(15)	512

* Actual or estimated result

The actual net operating surplus result for 2009-10 of $187 million was heavily influenced by Commonwealth funding in response to the global financial crisis and other changes.

The changes since the estimated surpluses of the 2008-09 Budget (before the global financial crisis) represent a $1.7 billion unfavourable turnaround over the four years to 2011-12 in the changed economic environment.

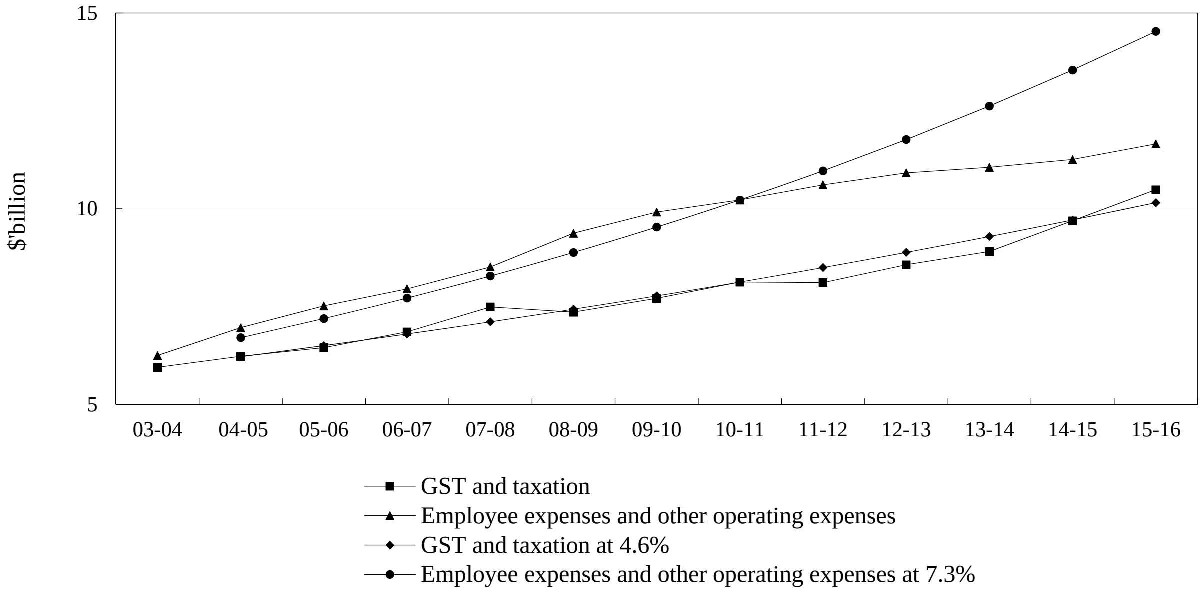
For the estimates for the years 2012-13 to 2014-15, successive Budgets have lowered the estimated net operating result from the previous Budget. This has had a marked effect as expected surpluses in the 2011-12 Budget become estimated deficits in the 2012-13 Budget. The cumulative unfavourable expected turnaround in the net operating surplus over this period amounts to $2.5 billion. This reflects the deterioration of GST and taxation revenue estimates over this period. There remains a high degree of uncertainty in the global economic environment.

As an operating surplus is not expected until 2015-16, flexibility is limited to contingencies or policy changes to buffer against unfavourable influences and events that may affect outcomes.

Buffers are built into the Budget through contingency provisions including headroom. These amounts are provided for unexpected events or for expenditure that is subject to further approvals. The 2012-13 Budget includes contingency buffers to a similar extent as previous years. Beyond this, and in the absence of other changes in spending or taxation policies, unfavourable outcomes will flow to the net operating result and, in the event of deficits, to net debt.

The net operating result is at risk from both revenue and expense outcomes. Chart 2.8 compares trends for some previously discussed key revenue and expenses items in the Budget namely GST and taxation revenue and employee expenses and other operating expenses.

Chart 2.8 – Comparison of GST and taxation revenue and employee expenses and other operating expenses



In chart 2.8, the GST and taxation revenue line tracks actual revenues up to 2010-11 and estimated revenues from 2011-12 to 2015-16. For the seven years to 2010-11, these two combined items grew on average annually by about 4.6%. Applying this average growth rate from 2003-04 through to 2015-16 creates the GST and taxation revenue at 4.6% line. It can be seen by the closeness of the two lines that the 2012-13 Budget estimates are consistent with that past average experience. Further comments on operating revenue risks are provided in section 2.6.2 below.

For the seven years to 2010-11 combined employee expenses and other operating expenses grew on average annually by about 7.3%. Applying this average growth rate from 2003-04 through to 2015-16 creates the employee expenses and other operating expenses at 7.3% line. Comparing the trend of this line to the estimated expenses for the 2012-13 Budget shows a diverging difference between the two lines. This difference highlights the significance of the expenditure restraint required from the 2012-13 Budget.

2.6.2 Operating revenues

The estimated result for 2011-12 expects the main revenue lines, GST and taxation revenue, to be less than budgeted. GST revenue is expected to fall in 2011-12 and taxation revenue is expected to increase marginally. Over the forward estimates both these revenue lines are expected to grow in real terms. This improvement in taxation and GST revenues is based on the expected improvement in domestic and international economic conditions. GST revenue has now shown to be highly sensitive to household spending patterns. State taxation also varies with economic activity and demand for housing.

GST revenue in 2011-12 is estimated at $4.2 billion, representing 27% of total revenue. South Australia's GST revenue grants are expected to increase at rates that vary from estimated growth in the GST pool. Factors contributing to changes to South Australia's share of the GST pool include a declining population share and movements in South Australia's projected relativities which are particularly affected by different state taxation growth rates compared to other states and changes to the distribution of Commonwealth National Partnership agreement funding to the State.

The 2012-13 Budget comments that, in addition to a number of cyclical factors contributing to the current decline in GST revenue, GST collections are also facing a number of structural changes which means this trend may not be reversed. These structural changes include:

- consumption expenditure declining as a share of disposable income as household savings increase
- spending patterns shifting towards items not subject to GST.

The method of distributing GST to the States is currently under review. On 30 March 2011 the Prime Minister and the Commonwealth Treasurer commissioned the GST Distribution Review with the aim of developing a simpler, fairer, more predictable and more efficient distribution of the GST. The panel released its first interim report in April 2012 and its second interim report in June 2012. A final report is expected in the latter part of 2012. Any changes to the method of GST distribution may adversely impact on the level of GST distributed to the State. The review will not affect the distribution of GST revenue in 2012-13.

The two main elements of state taxation are payroll tax and conveyance duty. Growth in payroll tax is based on expected stronger growth in employment from 2012-13. For conveyance duty, property market conditions are expected to improve, returning to their long-term trend level over the medium-term.

The Budget comments that volatility in some key government revenues makes accurate forecasting of the revenue streams difficult. In particular, since 1995-96 the annual growth in conveyance duty revenue has ranged from negative 20.5% to positive 42.4%. The difference in volatility of the two main sources of taxation revenue is represented in the following chart, which shows actual annual nominal percentage changes from 2002-03 and expected changes over the forward estimates.

Chart 2.9 – Annual percentage change in payroll tax and conveyance duty

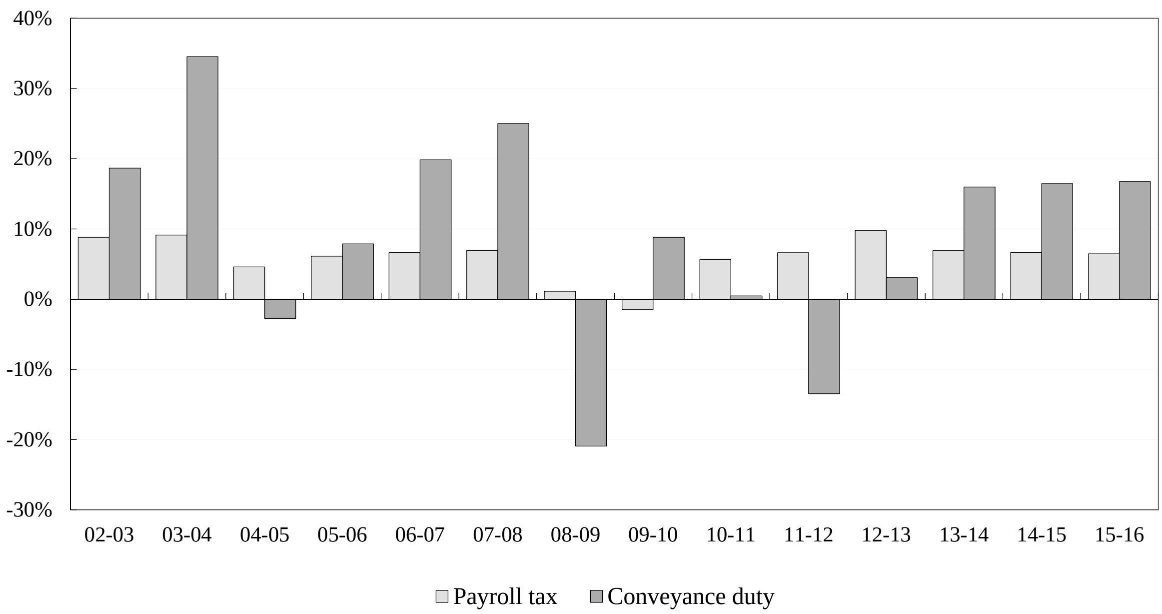


Chart 2.9 shows the relative stability of payroll tax growth over the period in comparison to the significant fluctuations in conveyance duty. The chart also demonstrates that, over the forward estimates, conveyance duty is expected to increase each year. For the three years 2013-14 to 2015-16 annual nominal growth is expected to be at around 16%.

The 2012-13 Budget reports that there is a risk that property prices and/or activity levels will be lower than estimated if softer employment conditions, tight credit requirements and uncertainty over global economic conditions further impacts upon underlying confidence in the property market. If this risk eventuates there may be a consequent downward impact on the level of conveyance duty expected to be collected by the State.

Risk analysis in the Budget Papers notes that:

- a 1% change in GST pool growth has a revenue impact for South Australia of about $43 million per annum

- a variance of 1% change in State taxation revenue, not including GST revenues, equates to about $41 million per annum.

- a 1% variation in property values equates to about $7 million in conveyance duty revenue

- a 1% variation in activity equates to about $6 million in conveyance duty revenue.

2.6.3 Operating expenses

In the absence of better than budgeted revenue outcomes, the key to achieving the Budget operating result targets is to control expenses. The 2012-13 Budget expects significant restraint in spending. The Budget Papers provide summary details of parameter and policy changes that occur between budgets that typically have added hundreds of millions to spending commitments.

Parameter effects usually include adjustments for enterprise bargaining outcomes, the carryover of expenditure from the previous year, revised timing of expenditure, expenditure associated with additional Commonwealth revenues and changes to interest expenses. Some expenses are covered by using contingency provisions set aside in the annual budget.

Parameter effects since the 2011-12 Budget have reduced operating expenses by $459 million (before provisions) over the four years to 2014-15. This reduction is mainly due to the reclassification of expenditure for the Adelaide Oval redevelopment from operating to investing. This reclassification adjustment does not have any impact on the net lending result. It also includes changes in the timing of payment of a number of on-passed Commonwealth grants, including the earlier payment of local government grants.

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

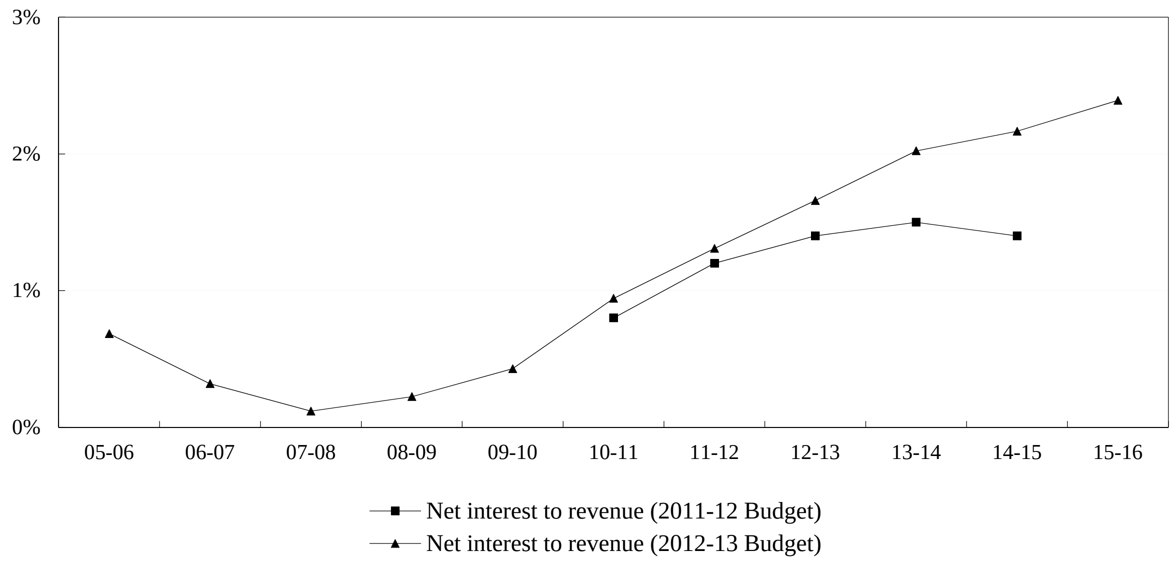
The Budget records that if public sector-wide wage outcomes for new enterprise agreements vary by 1% per annum from allowances in the forward estimates, the Budget impact will be approximately $290 million in 2015-16. Further, comment is made that if real wage restraint cannot be achieved, further FTE reductions and savings may be required in future Budgets to maintain the fiscal position.

The 2012-13 Budget reports that policy decisions since the 2011-12 Budget have added $642 million (before provisions) to operating expenses over four years to 2014-15. The ongoing practice of approving expenditure commitments between Budgets, while a practical necessity for many reasons, is an area that warrants a high degree of government management discipline given the deterioration and uncertainty of revenue forecasts and net operating balance in the 2012-13 Budget.

2.6.4 Ratio of interest to revenue

In the 2012-13 Budget, interest expenses are expected to rise over the forward estimates reflecting a higher level of borrowings up to 2015-16, as a consequence of the net lending deficits. Interest rates are expected to remain relatively stable across the forward estimates. Chart 2.10 shows the outcomes for the general government sector ratio of net interest expense to revenue for recent years and as estimated in the 2011-12 and 2012-13 Budgets.

Chart 2.10 – General government sector interest to revenue ratio



This chart shows the ratio of net interest to revenue rising steeply from 2009-10 to 2015-16. The 2015-16 year includes interest payments on the finance lease for the new Royal Adelaide Hospital for a part of that year.

The chart also shows the main impact on the increase of the ratio over the forward estimates is the significant deterioration in the GST grants and taxation revenue estimates in the 2012-13 Budget. This explains most of the divergence between the 2011-12 Budget line and the 2012-13 Budget line.

Exposure to rising interest rates is heightened through the increase in net debt. The Budget notes that a 1% increase in the average interest rate applying to general government sector debt would increase net interest expense by approximately $48 million in 2012-13 rising to $76 million in 2015-16.

Interest expenses are also impacted by movements in the State's cost of borrowing, which is influenced by the State's credit rating. DTF advised that Standard and Poor's did not downgrade the State's credit rating until after the formulation of the 2012-13 Budget. They did, however place the State on negative watch prior to the Budget and the price at which SAFA bonds were trading on the market reflected this change in credit outlook. Nonetheless, DTF advised this is not expected to impact on the cost of borrowing until new funds are raised or existing debt is refinanced. For each year's Budget SAFA determines a cost of funds based on existing debt pools plus expected refinancing costs. The expected refinancing costs reference prevailing market rates at that time.

2.6.5 Savings initiatives

Savings initiatives have been a major element of recent Budgets, including the 2012-13 Budget.

The 2010-11 Budget consolidated savings announced in earlier Budgets (of over $700 million per annum by 2013-14) and new savings totalling $1.5 billion over a four year period arising from the recommendations of the Sustainable Budget Commission. These were additional to cost recovery and revenue measures ($478.6 million) and some retained savings included in agencies from previous Budgets.

The 2010-11 Budget Papers itemised the new savings initiatives in Budget Paper 6, 2010-11 Budget Measures Statement. This provided a reference for monitoring progress of those initiatives. The Budget Papers did not restate initiatives scheduled to commence in 2010-11, or that were not fully implemented, from previous Budgets.

The 2012-13 Budget introduced new savings initiatives totalling $430.7 million over the four years of the forward estimates. The two main measures were:

- an increase in the efficiency dividend from 0.25% to 1% of employee expenses. This measure will not be introduced until 2013-14 and is expected to realise savings of $41.5 million in 2013-14, increasing to $129.5 million in 2015-16

- the reduction of a further 1000 FTE staff over the forward estimates, starting in 2013-14 with savings of $25 million and increasing to $86.6 million in 2015-16.

As previous Audit Reports have emphasised, the savings task falls on all portfolios of government and there has been mixed success over the years in meeting savings targets. The Health and Ageing portfolio has not been able to achieve savings targets or has experienced other service demands that have necessitated additional funding.

For 2011-12, DTF advised that agencies generally achieved their allocated savings targets. A number of agencies did not achieve their specific saving (eg for timing reasons) but found a replacement saving to ensure their overall target was achieved. The largest exception was again the Department for Health and Ageing, which had a $54.5 million shortfall relating mainly to an unachieved outpatient services reforms measure and unachieved efficient price reform.

There remains approximately $1 billion of new savings to be achieved for the two years to 2013-14 associated with the 2010-11 Budget initiative. In addition, the 2012-13 Budget has identified additional savings of $430.7 million over the forward estimates. The Department for Health and Ageing has the largest individual agency savings target, comprising:

- savings for the two years remaining of the 2010-11 Budget initiative of $240.2 million
- savings identified in the 2012-13 Budget of $184 million over the forward estimates.

Table 8.4 in this Report provides details of savings by portfolio for the 2010-11 Budget initiative. Table 2.4 of 2012-13 Budget Paper 3 provides details of savings by portfolio for the 2012-13 Budget savings initiative.

Another major savings area is the shared services initiative which, since its inception in 2007, has not met its original savings targets. Shared Services SA activities are discussed in Part A of this Report.

As previous Audit Reports have highlighted, an inherent risk of the saving strategy of government is its sheer size and breadth. Achieving the task requires significant discipline and whilst agencies have experience with implementing savings strategies over recent years the savings targets have not always been achievable by all agencies. A further savings task now includes significant savings identified in the 2012-13 Budget. It presents risks including industrial action, public demand to maintain services and ineffective and inefficient administrative performance.

It is also noted that the efficiency dividend increase in the 2012-13 Budget is a broad savings measure that does not identify specific areas of government activity where savings are expected to be realised. The increase in the efficiency dividend and the broad nature of this savings initiative adds an additional element of flexibility and hence budget management oversight complexity to the overall savings task.

2.6.6 Full-time equivalents reduction management strategy

A key part of the 2010-11 savings strategy involved further reduction in public sector FTEs by 3743 FTEs, excluding increases from other initiatives. The 2012-13 Budget introduces a savings initiative to reduce a further 1000 FTE staff over the forward estimates, starting in 2013-14 with savings of $25 million and increasing to $86.6 million in 2015-16.

To assist agencies to achieve the 2010-11 savings target, the Government introduced an enhanced redeployment process to match excess employees with suitable vacant roles. The Government considered that successful redeployment of excess employees into funded vacancies would significantly reduce the potential cost of reducing the workforce. The Government also approved further targeted voluntary separation program arrangements. A key condition is that TVSP offers are only to be made to employees who were declared excess to requirements because their positions have been or are to be abolished.

DTF advised that, consistent with the FTE reduction initiative in the 2012-13 Budget, the TVSP will continue to be available until 2015-16. The 2012-13 Budget states that an additional $60.4 million has been provided over three years for TVSP payments associated with the savings measure in that Budget to reduce an additional 1000 FTEs.

The TVSP is structured to encourage acceptance of an offer within six months of it being made but offers may be accepted beyond that time frame for a lesser amount. Given this timeframe and structure, it may be some time before it is clear what impact the scheme has had in providing incentive for reducing FTE numbers and meeting targeted savings.

The 2012-13 Budget states that FTE reductions can also be achieved in other ways (for example, natural attrition) and that the Government will honour its pledge of a ‘no forced redundancy’ policy for the remainder of this electoral term. Commencing in 2014, a process will be introduced whereby a public sector employee who has been a long-term redeployee would be able to be separated with appropriate financial severance and in accordance with the *Public Sector Act 2009*.

DTF has advised Audit that between 1 November 2010 and 30 June 2012 893.5 FTE reductions were achieved through TVSP payments (excluding executive reductions) as reported to DTF. Table 8.7 and related commentary in chapter 8 of this Report provides further details.

For 2011-12 Audit sought an update of FTE monitoring arrangements and data as at 30 June 2012. DTF’s response, based on data received from major agencies, showed that, overall, agencies were estimating that they would be 394 FTEs below their budgeted FTE levels as at 30 June 2012. The overall position comprised various agencies being over and under their cap. For example:

- Health and Ageing has reported that actual FTEs were 431 FTEs above its cap primarily reflecting overspending on salaries and wages in health service units

- Primary Industries, Resources reported actual FTEs of 131 below its cap, primarily due to delays in establishing and finalising contracts with external parties, filling vacancies and uncertainty of funding from research and development corporations.

Table 8.6 and related commentary in chapter 8 this Report provides further details.

2.6.7 Capital payments

For the period 2009-10 to 2011-12 the State has achieved budgeted capital expenditure exceeding $2 billion annually. Even so, as in past years, carryover adjustments were made for delays where expenditure will now be incurred in later years. As part of the budget carryover process, investing carryovers from 2011-12 to 2012-13 and future years are $318 million.

As reported in previous years the significance of the increase in capital outlays and activity introduces a heightened risk to the proper management and control of capital projects. This situation remains, with purchases of non-financial assets estimated to be $2.1 billion in 2012-13. The budget includes a slippage allowance for 2012-13 of $250 million, compared to $300 million in the previous year.

The capital program also comprises large projects with inherent complexities and risks. Over the four years to 2015-16 capital spending includes $675 million on major rail projects, $715 million on road projects, $480 million on the redevelopment of major metropolitan and regional hospitals and $364 million for the redevelopment of Adelaide Oval.

2.6.7.1 New Royal Adelaide Hospital - Public Private Partnership project

In June 2011 the Government announced financial close on a contract with SAHP to build, operate and maintain the new Royal Adelaide Hospital under a PPP arrangement. The Government agreed on a fixed price for the design, construction, risk management and running and maintenance costs of the new hospital. The total capital cost of the new hospital at contractual close was $2.09 billion comprising SAHP's contracted design and construction cost of $1.85 billion and $244.7 million for state works including clinical equipment.

The new Royal Adelaide Hospital is recognised as an asset and a finance lease liability of $2.8 billion in the 2015-16 forward estimate year. This accounts for the large increase in net debt in 2015-16. The amount represents the net present value of design and construction costs, lifecycle payments, interest and other project costs.

Annual service payments are also budgeted to commence in 2015-16, with $126.9 million included for that year. This amount only represents a part year payment based on the expected opening date of the new Royal Adelaide Hospital. DTF has advised that in a full year the total annual payment is estimated to comprise:

- annual service payment – $323.15 million
- operating expenses – $72.1 million, indexed annually.

Only part of this amount will be expensed each year as it includes cash payments that are applied to the reduction in the lease liability. DTF has advised that in a full year the liability is amortised at around $75 million each year. The remainder of the payment is reflected as an expense, including finance charges on the lease and operating expenditure.

DTF also advised that an annual expense of $75 million is expected relating to the amortisation of the asset on the balance sheet.

2.6.7.2 Asset sales

Sales of non-financial assets are netted from purchases of non-financial assets when determining total net acquisition of non-financial assets. Total asset sales for the general government sector over the four years to 2015-16 are estimated to be $690 million.

When combined with the PNFCs, total budgeted asset sales for NFPS are $1355 million in 2012-13, well in excess of total asset sales in recent years. Further asset sales of $532 million are estimated for 2013-14 making asset sales a significant element to the estimated net debt projections for the four years of the 2012-13 Budget.

The estimated sales in the forward estimates include proceeds from the forward sale of up to three harvest rotations for ForestrySA plantations and a recently proposed sublicence giving the right to operate the SA Lotteries' brands and products for a defined period of time. Proceeds from these initiatives and other asset sales have not been separately disclosed in the Budget so as to avoid prejudicing processes, but they are substantial to the estimated net lending results within the four years of the 2012-13 Budget. The Budget notes that reductions in interest costs in the Budget arising from debt retirement may be at risk if the Government is unable to achieve the value estimated for divestment of ForestrySA harvest rotations, the new SA Lotteries sublicence and selected government owned properties.

The Government announced it would proceed with the forward sale of three forest rotations in May 2011. In late August 2012 the Government announced that it has agreed to sell the forward rotations to a consortium led by the Campbell Group, LLC, representing a number of investors including Australia's Future Fund. Completion of the sale is expected to occur later this year.

The Budget notes that for the lotteries licence sale process, the Government has appointed a transaction adviser. This adviser is providing detailed advice to the Government about the commercial structure and marketing strategy of the transaction, which is expected to be completed in 2012-13.

2.6.8 Budget monitoring

The critical importance of strong monitoring of budget progress has been continually emphasised in previous Audit Reports. DTF has advised Audit of specific measures in place. They include monthly monitoring of financial performance and quarterly monitoring of capital projects, budget initiatives and FTEs. Further, monitoring reports continue to be provided to the SBCC based on information supplied by agencies and analysis prepared by DTF.

Last year, DTF advised that given the magnitude of the Budget improvement measures introduced in the 2010-11 Budget and the importance to the fiscal outlook of the achievement of these measures, an enhanced monitoring process was introduced in 2010-11 to monitor agency progress in achieving the measures and FTE reductions. Processes concluded or introduced since then are described in section 8.4.8 of chapter 8 of this Report.

2.6.8.1 Department for Health and Ageing

DTF advised that, at the time of the 2012-13 Budget, the Department for Health and Ageing was projected to overspend its 2011-12 Budget by $122 million. A provision for this amount was made in the Budget for this projected overspend. This funding was provided to offset projected overspends in prison health, mental health, the post-acute care program as well as unachieved revenue and savings targets.

In addition, the 2012-13 Budget includes new operating initiatives totalling $167 million in 2012-13 and 2013-14 to reprofile the Department for Health and Ageing's budget savings task. The aim is to provide the Department with additional resources for a more even annual build up of savings to enable it to achieve its aggregate savings target by 2014-15.

DTF has advised that the 2011-12 overspend of $122 million and the $167 million in operating initiatives in the 2012-13 Budget have been factored into the Health and Ageing savings targets as clawback in subsequent years.

Further, a new Office for Business Review and Implementation (OBRI) has been established in the Department for Health and Ageing to drive the achievement of savings and an improved overall budget result. DTF advised the unit was operational from February 2012 and achievements and milestones include the following:

- Establishment of a Business Review and Implementation Steering Committee, which includes Treasury and Finance representation.

- Consultants have undertaken a hospital budget and performance efficiency review of the three main Local Health Networks and produced separate reports for each entity.

- A Cabinet Submission is being developed proposing a response to the recommendations of the consultants' reports. This will include providing options for additional measures required to meet forward budget estimates.

- OBRI has developed a financial management framework, comprising a governance guide and financial management handbook. The documents are currently being redrafted to reflect Business Review and Implementation Steering Committee feedback.

- OBRI has developed a project management framework, together with guidance and templates to assist with the management of savings projects.

2.7 Concluding observations

The 2012-13 Budget marks a significant point in the position of the State finances. It is the fourth Budget since the onset of the global financial crisis. As with the three previous Budgets there is again deterioration across the forward estimates in the key indicators, the net operating balance, net lending and net debt to what was estimated in the immediately preceding Budget. This Budget reflects the impact of the ongoing global economic uncertainty on State revenues, with a significant deterioration in GST and taxation revenue estimates.

The Government has stated it has sought to balance the need to make a range of adjustments to the budget to ensure the budget position is sustainable and able to withstand future shocks, while continuing to pursue its future priorities. The Government has also revisited its fiscal targets as part of the 2011-12 MYBR and established two new key fiscal targets. They are a net operating surplus by the end of the forward estimates and a maximum ratio of general government net debt to revenue of 50%. In acknowledging the setting of the new fiscal targets, a long established budget performance target, a triple-A credit rating, has not been maintained.

The 2012-13 Budget projects a return to a significant net operating surplus in 2015-16. To achieve this outcome it relies on a number of key elements:

- growth of GST and taxation revenue that returns these revenue lines to long-term historical trend

- the realisation of a major savings program initiated as part of the 2010-11 Budget and added to in successive Budgets

- as part of the savings strategy, achieved targeted savings in Health and Ageing. This portfolio has not achieved its targeted savings in any of the past three years

- keeping track of progress with budget outcomes through established monitoring processes, including enhancements in 2011-12 such as considering agency progress in achieving current year saving measures and plans to deliver measures in subsequent years and enhanced monitoring reporting to the SBCC.

The 2012-13 Budget projects a return to a net operating surplus in 2015-16 ($512 million). Deficits are expected for each of the three years 2012-13 to 2014-15. The cumulative net operating deficit over the four years of the 2012-13 Budget is $1.148 billion. Further, the 2012-13 Budget projects net lending deficits over each year of the forward estimates, with the cumulative amount being $5.015 billion. This amount is impacted by the recognition of the new Royal Adelaide Hospital ($2.8 billion) in 2015-16.

The general government sector net debt is expected to increase from $4.3 billion in 2011-12 to $8.8 billion in 2015-16. Expressed as a percentage of revenue, this increases net debt from 27% in 2011-12 to 49.1% in 2015-16. This is very close to the maximum 50% established for the Government's new fiscal target. The net debt increase reflects net lending deficits due to high levels of capital expenditure and net operating deficits.

The projected nominal growth in total revenue in 2014-15 and 2015-16 are higher than any year of actual growth over the last 9 years, excluding the 2009-10 year where large Commonwealth stimulus grants were received. Comparison with past experience shows that the 2012-13 Budget estimates for key revenue lines are consistent with past average experience but revenue performance is sensitive to economic activity. Further, the revenue projections face a number of downside risks, including potential structural changes in GST revenue, possible changes to the method of distribution of GST revenue by the Commonwealth and the expected improvement in the property market not eventuating.

Comparing the trend of key estimated expenses for the 2012-13 Budget with past average experience shows a diverging difference. This difference highlights the significance of the expenditure restraint required in the 2012-13 Budget.

There remains approximately $1 billion of new savings to be achieved for the two years to 2013-14 associated with the 2010-11 Budget initiative. In addition, the 2012-13 Budget has identified additional savings of $430.7 million over the forward estimates. Agencies now have some experience with implementing savings programs but experience has shown that the savings targets are not always achievable by all agencies. DTF reports that generally, savings for 2011-12 were achieved. The largest exception was in Health which had a $54.5 million shortfall. The Health and Ageing portfolio has a very poor record in meeting savings targets in the past.

The management of the Health and Ageing budget and savings task continues to be a significant challenge. The 2012-13 Budget projects a $122 million overspend for 2011-12 and has included operating initiatives of $167 million to provide the Department with additional resources for a more even annual build up of savings to enable it to achieve its aggregate savings target by 2014-15. The Government has established an OBRI in the Department for Health and Ageing to drive the achievement of savings and an improved overall budget result.

The 2012-13 Budget continues a large capital spending program with purchases of non-financial assets estimated to be $2.1 billion in 2012-13. This presents a continuing heightened risk to the proper management and control of capital projects.

Total budgeted asset sales for the NFPS are $1355 million in 2012-13, well in excess of total asset sales in recent years. Further asset sales of $532 million are estimated for 2013-14. The budget incorporates two significant asset realisation processes for the forward sale of up to three harvest rotations for ForestrySA plantations and a proposed sublicence giving the right to operate the SA Lotteries' brands and products for a defined period of time.

The 2012-13 Budget forecasts operating deficits through to 2014-15. When the new Royal Adelaide Hospital is recognised in 2015-16 the debt to revenue ratio is estimated to be 49.1%. This is acutely close to the maximum 50% established as a new fiscal target by the Government. The progressive downward revision of key indicators across four successive budgets demonstrates that, should the current economic climate prevail and persist, achieving the budget outcomes remains a most challenging task.

3 Reporting framework

3.1 Introduction

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

- UPF
- AASs
- Treasurer's Statements pursuant to the PFAA.

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

3.2 Uniform Presentation Framework

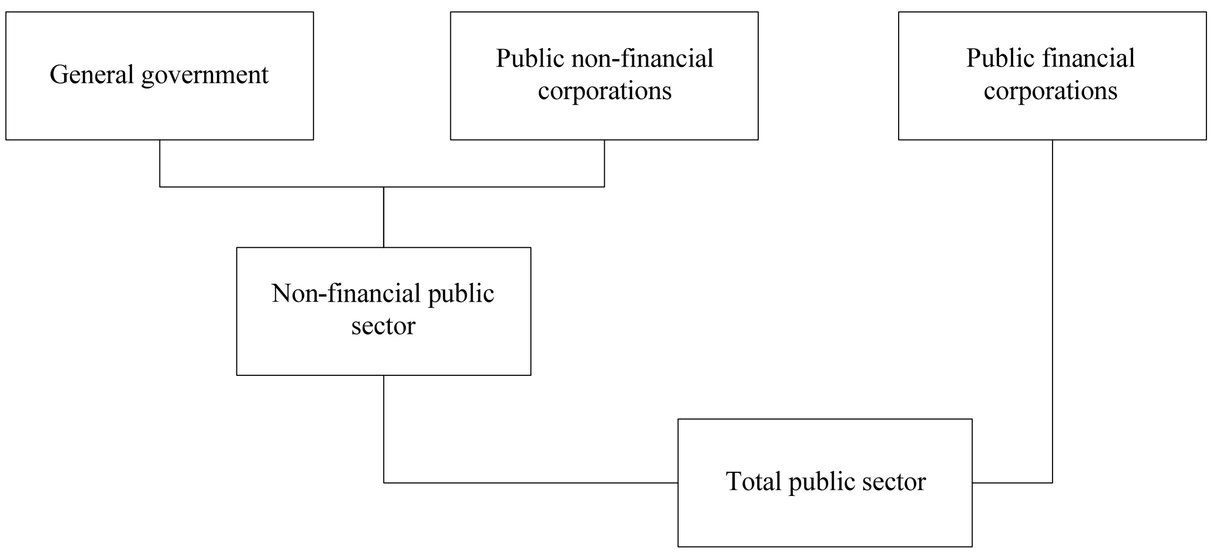
3.2.1 Background

By agreement between the Commonwealth, states and territories, each jurisdiction presents their Budget Papers and mid-year budget update on a UPF basis.

The UPF is a reporting standard based on the ABS's accrual based GFS framework. The primary objective of the UPF is to ensure that Commonwealth, state and territory governments provide a common core of financial information in Budget Papers to enable direct comparisons amongst jurisdictions.

In South Australia, the Budget is prepared using the GFS framework. The GFS framework excludes revaluations from the GFS net operating balance, as they are not transactions for the purposes of the GFS framework.

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



A description of the makeup of the three primary sectors is as follows.

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

PNFCs **–** trading enterprises mainly engaged in the production of goods and services for sale in the marketplace at prices that aim to recover most or all of the costs involved. In South Australia the sector includes the South Australian Housing Trust and the South Australian Water Corporation (SA Water). The consolidation of the general government and PNFCs represents the NFPS.

PFCs **–** bodies primarily engaged in the provision of financial services. This includes financial institutions such as SAFA, South Australian Asset Management Corporation, HomeStart Finance and Superannuation Funds Management Corporation of South Australia (Funds SA).

The Budget Papers include the following GFS financial statements:

- general government sector Operating Statement and Balance Sheet
- PNFC sector Operating Statement and Balance Sheet
- NFPS Operating Statement and Balance Sheet
- cash flow statements for these sectors.

The PFC sector data is not published in the Budget Papers.

3.2.1.1 Key Government Financial Statistics headline amounts

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

- ***GFS net operating balance*** **–** the excess of GFS revenues over GFS expenses.

- ***GFS net lending/borrowing*** **–** the net operating balance less net acquisition of non-financial assets. It indicates the extent to which accruing operating expenses and net capital investment expenditure is funded by revenues.

- ***Net worth*** **–** a financial position measure that comprises total assets (financial and non-financial) less total liabilities less any contributed capital. This measure includes non-current physical assets (land and fixed assets) and employee entitlements such as unfunded superannuation and employee leave balances.

- ***Net financial liabilities*** **–** comprises total liabilities less financial assets (net financial worth), but excludes equity investments (net worth) in the other sectors of the jurisdiction.

- ***Net debt*** **–** comprises certain financial liabilities less financial assets. The items included in this measure are discussed in depth in the Budget Papers.[3]

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

3.2.2 Scope of audit review of Government Financial Statistics financial statements

This Report primarily covers commentary on GFS based information. Although Audit seeks to have a sound understanding of the Budget preparation process, the data and assumptions are not subject to audit. Work performed on the 2012-13 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.

Accordingly, no opinion is provided on the accuracy of either the historic or prospective figures presented.

3.3 Australian Accounting Standards

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

3.3.1 Agency financial reports

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

3.3.2 AASB 1049 Whole of Government and General Government Sector Financial Reporting

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

The whole-of-government/general government CFR has been prepared pursuant to accounting standard AASB 1049. AASB 1049 specifies requirements for whole-of-government financial reports and general government sector financial reports of each government. The standard requires compliance with other applicable AASs except as specified in the standard and disclosure of additional information such as reconciliations to key fiscal aggregates determined in accordance with the ABS GFS Manual.

3.3.3 Convergence of Government Financial Statistics and Australian Accounting Standards

The AASB has been working towards the objective of harmonising GAAP and the GFS to achieve a single standard to produce comparable government budgets and financial statements that are auditable and comparable. Some elements of this project were undertaken in response to a direction from the Financial Reporting Council.

Following the release of a previous exposure draft, ED 174, which did not result in a standard being issued, the AASB released ED 212 Not-for-Profit Entities within the General Government Sector in June 2011. Responses were due to the AASB by 31 October 2011.

After receiving feedback on ED 212, the AASB has tentatively decided not to be proceed with the proposal to align GAAP and GFS recognition and measurement options. Further, the AASB tentatively decided not to proceed with the proposed modified presentation of financial statements for not for profit entities within the general government sector (for example 'government department' entities).

The AASB's decisions were based on a range of issues including:

- enabling entities within the general government sector to select accounting policies available to non-general government sector public sector entities
- the costs of implementing GFS-aligned measurement policies
- implications arising from potential projects on presentation and disclosure in financial statements by international standards setting bodies
- the divided views expressed by those commenting on ED 212 regarding the benefits of its proposals.

While having tentatively decided not to proceed with a number of proposals in ED 212, the AASB intends to develop a standard requiring not for profit entities within the general government sector to disclose:

- original budgeted financial statements, where such statements are presented to Parliament, recast if necessary to align with the presentation and classification adopted in the financial statements
- original budgeted information about administered items, where such information is presented to Parliament, recast if necessary to align with the presentation and classification adopted in the financial report for the information about administered items presented in accordance with AASB 1050 Administered Items.

In addition, an explanation of major variances, including those arising from material revisions to budgets, would also be required.

The AASB intends to formally communicate its position relating to this project to the Financial Reporting Council.

3.4 Treasurer's Statements – *Public Finance and Audit Act 1987*

The Treasurer's Statements are prepared pursuant to the requirements of the PFAA and reported as the appendix in Volume 6 of Part B of the Auditor-General's Annual Report to Parliament.

A summary of information prepared on this basis is provided in section 11 of this Report.

4 Summary of key fiscal measures and targets

4.1 South Australian fiscal targets

The 2012-13 Budget Papers[4] indicate that the Government is committed to the following fiscal targets:

Target 1: *A net operating surplus by the end of the forward estimates.*

Target 2: *Once surplus is achieved, operating expenditure growth will be limited to trend growth in household income.*

Target 3: *Achieve a level of general government net debt that remains affordable over the forward estimates – a maximum ratio of net debt to revenue of 50%.*

4.1.1 General government net operating balance

A net operating surplus means that revenues will cover expenses, including interest and depreciation. As part of the 2011-12 MYBR the Government revised its relevant target on the net operating balance and has set a target of achieving a surplus by the end of the forward estimates (2015-16). South Australia is forecasting a net operating surplus of $512 million in 2015-16 with deficits expected in each of the preceding three years of the 2012-13 Budget.

In the 2011-12 Budget the Government had targeted at least a net operating surplus in the general government sector every year.

The Government has also targeted limiting expenditure growth once a net operating surplus is achieved.

4.1.2 General government net debt to revenue

The Government has established a new debt fiscal target. It is a maximum ratio of net debt to revenue of 50%. This differs from a broader measure used in previous years of net financial liabilities to revenue. Net financial liabilities include the present value of the unfunded superannuation liability, which can fluctuate significantly from year to year depending on the discount rate required to be used to calculate the liability.

4.2 Fiscal measures in other jurisdictions

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

Jurisdiction	Budget fiscal objective/strategy[(a)(b)]
Commonwealth	Achieving a budget surplus, on average, over the medium-term. Keeping taxation as a share of gross domestic product below the level for 2007-08 (23.7% of gross domestic product) on average. Improving the Government's net financial worth over the medium-term.

4 Budget Statement 2012-13, Budget Paper 3, page 9.

Jurisdiction	Budget fiscal objective/strategy[(a)(b)]
NSW	General government sector net financial liabilities at or below 6% of GSP by June 2015. General government sector net debt at or below 0.9% of GSP. Total state sector unfunded superannuation liabilities eliminated by 30 June 2030.
Vic	Infrastructure investment of 1.3% of GSP (as a five year rolling average). General government net debt reduced as a percentage of GSP over the decade to 2022. Fully fund the unfunded superannuation liability by 2035. A net operating surplus of at least $100 million and consistent with the infrastructure and debt parameters.
Qld	Stabilise then significantly reduce debt (NFPS). Achieve a general government net operating surplus as soon as possible, but not later than 2015-16. Achieve and maintain a general government sector fiscal balance by 2014-15. Target full funding of long-term liabilities such as superannuation in accordance with actuarial advice.
WA	Achieve an operating surplus for the general government sector. Ensure that real per capita own-purpose general government expenses do not increase. Maintain or increase the real net worth of the total public sector. Maintain the ratio of total NFPS net interest costs as a share of revenue at or below 4.5%.
Tas	Achieve a net operating balance greater than $50 million by 2014-15 and $200 million by 2022-23.
ACT	Achieve a general government sector net operating surplus. Maintain the territory's AAA credit rating. Manage debt prudently and maintain net financial liabilities within the range of all AAA rated jurisdictions. To fully fund the Territory's unfunded superannuation liability by 2030.
NT	Expenditure growth not to exceed revenue growth, excluding tied Commonwealth funding

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

4.3 Some audit observations on the fiscal measures

The most prevalent position is to target net operating surpluses in the general government sector (based on the GFS accrual method as is the position in this State), and the establishment of targets for fully funding unfunded superannuation liabilities. The Australian Capital Territory and New South Wales are the only jurisdictions to give specific focus to net financial liabilities.

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

5 Estimated results for 2011-12

5.1 Overview

The following section summarises the estimated operating results for 2011-12.

5.2 2011-12 estimated results

5.2.1 General government sector

The estimated result for the year was a net operating deficit of $284 million (budget $263 million deficit) and net lending deficit (borrowing) of $1300 million (budget $1252 million). The following table shows 2010-11 financial year data and differences between the estimated result and budget for 2011-12.

Table 5.1 – General government budget comparisons 2010-11 to 2011-12

Revenue:	2010-11 Actual $'million	2011-12 Budget $'million	2011-12 Estimated Result $'million	Difference to budget $'million	Difference to budget %
Taxation revenue	3 831	4 129	3 873	(256)	(6)
Grants:					
Current	7 109	7 666	7 417	(249)	(3)
Capital	1 076	730	1 185	455	62
Sale of goods and services	1 879	2 054	2 003	(51)	(2)
Interest income	168	172	167	(5)	(3)
Dividend and income tax equivalent income	403	371	413	42	11
Other	550	605	782	177	29
Total revenue	15 017	15 727	15 838	111	1
Less: **Expenses:**					
Employee expenses	6 400	6 606	6 737	131	2
Superannuation expenses					
Superannuation interest cost	427	412	407	(5)	(1)
Other superannuation expenses	621	701	717	16	2
Depreciation and amortisation	670	768	756	(12)	(2)
Interest expenses	308	366	372	6	2
Other operating expenses	3 824	4 105	3 874	(231)	(6)
Grants	2 819	3 034	3 259	225	7
Total expenses	15 069	15 990	16 122	132	1
Net operating balance	(53)	(263)	(284)	(21)	8
Less: **Net acquisition of non-financial assets**					
Purchases of non-financial assets	2 122	2 125	2 180	55	3
Less: Sales of non-financial assets	82	369	408	39	11
Less: Depreciation	670	768	756	(12)	(2)
Plus: Change in Inventory	-	-	-	-	-
Plus: Other movements in non- financial assets	-	-	-	-	-
Total net acquisition of non-financial assets	1 370	988	1 016	28	3
Net lending (borrowing)	(1 422)	(1 252)	(1 300)	(48)	4

Note: Totals may not add due to rounding.

As shown in the table, when compared to the net operating deficit of $53 million in 2010-11, the 2011-12 Budget anticipated a net operating deficit of $263 million. This movement of $210 million was due mainly to budgeted increases in employee expenses, other operating expenses and grants, partially offset by planned increases in taxation revenue, grant revenue and the sale of goods and services.

The estimated result for 2011-12 shows a $21 million deterioration from budget, leading to a net operating deficit of $284 million. This increase in the estimated net operating deficit principally results from decreases in current grants (predominately GST grants) and taxation revenue, together with increases in in employee and grant expenses, all partially offset by decrease in other operating expenses and estimated increases in capital grant revenue and other revenues.

Capital grant revenue is expected to increase due to the timing of a number of on-passed Commonwealth grants, including the earlier payment of local government grants as announced in the Commonwealth Budget.

Other revenue is expected to be higher than originally budgeted due mainly to the recognition of contributed assets associated with the Adelaide Oval redevelopment.

5.2.1.1 Net acquisition of non-financial assets

The 2011-12 estimated result for purchases of non-financial assets of $2180 million is $55 million above the 2011-12 Budget.

Table 5.2 shows that consistent with the high value of capital spending, some large adjustments were made in the course of 2011-12. The original Budget was increased by policy decisions and carryovers from 2010-11 totalling $181 million. The estimated result for 2011-12 also includes the impact of the recognition of contributed assets associated with the Adelaide Oval redevelopment.[5]

The estimated result for 2011-12 allows for mid-year budget adjustments and carryovers beyond the year. Carryovers into 2012-13 and beyond of $318 million includes deferral of $102 million for rail revitalisation (including electrification of the Gawler and Noarlunga lines). Finally, the estimated result is influenced by the removal of the slippage allowance reflecting the reduced uncertainty of projections.

Table 5.2 – Purchases of non-financial assets budget to estimated result comparison 2011-12

		$'million	$'million
2011-12 Budget			2 125
Add:	Policy decisions	70	
	Carryover from 2010-11	111	
	Adelaide Oval reclassification	188	369
Less:	Use of 2011-12 provisions and MYBR adjustments	(40)	
	Carryovers into 2012-13 and beyond	(318)	
	Cabinet approved reprofiles	(107)	
	Other	(50)	(515)
Add back:	Capital slippage reversal		200
2011-12 estimated result			2 180

Note: Totals may not add due to rounding.

5 Budget Statement 2012-13, Budget Paper 3, page 64.

5.2.2 Non-financial public sector

The NFPS (consolidating the general government and PNFC sectors) estimated result for the year was a net lending deficit (borrowing) of $1857 million, which is $782 million more than budget for the year.

The following table summarises the position.

Table 5.3 – NFPS Budget comparisons 2010-11 to 2011-12

	2010-11 Actual $'million	**2011-12 Budget $'million**	**2011-12 Estimated result $'million**	Difference to budget $'million	Difference to budget %
Revenue	15 960	16 836	16 827	(9)	-
Less: **Expenses**	15 939	17 112	17 142	30	-
Net operating balance	21	(276)	(315)	(39)	(14)
Less: **Net acquisition of non-financial assets**	1 920	799	1 543	744	93
Net lending (borrowing)	(1 898)	(1 075)	(1 857)	(782)	73

Note: Totals may not add due to rounding.

The increase in the net lending deficit (borrowing) by $782 million comprises the deterioration in the general government result by $48 million and the PNFC sector's result by $734 million.

The increase in the PNFC sector's[6] net lending deficit (borrowing) from budget is due mainly to a decrease in sales of non-financial assets reflecting revisions to the estimated timing of key asset sales.

[6] Budget Statement 2012-13, Budget Paper 3, table A.2.

6 Budget 2012-13 overview

6.1 Overview

The following commentary focuses on the trends arising from the 2012-13 Budget. It provides an overview of:

- the Budget for 2012-13 having regard to the estimated result for 2011-12
- a longer term view of the forecast results going forward to 2015-16.

The analysis deals only with the accrual based GFS framework.

6.1.1 Matters of significance to the 2012-13 Budget

The 2012-13 Budget projects a return to a net operating surplus in 2015-16. Deficits are expected for each of the preceding three years. The cumulative net operating deficit over the four years of the 2012-13 Budget is $1148 million. The 2012-13 Budget also projects net lending deficits for each year of the forward estimates, with a cumulative amount of $5015 million. This amount is impacted by the recognition of the new Royal Adelaide Hospital ($2.8 billion) in 2015-16.

The 2012-13 Budget reinforced the adverse effect of ongoing weaker than expected economic conditions, particularly constrained household consumption and a very subdued property market. As a result, taxation and GST revenue growth were revised downward significantly from the projections in the 2011-12 Budget. For the period 2011-12 to 2014-15 taxation revenue was revised downward by $1551 million and GST revenue was revised downwards by $1276 million.

Other specific items to note in the 2012-13 Budget estimates years are:

- new operating and investing initiatives totalling $963 million over the next four years[7]
- targeted savings and revenue offsets totalling $663 million over four years[8]
- investing suspensions and deferrals totalling $444 million of the next four years[9]
- expenditure restraint compared to revenue growth is projected to lift the net operating balance to $512 million by 2015-16
- general government sector net debt increasing by $4473 million to $8755 million by June 2016.

Budgeted total revenues and expenses for 2012-13 are both lower than was previously estimated in the 2011-12 Budget.

Total revenue for 2012-13 is now budgeted at $15.1 billion, $1119 million or 6.9% less than was estimated for 2012-13 in the previous 2011-12 Budget. Expenses for 2012-13 are now budgeted at $15.9 billion, $138 million or less than 1% lower than was estimated at the time of the 2011-12 Budget.

7 Budget Statement 2012-13, Budget Paper 3, table 2.1.
8 Budget Statement 2012-13, Budget Paper 3, table 2.1.
9 Budget Statement 2012-13, Budget Paper 3, table 2.1.

As a consequence of these changes, a net operating balance deficit of $867 million is now budgeted, down from the estimated $114 million 2012-13 surplus result projected in the 2011-12 Budget.

6.2 General government sector – Operating Statement

Table 6.1 sets out the differences between the 2012-13 Budget and the estimated results for 2011-12.

Table 6.1 – GFS – General government sector budget comparison of 2011-12 estimate results and 2012-13 Budget

	2011-12 Estimated result $'million	**2012-13 Budget $'million**	Difference $'million	Difference %
Revenue:				
Taxation revenue	3 873	4 057	184	5
Grants:				
Current grants	7 417	7 498	81	1
Capital grants	1 185	373	(812)	(69)
Sale of goods and services	2 003	2 006	3	-
Interest income	167	167	0	-
Dividend and income tax equivalent income	413	349	(64)	(16)
Other	782	608	(174)	(22)
Total revenue	15 838	15 059	(779)	(5)
Less: **Expenses:**				
Employee expenses	6 737	6 930	193	3
Superannuation expenses				
Superannuation interest cost	407	340	(67)	(16)
Other superannuation expenses	717	742	25	4
Depreciation and amortisation	756	822	66	9
Interest expenses	372	414	42	11
Other operating expenses	3 874	3 987	113	3
Grants	3 259	2 692	(567)	(17)
Total expenses	16 122	15 926	(196)	(1)
Net operating balance	(284)	(867)	(583)	205
Less: **Net acquisition of non-financial assets**				
Purchase of non-financial assets	2 180	2 147	(33)	(2)
Less: Sales of non-financial assets	408	291	(117)	(29)
Less: Depreciation	756	822	66	9
Total net acquisition of non-financial assets	1 016	1 034	18	2
Net lending (borrowing)	(1 300)	(1 901)	(601)	46

Note: Totals may not add due to rounding.

As shown, the major differences for the 2012-13 year are:

- a 69% decrease in capital grants income, principally Commonwealth National Partnership grants. This large decrease reflects the timing of Commonwealth payments for the Adelaide Desalination Plant and road infrastructure payments and the conclusion of payments under the Commonwealth's Nation Building - Economic Stimulus Plan in 2011-12, and is partly reflected in the decrease in grant expenses
- increased taxation revenue due mainly to projected increases in payroll tax and gambling taxes

- a $174 million increase in other revenue principally arising from the recognition of contributed assets associated with the Adelaide Oval redevelopment
- increases in employee expenses and other operation expenses
- a $117 million decrease in sales of non-current assets due mainly to the once off transfer of land from Defence SA to the Urban Renewal Authority.

More detail of the factors influencing the 2012-13 Budget is considered in the context of the longer term trends discussed later in this Report.

6.2.1 Reconciliation of variations since 2011-12 Budget

Each year a reconciliation is included in the Budget Papers of the current budget estimates with the corresponding estimates for the previous year. This explains differences between budgets arising from what the Government categorises as parameter and policy changes.

'Parameter changes' are those that flow from other than policy choices. Revenue includes taxation changes from economic activity and Commonwealth revenue. Expenses include carryovers between years from timing effects, reclassifications and corrections.

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

The following table summarises all parameter and policy changes made since the 2011-12 Budget that affect the net operating balance and provisions used to offset some of those changes.[10]

Table 6.2 – Reconciliation of general government sector net operating balance

	2011-12 Estimated result $'million	2012-13 Budget $'million	2013-14 Estimate $'million	2014-15 Estimate $'million
2011-12 Budget	(263)	114	80	655
Parameter and other variations:				
Revenue - taxation	(263)	(426)	(457)	(442)
Revenue - other	281	(799)	(542)	(364)
Operating expenses	(29)	400	110	(22)
Net effect of parameter and other variations	(11)	(825)	(889)	(828)
Policy measures:				
Revenue - taxation	8	70	73	74
Revenue - other	(9)	(11)	2	5
Revenue – offsets	95	47	16	0
Operating expenses	(199)	(348)	(119)	24
Net effect of policy measures	(105)	(242)	(28)	103
Use of provisions set aside in the 2011-12 Budget and the 2011-12 MYBR:				
Operating expenses	96	87	58	57
2012-13 Budget	(284)	(867)	(778)	(15)

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

10 Budget Statement 2012-13, Budget Paper 3, table 1.5.

6.2.1.1 Revenue variations

Table 6.2 highlights the expected downward revision of State taxation revenue and other revenue across the forward estimates. The decrease in other revenue includes parameter changes in the receipt of Commonwealth GST grants.

The following table shows the components of revenue parameter changes.[11]

Table 6.3 – Revenue parameter changes

	2011-12 Estimated result $'million	2012-13 Budget $'million	2013-14 Estimate $'million	2014-15 Estimate $'million
Commonwealth Specific Purpose and National Partnership grants:				
Capital	413	(141)	25	(29)
Current	(55)	(130)	77	135
Commonwealth contributions	-	-	-	-
GST revenue grants and transitional assistance	(254)	(303)	(409)	(312)
Property related taxes	(235)	(387)	(423)	(414)
Dividends and income tax equivalents	48	(56)	(45)	(4)
Interest income	(5)	(28)	(38)	(35)
Other	107	(180)	(185)	(147)
Total	19	(1 225)	(998)	(806)

Table 6.3 shows the downward revisions, since the 2011-12 Budget, in GST distributions from the Commonwealth across the forward estimates, and downward revisions to property related taxes (particularly conveyance duty) over the same period.

Commonwealth specific purpose and National Partnership grants have been revised to reflect the latest estimates included in the Commonwealth's 2012-13 Budget.

6.2.1.2 Operating expense variations

Table 6.2 shows that parameter effects are estimated to reduce operating expenses by $459 million over the four years to 2014-15. This reduction is mainly due to the reclassification of expenditure for the Adelaide Oval redevelopment from operating to investing.

Policy spending decisions add a further $642 million to operating expenses over the four year period of which $199 million is for 2011-12.[12] The following table shows the value of policy measures taken in each of the past five years after presentation of the Budget for the year.

Table 6.4 – Policy spending decisions

	2007-08 $'million	2008-09 $'million	2009-10 $'million	2010-11 $'million	2011-12 $'million
Policy measure operating expenses	274	296	344	125	199

[11] Budget Statement 2012-13, Budget Paper 3, table 1.7 and 2011-12 MYBR, table 1.5.
[12] Budget Statement 2012-13, Budget Paper 3, table 1.5.

Table 6.4 shows that $1238 million was added to spending for the past five years. This increase reflects established practice of discretionary expenditure decisions being taken after Budgets are announced. In years prior to the 2011-12 Budget this additional expenditure was generally supported by favourable revenue outcomes. As shown in table 6.2, policy expense adjustments since the 2011-12 Budget are only partially offset by revenue variations, contributing to the deterioration in the estimated net operating deficit to $284 million.

6.3 Public non-financial corporation sector – Operating Statement

A net operating deficit of $33 million is budgeted in 2012-13, a minor deterioration from the estimated result for 2011-12.

Net lending is budgeted to improve to $729 million in 2012-13 due mainly to an increase in the budgeted sales of non-financial assets. The differences between the two years are set out in the following table.

Table 6.5 – GFS – PNFC budget comparison 2011-12 and 2012-13

Revenue:	**2011-12 Estimated Result $'million**	**2012-13 Budget $'million**	Difference $'million	Difference %
Sale of goods and services	1 729	1 904	175	10
Other	1 072	737	(335)	(31)
Total revenue	2 800	2 640	(160)	(6)
Less: **Expenses:**				
Employee expenses	191	200	9	5
Depreciation and amortisation	367	411	44	12
Interest expenses	251	265	14	6
Other property expenses	360	320	(40)	(11)
Other operating expenses	1 270	1 340	70	6
Other expenses	391	137	(254)	(65)
Total expenses	2 830	2 674	(156)	(6)
Net operating balance	(31)	(33)	(2)	7
Less: **Net acquisition of non-financial assets**				
Purchase of non-financial assets	1 227	766	(461)	(38)
Less: Sales of non-financial assets	424	1 071	647	153
Depreciation	367	411	44	12
Add: Change in inventories	91	(46)	(137)	(151)
Total net acquisition of non-financial assets	527	(762)	(1 289)	(245)
Net lending (borrowing)	(557)	729	1 286	(231)

Note: Totals may not add due to rounding.

6.4 Non-financial public sector – Operating Statement

The 2012-13 budgeted result for the NFPS is a net operating deficit of $901 million, a deterioration of $586 million from the 2011-12 estimated result.

6.5 A longer term perspective of financial performance

The following sections provide additional details in an historical perspective.

6.5.1 General government sector Operating Statement time series

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

Table 6.6 – GFS - General government sector Operating Statement - time series

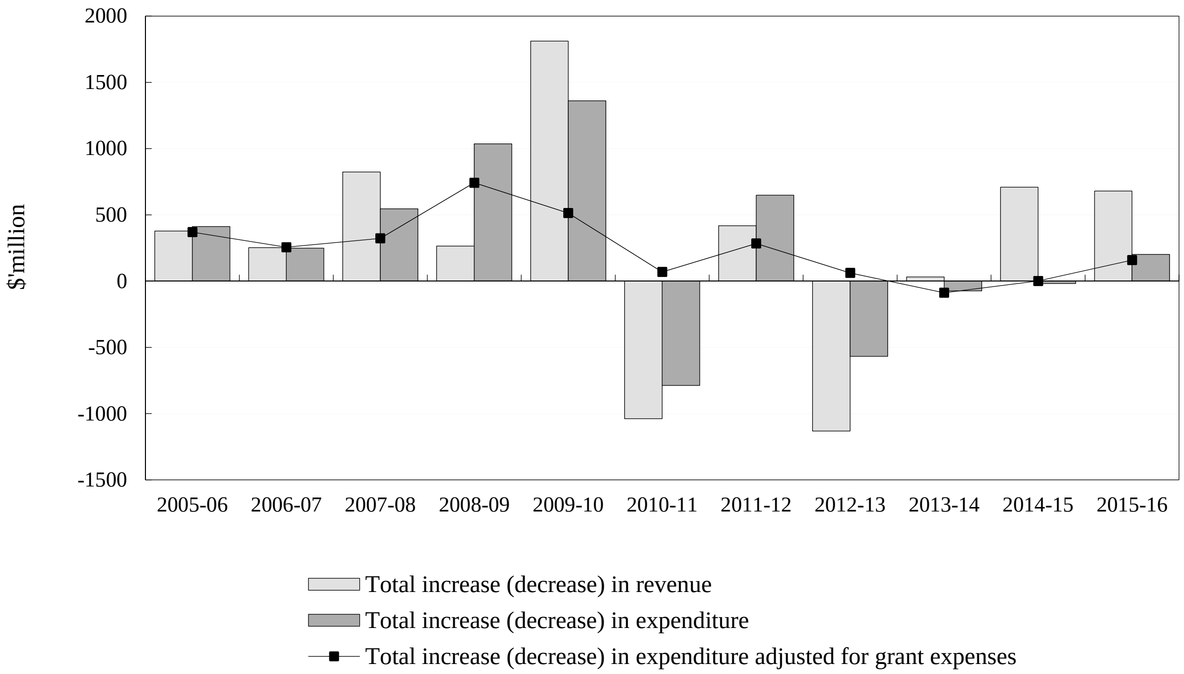
Revenue:	2006-07 Actual $'million	2007-08 Actual $'million	2008-09 Actual $'million	2009-10 Actual $'million	2010-11 Actual $'million	2011-12 Est. result $'million	2012-13 Budget $'million	2013-14 Estimate $'million	2014-15 Estimate $'million	2015-16 Estimate $'million
Taxation revenue	3 250	3 570	3 537	3 649	3 831	3 873	4 057	4 266	4 566	4 907
Grants:										
Current	5 715	6 294	6 651	7 039	7 109	7 417	7 498	7 753	8 326	8 967
Capital	254	322	598	1 841	1 076	1 185	373	273	355	418
Sales of goods and services	1 464	1 572	1 697	1 936	1 879	2 003	2 006	2 051	2 154	2 250
Interest income	167	203	150	138	168	167	167	155	164	179
Dividend and income tax equivalent income	450	429	382	433	403	413	349	362	405	411
Other	456	490	517	497	550	782	608	625	682	690
Total revenue	11 757	12 879	13 531	15 534	15 017	15 838	15 059	15 485	16 651	17 824
Less: **Expenses:**										
Employee expenses	4 933	5 268	5 749	6 221	6 400	6 737	6 930	6 970	7 121	7 339
Superannuation expenses:										
Superannuation interest cost	316	276	383	455	427	407	340	330	319	307
Other superannuation expenses	506	546	580	600	621	717	742	741	753	764
Depreciation and amortisation	498	525	566	633	670	756	822	893	988	1 036
Interest expenses	204	218	180	204	308	372	414	465	521	601
Other operating expenses	3 021	3 246	3 624	3 695	3 824	3 874	3 987	4 087	4 138	4 317
Grants	2 069	2 337	2 682	3 540	2 819	3 259	2 692	2 777	2 828	2 948
Total expenses	11 547	12 414	13 764	15 347	15 069	16 122	15 926	16 264	16 666	17 311
Net operating balance	209	464	(233)	187	(53)	(284)	(867)	(778)	(15)	512
Less: **Net acquisition of non-financial Assets**										
Purchases of non-financial assets	771	875	1 305	2 144	2 122	2 180	2 147	1 462	1 057	3 629
Less: Sales of non-financial assets	134	108	108	29	82	408	291	309	55	35
Less: Depreciation	498	525	566	633	670	756	822	893	988	1 036
Add: Change in inventories	-	-	7	3	-	-	-	-	-	-
Add: Other movements in non-financial assets	-	-	-	(206)	-	-	-	-	-	-
Total net acquisition of non-financial Assets	139	242	639	1 279	1 370	1 016	1 034	260	15	2 558
Net lending (borrowing)	71	222	(872)	(1 092)	(1 422)	(1 300)	(1 901)	(1 038)	(31)	(2 045)

Note: Totals may not add due to rounding.

6.5.2 Net operating balance influences

The following chart shows the increase or decrease, in real terms, of total revenue and total expenses to the previous year for the 11 years to 2015-16.

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



(a) Estimated June 2012 values
(b) 2009-10 and 2010-11 are influenced by Commonwealth stimulus grants

Chart 6.1 starkly demonstrates the short and medium-term responses to the global financial crisis. 2009-10 shows the highest growth in revenues over the period due to additional Commonwealth stimulus money.

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

The decrease in revenues and expenses for 2012-13 reflect the timing of Commonwealth payments for the Adelaide Desalination Plant and road infrastructure projects, the wind-up of Commonwealth stimulus funding and reductions, in real terms, of Commonwealth GST grants.

Real revenue increases are forecast for 2014-15 and 2015-16 due mainly to budgeted increases in Commonwealth GST grants and State taxation revenue.

7 Revenue

Trend data in charts in this section is in real terms at estimated June 2012 values unless otherwise stated.

7.1 Revenue overview

Immediate and large reductions in GST revenue grants and taxation revenue following the 2008-09 global financial crisis were offset by Commonwealth economic stimulus and other nation building funding to the States. The crisis also coincided with major changes in the Commonwealth's financial relations with the States. This resulted in other changes in timing and composition of Commonwealth revenues.

Expected reductions in GST revenue grants and taxation revenue in the 2012-13 Budget are far more significant than what was expected in previous budgets. This has had a major impact on the net operating balance and net debt projections. These reductions are not offset by Commonwealth economic stimulus funding, as was the case in the wake of the global financial crisis.

Total general government sector revenues are estimated to be $15.1 billion in 2012-13, a decrease of $779 million (4.9%) from the previous year's estimated result, and a real decrease of $1131 million or 7.1%.

In real terms total revenue is expected to increase by 1.8% by 2015-16.

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

Chart 7.1 – General government sector total revenue (real)

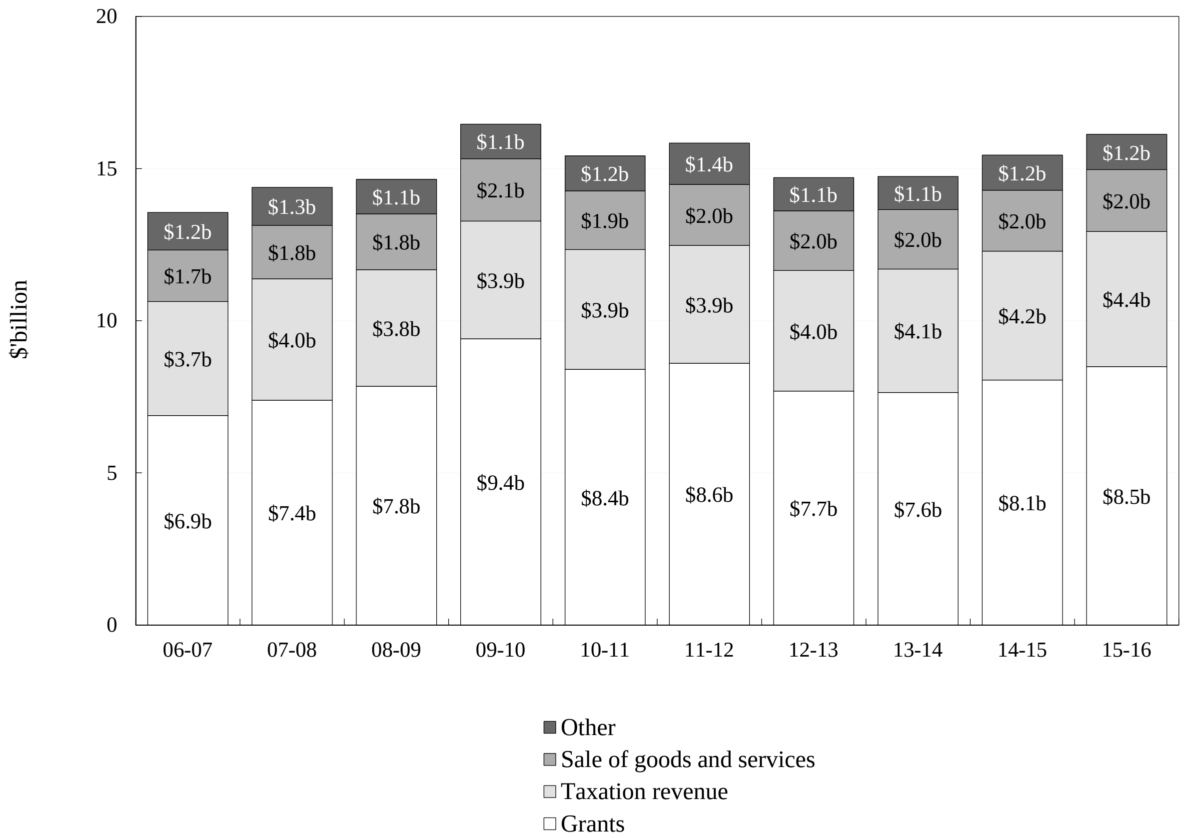


Chart 7.1 highlights the importance of Commonwealth grants to the State's revenues. Over most years Commonwealth grants represent about 50% of total revenue. During the period 2008-09 to 2011-12 Commonwealth revenue increased as a proportion of total State revenue, peaking at 55.9% in 2009-10. This increase was mainly due to temporary stimulus funding following the global financial crisis.

This percentage declines to 51.1% by 2012-13, a return to historical trends. While a relatively small change in percentage terms, this represents some hundreds of millions of dollars when total revenues are in the order of $15.8 billion (2011-12 nominal) and supports significant spending activity in targeted areas.

The following commentary provides some additional analysis of the main revenue areas. Detailed commentary is provided in chapter 3 of the Budget Statement, Budget Paper 3.

7.2 Commonwealth grants

The Intergovernmental Agreement on Federal Financial Relations provides the framework for the Commonwealth's financial relations with the states and territories.

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

The following table outlines estimated Commonwealth grants for the five years to 2015-16 and demonstrates a 9.7% increase (nominal) over that period.

Table 7.1 – Commonwealth grants 2011-12 to 2015-16 (nominal)

	2011-12 $'million	2012-13 $'million	2013-14 $'million	2014-15 $'million	2015-16 $'million
Current grant revenue	7 260.0	7 355.9	7 612.2	8 185.5	8 827.1
Capital grant revenue	1 154.6	342.5	257.1	338.5	401.4
Total grants	8 414.6	7 698.4	7 869.3	8 524.0	9 228.5

Table 7.1 highlights an anticipated decline in large Commonwealth capital grants in 2012-13, reflecting the timing of receipts for the Adelaide Desalination Plant, road infrastructure projects and the wind up of the Commonwealth's economic stimulus plan.

The increase in current grants is due mainly to budgeted increases in GST revenue grants.

7.2.1 GST revenue grants

GST revenue grants for 2011-12 are expected to be $253 million lower than the original budget estimate, reflecting softer growth in consumption and dwelling investment than originally estimated by the Commonwealth Treasury. The total GST pool is expected to decline by around 0.6% in 2011-12, compared to the Commonwealth's original budget estimate of growth of 6.4%.

GST revenue grants are distributed according to the principle of HFE. The principle of HFE is based on ensuring that each state has the capacity to provide public services at a similar standard and level of efficiency as the other states for a comparable revenue-raising effort.

The method of distributing GST to the States is currently under review. On 30 March 2011 the Prime Minister and the Commonwealth Treasurer commissioned the GST Distribution Review with the aim of developing a simpler, fairer, more predictable and more efficient distribution of the GST. The panel released its first interim report in April 2012 and its second interim report in June 2012. A final report is expected in the latter part of 2012. Any changes to the method of GST distribution may adversely impact on the level of GST distributed to the State. The review will not affect the distribution of GST revenue in 2012-13.

Over the forward estimates, South Australia’s GST revenue grants are expected to grow by 2.9% in 2013-14, 10.4% in 2014-15 and 8.8% in 2015-16.

7.2.2 Specific purpose payments

SPPs are provided under section 96 of the *Constitution* for both recurrent and capital expenditure purposes.

States are required to spend the funding received under each national SPP in the relevant sector but have the flexibility to allocate funds within that sector to meet agreed objectives. Previously, the allocation of Commonwealth payments for specific purposes among the states was based on many approaches including Commonwealth discretion, historical allocation and formula based allocation.

The Commonwealth will eventually distribute national SPPs between the states on a purely per capita basis according to ABS’s population estimates. This change is being phased in over five years from 2009-10.

In August 2011 the Council of Australian Governments agreed to a new National Health Reform Agreement to deliver reforms to the organisation, funding and delivery of health and aged care. From 1 July 2012 the National Health Care SPP will be replaced by National Health Reform funding which will comprise base funding equivalent to the National Healthcare SPP and, from 1 July 2014, efficient growth funding.

Over the forward estimates, SPPs are expected to increase from $2425 million in 2011-12 to $2661 million (real) in 2015-16, a real increase of $236 million. Over the forward estimates, growth in national SPPs reflects indexation arrangements specified in the Intergovernmental Agreement on Federal Financial Relations partially offset by the phasing in of per capita distribution.

National SPP grants include grants provided to the states for on passing, mainly for non-government schools and local government. For 2012-13 SPP grants for on passing total $789 million.

7.2.3 National Partnership Commonwealth grants

NPPs are a form of time limited payment under the Federal-state funding arrangements to fund specific projects and to facilitate and/or reward states that deliver on nationally significant reforms.

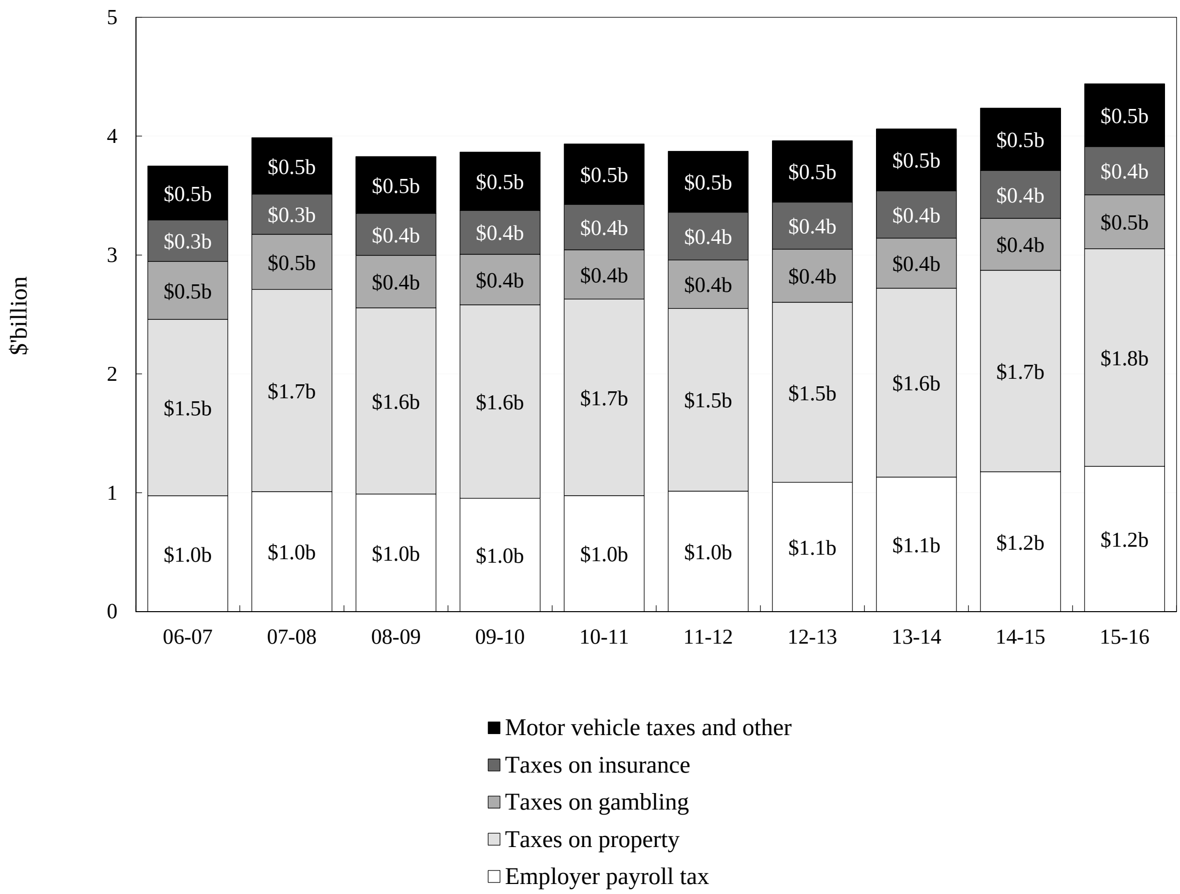
In 2012-13, South Australia will receive an estimated $593 million of NPP funding for recurrent purposes. This is a decrease of $134 million compared to the $727 million estimated for 2011-12. This decrease reflects changes in the timing of funding allocations and the conclusion of funding for a number of large NPPs.

7.3 Taxation revenue

Taxation revenue is the second largest source of revenue to the State and represents about 25% of revenues in 2011-12. It comprises a diverse range of activities, including payroll, property, motor vehicles and gambling activities.

The following chart examines the trend in the components of taxation receipts (in real terms) over the 10 year period to 2015-16.

Chart 7.2 – Taxation revenue (real)



Total taxes, in real terms, marginally reduced in 2011-12 before rising over the remaining forward estimates. Chart 7.2 demonstrates that throughout this time series, variations in taxation revenue are primarily attributable to property taxes.

Taxation revenue for 2012-13 is estimated to be $4057 million (nominal), an increase of $184 million over the estimated result for 2011-12. It is expected to be $4907 million (nominal) in 2015-16, a real increase of $567 million compared to 2011-12.

7.3.1 Property taxes

Property taxes include land tax, stamp duty (including on the conveyance of property and transfers of non-quoted marketable securities), the Emergency Services levy on fixed property, the Save the River Murray levy, regional natural resources management levies and guarantee fees.

Property taxes for 2012-13 are estimated to be $1552 million (nominal), a real decrease of $21 million from the estimated result for 2011-12. They are expected to be $2024 million (nominal) in 2015-16, a real increase of $296 million compared to 2011-12. Chart 7.3 shows the trend in property taxes (in real terms).

Chart 7.3 – Taxes on property (real)

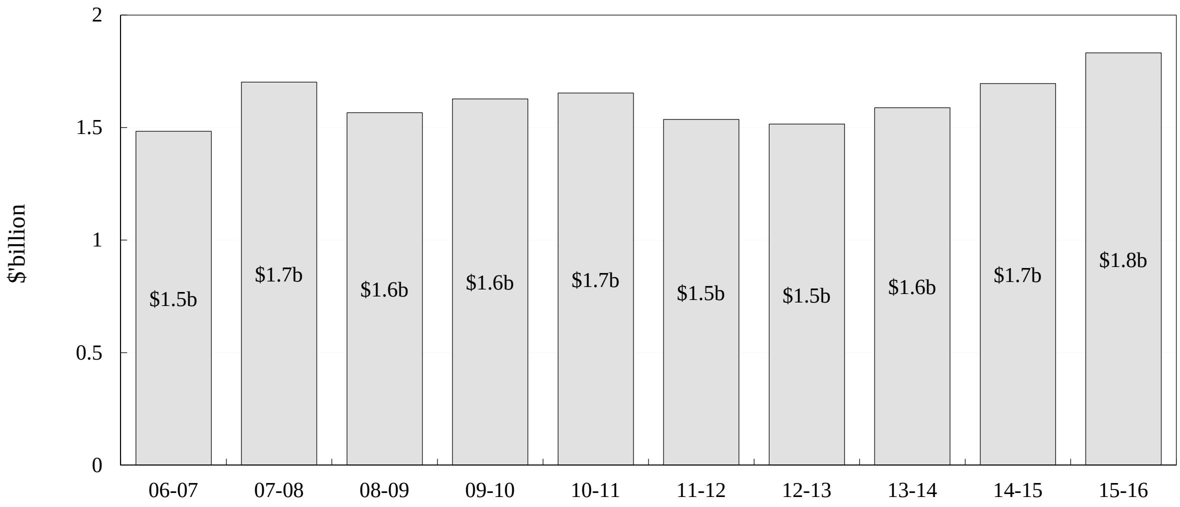


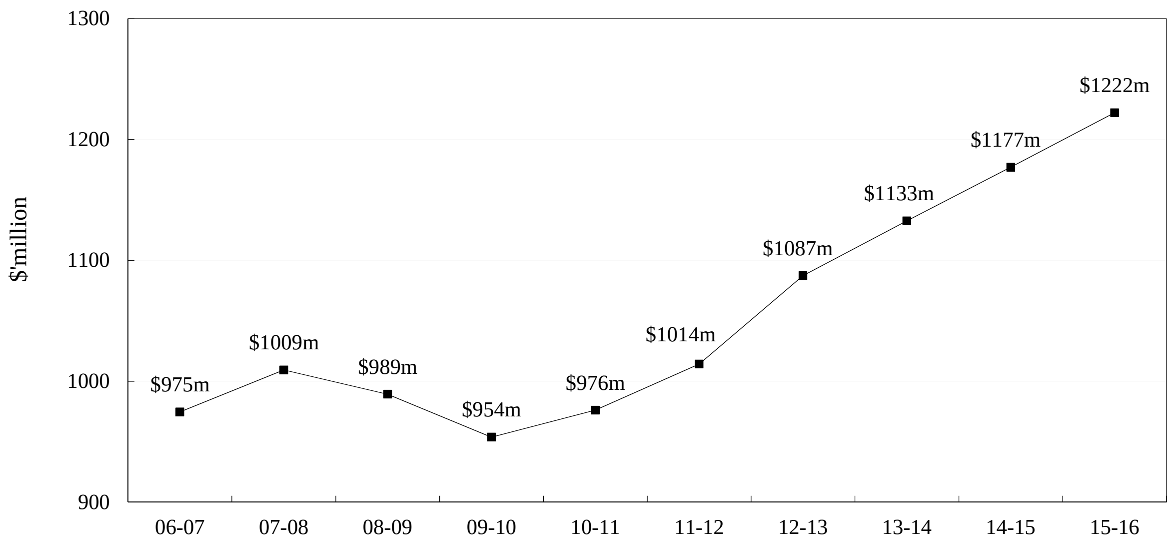
Chart 7.3 highlights the estimated decrease in property taxes for 2011-12 and 2012-13, before a return to their longer term trend levels.

The growth in property tax revenues over the forward estimates is attributable to growth estimates in property transactions, from the 25 year low level recorded in 2011-12, and annual real growth in property prices from 2013-14.

7.3.2 Payroll tax

Payroll tax is a principal source of taxation revenue. Chart 7.4 shows payroll tax revenue is anticipated to increase in real terms over the forward estimates.

Chart 7.4 – Employer payroll tax (real)



Payroll taxes for 2012-13 are estimated to be $1113 million (nominal), a real increase of $73 million from the estimated result for 2011-12. The payroll tax threshold remained at $600 000 on 1 July 2011. In addition, the payroll tax rate also remained at 4.95%.

Payroll tax is expected to be $1351 million (nominal) in 2015-16, a real increase of $208 million compared to 2011-12.

7.3.3 Gambling taxes

Gambling taxes for 2012-13 are estimated to be $457 million (nominal), a real increase of $39 million from the estimated result for 2011-12. Gambling taxes are expected to be $501 million (nominal) in 2015-16, a real increase of $45 million compared to 2011-12. The following chart shows the trend in gambling taxes.

Chart 7.5 – Gambling taxes (real)

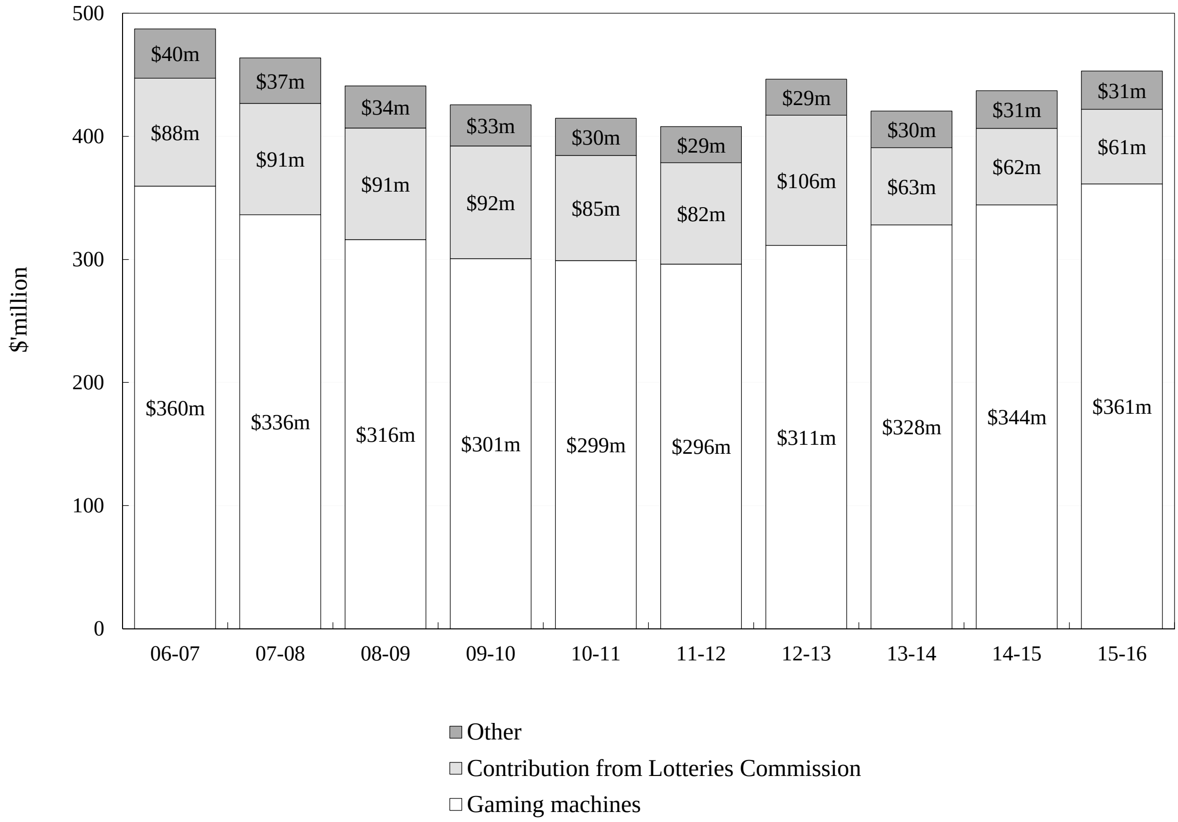


Chart 7.5 demonstrates the downward trend in total gambling revenue since 2006-07, particularly in revenue from gaming machines in hotels and clubs. From 2012-13 and over the forward estimates period gaming machine revenue is expected to grow broadly in line with household consumption expenditure.

Contributions from SA Lotteries in 2012-13 are boosted by the expected return of reserves in line with the Government's planned creation of a new lotteries licence. From 2013-14 distributions from SA Lotteries are expected to cease. The tax of lottery net gambling revenue will continue to be received from the holder of the lotteries sublicence.

7.4 Sales of goods and services

Revenue from sales of goods and services represented 13% of estimated total revenues in 2011-12. Sales of goods and services by the general government sector include government fees and charges most of which will have increased by 3.3% from 1 July 2012 reflecting the annual indexation of fees.

Revenue from sales of goods and services are expected to be $2250 million (nominal) in 2015-16, a real increase of $32 million compared to 2011-12.

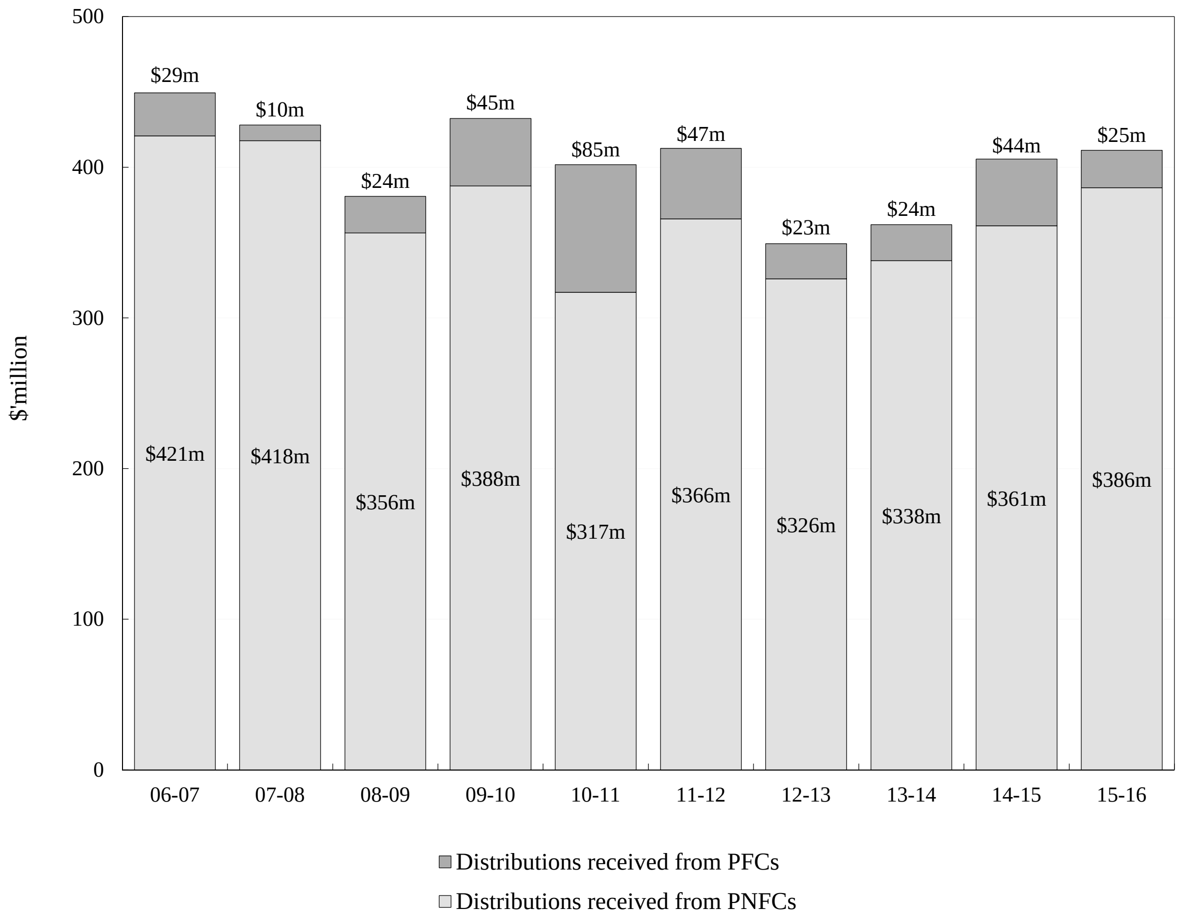
7.5 Dividend and income tax equivalent income

Dividend and income tax equivalent income are the distributions received from PNFCs and PFCs. They include returns of accumulated capital.

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

Chart 7.6 shows the trend in distributions received from PNFCs and PFCs for the 10 years to 2015-16.

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



Total distributions for 2011-12 are estimated at $413 million, $41 million higher than expected due to improved distributions from SA Water partially offset by reduced estimates from the new Urban Renewal Authority.

Distributions from SA Water represent the single largest component of this revenue source, comprising 87% of estimated total distributions for 2012-13.

For 2011-12, the distributions from SA Water were revised upwards due mainly to decreased expenses associated with the delay of the delivery of water for the Adelaide Desalination Plant, the impact of the preservation of access to water purchased for critical human water needs and delays in a number of smaller infrastructure projects.

7.6 Other revenue

Other revenue mainly comprises royalties, fines and penalties and schools fundraising revenue. Other revenue is expected to be $690 million (nominal) in 2015-16, a real decrease of 20% compared to 2011-12. This decrease reflects the once-off recognition of contributed assets associated with the Adelaide Oval redevelopment in 2011-12.

7.7 Risks to revenue

The Budget Papers provide detailed explanations of various risks to the amount and the flexibility of the revenue budget. Included in the risk analysis is:

- ***Taxation*** – a variance of 1% in taxation revenue, not including GST revenues, equates to about $41 million per annum.

- ***GST revenue grants*** – a variance of 1% in GST revenue growth has a revenue impact of $43 million per annum. Revised Commonwealth Government estimates of the GST pool in 2011-12 are 5.8% below the estimate of the GST pool made at the time of the Commonwealth's 2011-12 Budget.

  Commonwealth general purpose payments are the vehicle for HFE. The methodology and data underlying the HFE process is determined by the Commonwealth Grants Commission. Methodology changes may impact on the State, either positively or adversely. A 0.01% change in South Australia's relativity results in a change in GST revenue grants of about $32 million.

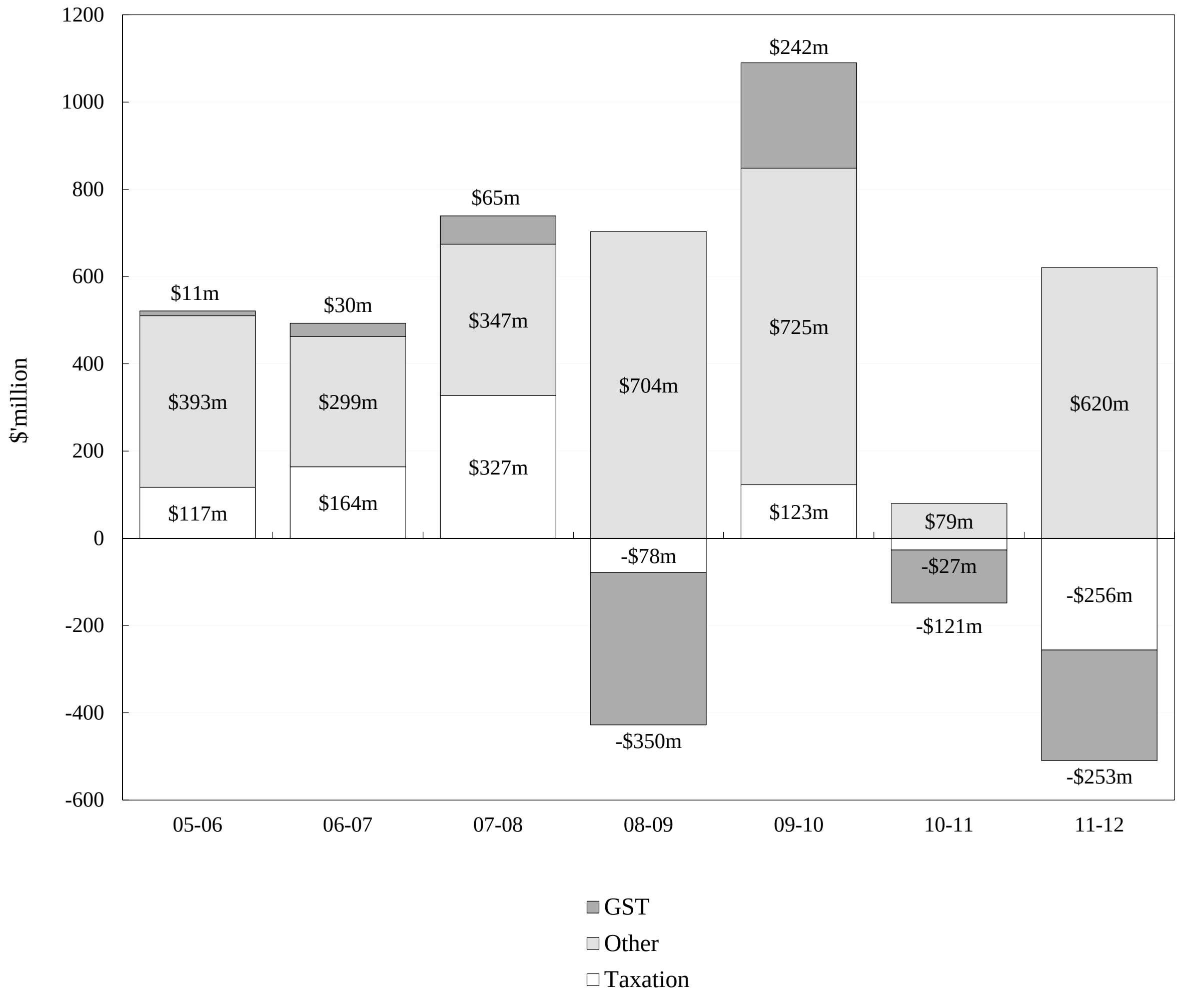
- ***Commonwealth specific purpose grants*** – payments for specific purposes from the Commonwealth account for about 21% of state government revenues. Variations in their level or the conditions applying to these payments pose a risk to the budget.

Readers are referred to the Budget Statement, Budget Paper 3, chapter 6 for the full details.

7.7.1 Past revenue outcomes

Notwithstanding the risks to the revenue budget, to provide a recent historic context, the following chart shows the difference between budgeted and actual revenues for the past seven years.

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



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

The chart highlights the very large favourable variations from budget that were enjoyed up to 2007-08, prior to the unfavourable variations in GST and taxation revenue noted in 2008-09 mainly attributable to the global financial crisis. In 2009-10 a return to a favourable variation to budgeted revenue was noted.

Results for 2010-11 were largely on budget, with favourable variations in other revenues (mainly distributions from PFCs and PNFCs), offset by an unfavourable variation in GST revenues and taxation.

Estimated results for 2011-12 anticipate decreases in GST and taxation revenue offset by a $620 million favourable variation in other revenue (predominately Commonwealth NPP grants).

8 Expenses

8.1 Expenses overview

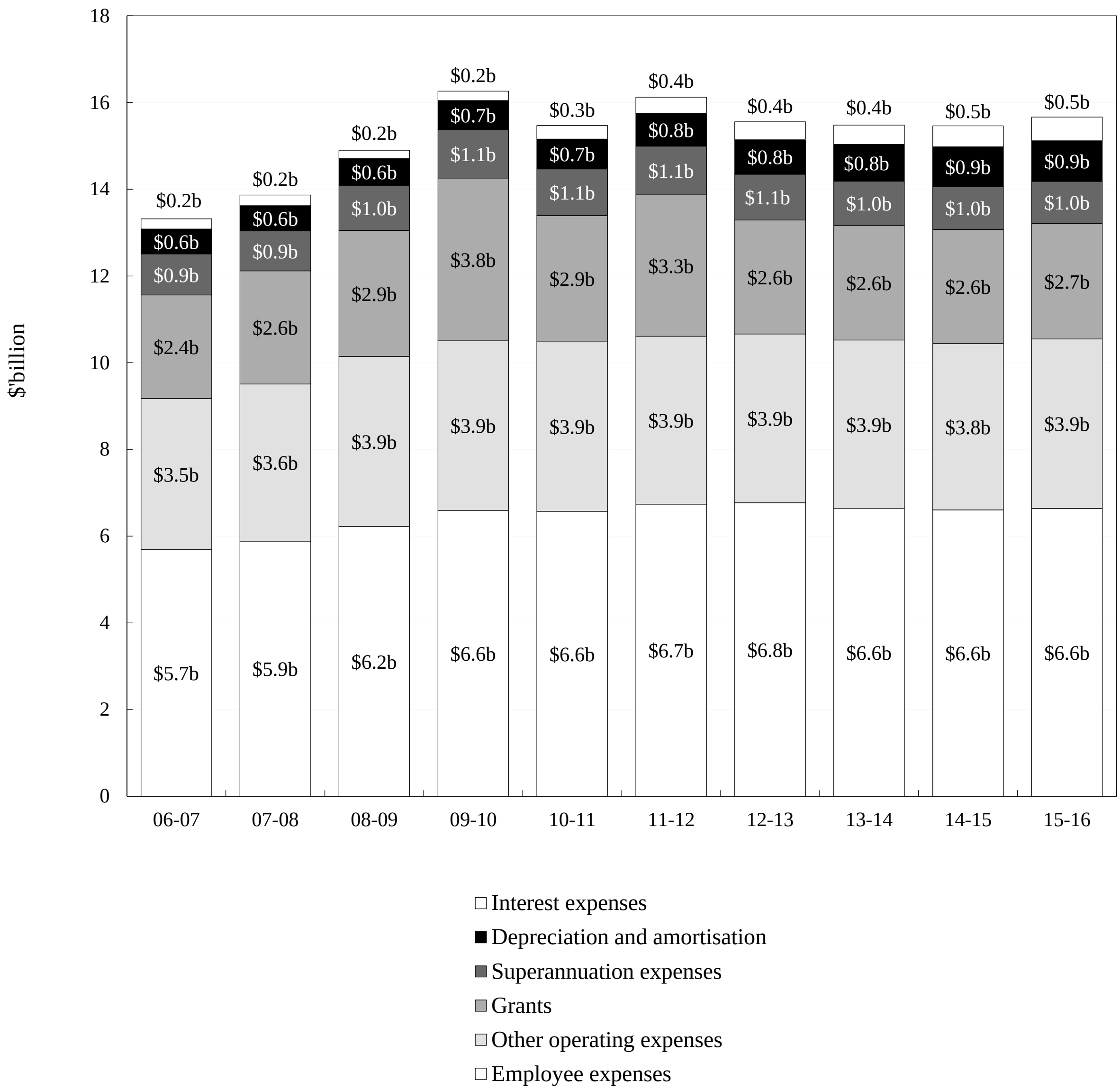
In the absence of better than budgeted revenue outcomes, the key to achieving the budget operating result targets is to control expenses. The 2012-13 Budget expects significant restraint in spending.

For 2011-12 estimated expenses total $16.1 billion and exceed budget by $132 million or 0.8%.

Total expenses for 2012-13 are budgeted to be $15.9 billion, $196 million or 1.2% lower than 2011-12 and grow to $17.3 billion in 2015-16.

The following chart highlights the trends in expenses (in real terms) that have emerged since 2006-07.

Chart 8.1 – General government sector - expenses (real)



The chart shows expenses grow annually from 2006-07 to 2009-10, remaining relatively constant thereafter.

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

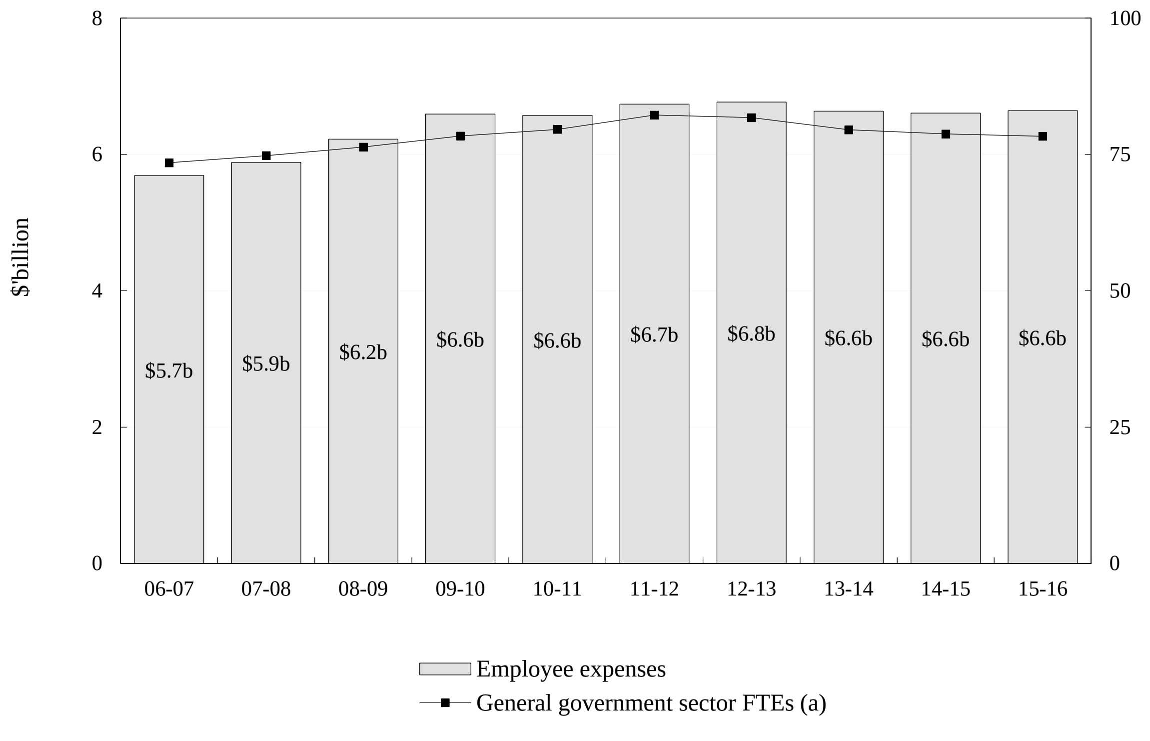
8.2 Expenses by type

8.2.1 Employee expenses

Employee expenses (an estimated $6737 million in 2011-12) represent the highest proportion (42%) of total expenses. They are estimated to increase by 2.9% in 2012-13 and then on average 1.9% per year to 2015-16.

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

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



(a) 2006-07 are actual FTEs provided by OPER
(b) FTEs for 2007-08 and beyond are DTF estimates

The chart highlights the actual growth in real terms of employee expenses through to 2011-12. This growth is consistent with FTE numbers. Employee expenses are expected to grow modestly in 2012-13, before projecting downward in 2013-14 and then remaining constant.

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

In the five years to 2011-12 employee expenses grew, in real terms, by an average of 3.5% per year. The 2012-13 Budget shows employee expenses increasing in real terms by 0.46% for the 2012-13 year. This is partly because, for presentation purposes, the employee expenses line in the forward estimates does not include full estimates for enterprise agreements to be renegotiated or finalised in 2012-13. A proportion of the salaries and wages contingency allowance is included in other operating expenses.

The 2012-13 Budget provides for anticipated public sector wage increases over the forward estimates period, both in individual agency budgets, and in the total of the contingency items in the 'Administered Items for Department of Treasury and Finance' to cover future enterprise agreement outcomes.

A major risk to the Budget and, in particular the forward estimates, is the outcomes from enterprise agreements and control of FTE numbers.

At the time of the presentation of the 2012-13 Budget the main enterprise agreements currently under negotiation or expected to commence negotiation during the next 12 months include:

- school and preschool employees and TAFE lecturers
- salaries medical officers, clinical academics and visiting medical specialists
- nurses
- wages parity salaried and weekly paid groups.

Examples of recent annual outcomes (excluding non-wage items) within agreements are:

- *SA Metropolitan Fire Service Enterprise Agreement 2011:* Annual salary increases of 2.5% salary from 1 January 2012 and 1 January 2013, with a 3% increase from 1 January 2014. Firefighter specific salary increases of 1% on 1 July 2012 and 1 July 2013.

- *SA Ambulance Service Enterprise Agreement 2011:* Annual salary increases of 2.5% from 31 December 2009 to December 2011. Annual salary increases of 3% from 31 December 2012 and 31 December 2013. Ambulance specific annual salary increases of 1% on 30 June 2011, 30 June 2012 and 30 June 2014.

- *SA Public Sector Wages Parity (Plumbing, Metal and Building Trades Employees) Enterprise Agreement:* Annual salary increases of 2.5% from 31 December 2010 to 31 December 2013. Trades specific increase of 0.5% per year for 2011-2013.

Recent outcomes reflect the Government's attempts to contain wage outcomes in the current economic environment. The Government has indicated that future wage outcomes will be crucial in determining whether it can achieve the expenditure forward estimates in the 2012-13 Budget.

8.2.2 Other operating expenses

Other operating expenses include general purchases of goods and services.

These expenses are estimated to be $4 billion for 2012-13, an increase of $113 million or 3% in nominal terms from 2011-12. The projection for the forward years to 2015-16 is for a real terms increase of less than 1%.

The Budget Papers state that under the forward estimates indexation policy, agencies are required to absorb any cost increases within their existing budget allocations unless the specific price increase has a material effect on the agency budget. The materiality test applied is that a price change experienced has altered agency costs by more than 0.5 percentage points above or below the standard indexation provided for in agency budgets.

8.2.3 Contingency provisions

Contingency amounts are incorporated into the Budget to provide flexibility if additional expenditure is required to be made by the Government. The following table shows the composition of contingency provisions for 2011-12 and 2012-13.

Table 8.1 – Contingency provisions

	2011-12 Budget $'million	2011-12 Estimated result $'million	2012-13 Budget $'million
Employee entitlements	161	218	151
Investing contingencies	131	72	87
Supplies and services	279	102	160
	571	393	397

The 2012-13 Budget includes contingency amounts totalling $397 million, $173 million less than the previous Budget and $4 million more than the estimated outcome for 2011-12. While allocating sums to each of the categories for presentation purposes, contingency funds may also be transferred from other lines where available.

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

8.2.4 Grants

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

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

Over the period 2008-09 to 2012-13 grants expense is influenced by the flow through of Commonwealth grant revenue. Table 6.6 shows the changes in grants expense over the forward estimates. Grants are estimated to be $3259 million for 2011-12 or $225 million (7.4%) over budget predictions.

Grants are budgeted to decrease by $567 million to $2692 million in 2012-13 largely due to the timing of Commonwealth grants to SA Water for the Adelaide Desalination Plant, on-passing of Commonwealth grants for financial assistance to local government in 2011-12 previously budgeted for 2012-13 and a once-off grant of $85 million in 2011-12 to the South Australian Cricket Association related to the redevelopment of the Adelaide Oval.

8.2.5 Superannuation expenses

8.2.5.1 Superannuation interest cost

In 2012-13 and across the forward estimates, superannuation interest cost is expected to be lower than estimated in the 2011-12 Budget, in the order of $77 million each year. This decrease reflects the impact of the decrease in the long-term Commonwealth bond rate, which is a key determinant of the expense.

The return on superannuation fund assets also impacts on superannuation interest costs. The Budget Papers note that a 1% lower than expected return on superannuation assets invested by Funds SA would increase estimated unfunded superannuation liabilities by around $51 million. An increase in unfunded superannuation liabilities of this magnitude would increase superannuation interest cost, decreasing the net operating balance result by around $3 million per annum.

8.2.5.2 Other superannuation expenses

Other superannuation expenses are employer superannuation contributions incurred by government agencies during the reporting period and include superannuation contributions on salaries and wages. It also includes superannuation on-cost on accrued leave. Estimated other superannuation expenses were $717 million in 2011-12 and are projected to increase to $764 million in 2015-16, a real decrease of 3.6%.

8.2.6 Depreciation and amortisation

Estimated depreciation and amortisation expenses were $756 million in 2011-12 and are projected to increase by 37% to $1036 million in 2015-16. The increase reflects the growth in the value of fixed assets through purchases and revaluations.

8.2.7 Interest expense

Estimated interest expense in 2011-12 was $372 million and is projected to increase by 62% to $601 million in 2015-16, reflecting a higher level of borrowings up to 2015-16. Interest payments on the financial lease for the new Royal Adelaide Hospital will start in the second half of 2015-16. The first full year interest expense associated with the new Royal Adelaide Hospital will occur in 2016-17.

Interest expenses are also impacted by movements in the State’s cost of borrowing, which is influenced by the State’s credit rating. DTF advised that Standard and Poor’s did not downgrade the State’s credit rating until after the formulation of the 2012-13 Budget. They did, however place the State on negative watch prior to the budget and the price at which SAFA bonds were trading on the market reflected this change in credit outlook. Nonetheless, DTF advised that this is not expected to impact on the cost of borrowing until new funds are raised or existing debt is refinanced. For each year’s budget SAFA determine a cost of funds based on existing debt pools plus expected refinancing costs. The expected refinancing costs reference prevailing market rates at that time.

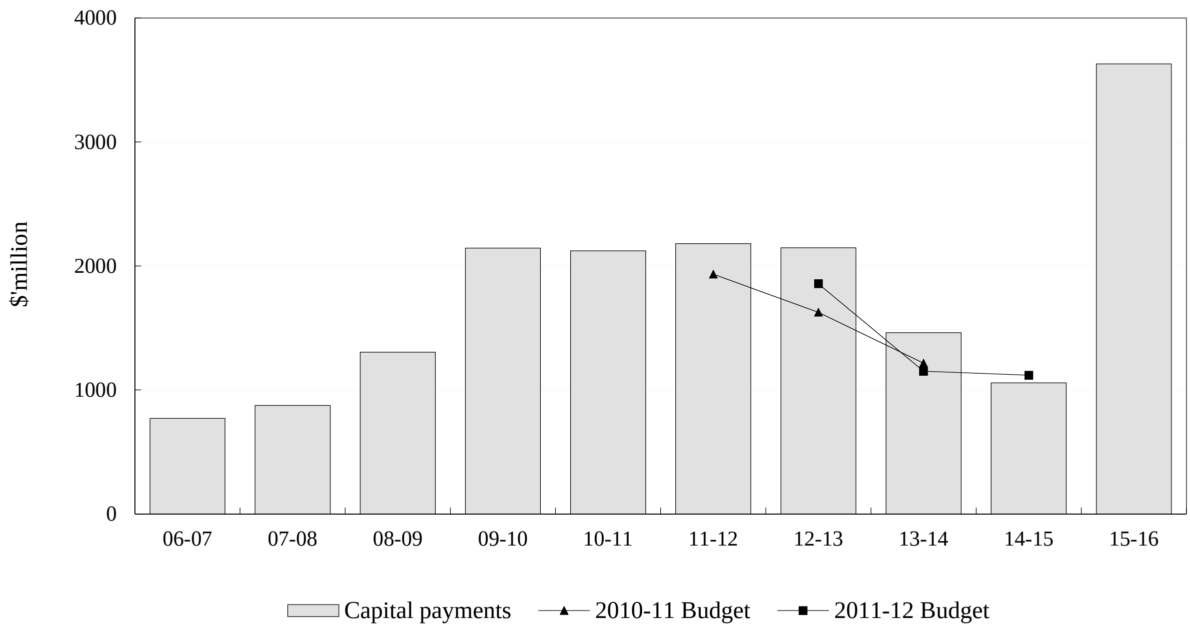
Further discussion in relation to debt movements is provided in section 9.6 of this Report.

8.2.8 Capital payments

Capital project payments are represented by the value of purchases of non-financial assets in the general government sector Operating Statement.

The following chart shows the purchase of non-financial assets over the 10 year period to 2015-16, overlayed with budgeted purchases from the 2010-11 and 2011-12 Budgets.

Chart 8.3 – General government sector purchase of non-financial assets (nominal)



In the 2009-10 Budget, the combined influence of State and Commonwealth spending initiatives, elevated general government sector capital spending estimates to high levels. Capital payments exceeded $2000 million in 2009-10 and 2010-11 and are estimated to reach $2180 million in 2011-12.

This level of capital spending is budgeted again for 2012-13, before reducing through to 2014-15. The large increase in the purchase of non-financial assets in 2015-16 represents the recognition of the new Royal Adelaide Hospital.

Although there will be components of future expenditure that have effectively been committed, the forward years contain funds contingent on approvals. The investing contingency provision for 2012-13 is $86.6 million.

Major projects carry high inherent risks including cost estimating, escalations and timeliness of completion. Sustained higher capital outlays than have been made in past years, need support from appropriate project management expertise, information systems and controls.

As in past years, carryover adjustments are made where appropriate if delays occur in budgeted project expenditure in the year but which will now be incurred in later years. The 2012-13 Budget included investing carryovers from 2011-12 into 2012-13 and future years of $318 million.

The 2012-13 Budget outlines investing project suspensions and deferrals totalling $444.2 million[13] across the forward estimates period. A summary of investing suspensions and deferrals for each agency is provided in table 2.5 of the Budget Statement. The more financially significant projects affected are:

- Rail Network Electrification Upgrade – suspension of the electrification of the Gawler and Outer Harbour rail lines. This suspension will reduce investing payments by $315.1 million over four years.
- Queen Elizabeth Hospital Redevelopment – Postponement of Stage 3A of the redevelopment to commence in 2015-16 reducing investment payments by $48 million across the forward estimates.
- Modbury Hospital Redevelopment – construction of the proposed rehabilitation in-patient unit has been postponed to commence in 2016-17, resulting in a $29 million reduction in investing payments across the forward estimates period.

8.2.9 Public Private Partnerships

A major PPP in progress is the new Royal Adelaide Hospital project.

In June 2011 the Government announced financial close on a contract with SAHP to build, operate and maintain the new Royal Adelaide Hospital under a PPP arrangement. The Government agreed on a fixed price for the design, construction, risk management and running and maintenance costs of the new hospital.

The total capital cost of the new hospital at contractual close was $2.09 billion comprising SAHP's contracted design and construction cost of $1.85 billion and $244.7 million for state works including clinical equipment.

The new Royal Adelaide Hospital is included as an asset and a finance lease liability of $2.8 billion in the 2015-16 forward estimate year. This accounts for the large increase in net debt in 2015-16. The amount represents the net present value of design and construction costs, lifecycle payments, interest and other project costs.

Annual service payments are also budgeted to commence in 2015-16, with $126.9 million included for that year. This amount only represents a part year payment based on the expected opening date of the new Royal Adelaide Hospital. DTF has advised that, in a full year the total annual payment is estimated to comprise:

- annual service payment – $323.15 million

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13 Budget Statement 2012-13, Budget Paper 3, page 28.

- operating expenses – $72.1 million, indexed annually.

Only part of this amount will be expensed each year as it includes cash payments that are applied to the reduction in the lease liability. DTF has advised that, in a full year the liability is amortised at around $75 million each year. DTF also advised that an annual expense of $75 million is expected relating to the amortisation of the asset on the balance sheet.

The liability for the new hospital is in addition to the estimate of $244.7 million of state investing expenditure (inclusive of road works managed by Department of Planning, Transport and Infrastructure) on the upgrade and connection of utilities, key clinical equipment, state project management and other site works.

8.2.9.1 Financial reporting of Public Private Partnership projects

Depending on the terms of contracts, PPPs may, through their contractual arrangements and assignment of risks and benefits under current accounting standards, be classified as, or have elements of either:

- a finance lease that transfers substantially all the risks and rewards incidental to ownership of an asset

- an operating lease that does not transfer substantially all the risks and rewards incidental to ownership and is excluded from the State Balance Sheet (may be off-Balance Sheet). In this case lease payments are recognised as an expense on a straight-line basis over the lease term unless another systematic basis is more representative of the time pattern of the user's benefit.

Under AASs whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

- the lease transfers ownership of the asset to the lessee by the end of the lease term

- the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised

- the lease term is for the major part of the economic life of the asset even if title is not transferred

- at the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset

- the leased assets are of such a specialised nature that only the lessee can use them without major modifications.

As mentioned previously, the capital component of the PPP arrangement for the new Royal Adelaide Hospital is to be recognised as a finance lease in the Balance Sheet, and consequently have an impact on net debt and net financial liabilities. As the State is the lessee, at the commencement of the lease term, lessees recognise finance leases as assets and liabilities in the statement of financial position at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. Any initial direct costs of the lessee are added to the amount recognised as an asset. Subsequently, minimum lease payments are apportioned between a finance charge and reducing the outstanding liability.

8.2.10 Asset sales

Sales of non-financial assets are taken into account in calculating the annual net lending result. They are netted from purchases of non-financial assets when determining total net acquisition of non-financial assets.

Total asset sales for the general government sector over the four years to 2015-16 are estimated to be $690 million.

When combined with the PNFCs, total budgeted asset sales for NFPS are $1355 million in 2012-13, well in excess of total asset sales in recent years. Further asset sales of $532 million are estimated for 2013-14 making asset sales a significant element to the estimated net debt projections for the four years of the 2012-13 Budget.

The estimated sales in the forward estimates include proceeds from the forward sale of up to three harvest rotations for ForestrySA plantations and the recently proposed SA Lotteries sublicence. Proceeds from these initiatives and other asset sales are not separately disclosed in the Budget so as to avoid prejudicing processes, but they are substantial to the estimated net lending results within the four years of the 2012-13 Budget. The Budget notes that reductions in interest costs in the Budget arising from debt retirement may be at risk if the Government is unable to achieve the value estimated for divestment of ForestrySA harvest rotations, the new SA Lotteries sublicence and selected government owned properties.

In August 2012 the Government announced that it has agreed to sell the forward rotations to a consortium led by the Campbell Group, LLC, representing a number of investors including Australia’s Future Fund. Completion of the sale is expected to occur later this year.

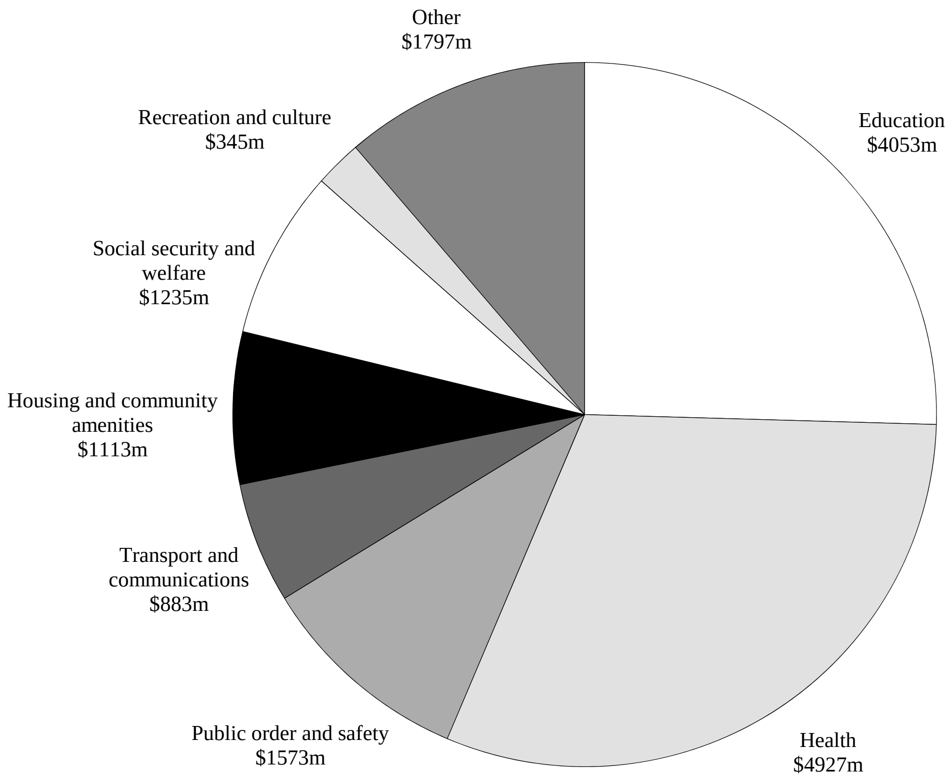
The Budget notes that the Government has appointed a transaction adviser for the lotteries licence sale process. This adviser is providing detailed advice to the Government about the commercial structure and marketing strategy of the transaction, which is expected to be completed in 2012-13.

8.3 Expenses by function

The GFS reporting framework also provides information on expenditure (excluding capital payments) by function for the general government sector. The following charts the 2012-13

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

Chart 8.4 – General government sector expenses by function[14]



8.4 Risks to expenses

8.4.1 Overview

As with revenue, the 2012-13 Budget provides detailed consideration of various risks to the expenditure budget and acknowledges the management task for achieving budgeted outcomes.[15]

Some of the key risks reported are:

- ***Wages and salaries*** – an increase of 1% per annum above the amounts factored into the Budget would have an adverse impact of approximately $290 million in 2015-16.

- ***Interest rates*** – a 1% increase in the average interest rate applying to general government sector net debt would increase net interest expense by about $48 million in 2012-13 rising to $76 million in 2015-16.

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14 Budget Statement 2012-13, Budget Paper 3, table 2.21
15 Budget Statement 2012-13, Budget Paper 3, page 107

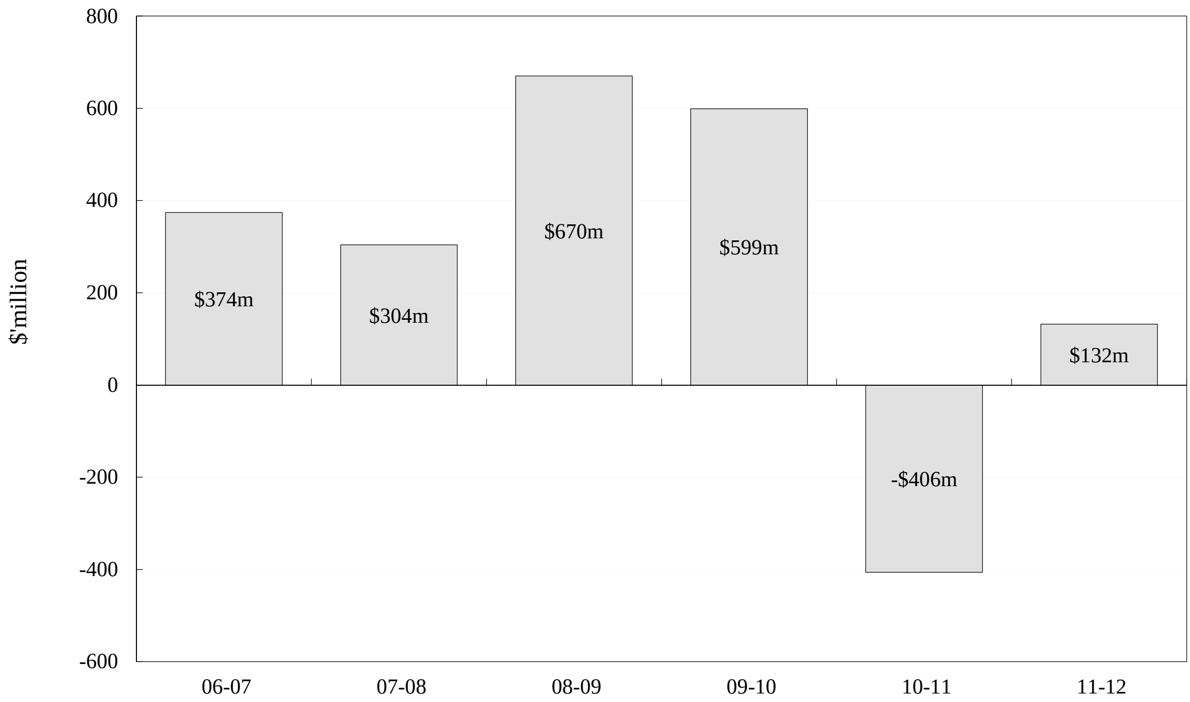
- ***Capital investment pressures*** – a number of departments have large capital investment programs over the forward estimates period. Historically there has been considerable cost escalation compared with original projections.

  If cost escalations exceed the amounts included in the capital investment program, annual net lending outcomes will be impacted. A 1% increase in costs for the capital program in the general government sector will increase expenditure by approximately $21 million in 2012-13.

- ***Changes in Commonwealth Government policy*** – the 2012-13 Budget identifies potential changes to the Commonwealth's policy settings for disability services and education funding. While these potential changes are not quantifiable at this time, a summary of the potential changes is provided in the 2012-13 Budget[16].

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

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



(a) 2011-12 is the difference between budget and the estimated result
(b) 2008-09 and 2009-10 are influenced by Commonwealth stimulus grants

The chart highlights that expenses exceeded original budget expense targets in the two years to 2007-08. These increases were due to parameter variations and policy measures.

Expenses also exceeded budget in 2008-09 and 2009-10 due mainly to additional Commonwealth economic stimulus grants provided in response to the global financial crisis.

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16 Budget Statement 2012-13, Budget Paper 3, page 108

For 2010-11 total expenses are $406 million less than budgeted, largely arising from decreases in grant and other operating expenses.

Total expenditure for 2011-12 is estimated to exceed budget by $132 million.

8.4.2 Savings and revenue offsets

For a number of years large value savings targets have featured as an essential element of fiscal strategy. A range of savings initiatives announced since the 2008-09 Budget were consolidated in the 2010-11 Budget after the Government had considered budget improvement measures recommended by the Sustainable Budget Commission.

8.4.3 Savings strategy 2010-11

The Sustainable Budget Commission reported to the Government and the 2010-11 Budget included savings measures that addressed and consolidated past savings with new savings. The Government stated that specific measures announced in the 2010-11 Budget identified savings measures to achieve remaining unspecified savings of over $700 million per annum by 2013-14. The 2010-11 Budget also included new operating savings totalling $1526 million over the next four years.

The following table sets out the total savings incorporated in the 2010-11 Budget. Revenue measures are excluded:

Table 8.2 – Summary of 2010-11 Budget new and existing operating savings

	2010-11 $'million	2011-12 $'million	2012-13 $'million	2013-14 $'million	4 year total $'million
New budget improvement savings					
Expenditure savings	99.0	254.1	389.8	474.6	1 217.5
Across government initiatives	25.8	73.1	101.4	108.1	308.5
Total new budget improvement savings	124.8	327.2	491.2	582.7	1 525.9
Existing saving measures and interest savings					
FTE savings (2008-09 MYBR)	28.0	45.0	56.0	59.0	188.6
Indexation (2009-10 Budget)	27.0	47.0	46.0	47.0	166.2
Efficiency dividend (2006-07 Budget)	-	11.0	27.0	44.0	82.5
Interest savings	-	7.0	35.0	80.0	122.0
Total existing saving measures and interest savings	56.1	110.0	163.3	230.0	559.3
Total new and existing savings	180.9	437.2	654.5	812.7	2 085.2

Note: Totals may not add due to rounding

Audit requested advice from DTF of any changes to the 2010-11 announced new savings measures including:

- information (by agency or portfolio) that details the achievement of the 2011-12 Budget savings announced in the 2010-11 Budget ($327.2 million)
- a reconciliation, by agency or portfolio, of the savings initiatives for 2012-13 and beyond announced in the 2010-11 Budget ($1073.9 million) with those remaining in the 2012-13 Budget.

The following table sets out adjustments made to the 2010-11 announced savings measures.

Table 8.3 – Summary of adjustments to 2010-11 Budget new operating savings

	2011-12 $'million	2012-13 $'million	2013-14 $'million	Total $'million
Parks Community Centre	-1.9	-4.2	-4.8	-10.9
Procurement efficiencies	-1.4	-1.4	-1.4	-4.2
Biosecurity animal health	-0.9	-1.0	-1.3	-3.2
Disability Client Trust Management	-0.7	-1.0	-1.1	-2.9
Court awarded costs against police	-1.6	-	-	-1.6
Reform of public sector recreation leave loading arrangements	-	-22.0	-22.2	-44.2
Family and community development program	-	-1.0	-2.0	-3.0
Facilities management	-	-2.4	-	-2.4
First Home Bonus Grant	-	-5.2	-0.4	-5.6
Total savings measures reversed or delayed	-6.4	-38.1	-33.3	-77.8

Note: Totals may not add due to rounding

The following table is provided at the portfolio level consistent with the format of table 2.4 in the 2010-11 Budget Statement. Revenue measures are excluded.

Table 8.4 – Summary of adjusted 2010-11 new budget operating savings

Portfolio	Revised 2010-11 $'million	Revised 2011-12 $'million	Revised 2012-13 $'million	Revised 2013-14 $'million	Total for 2012-13 and 2013-14 $'million
Attorney-General	1.7	10.0	18.4	20.6	39.0
Communities and Social Inclusion	1.6	10.1	18.6	18.9	37.5
Correctional Services	1.1	1.6	2.0	2.0	4.0
Courts Administration Authority	-	0.3	0.6	0.6	1.2
Defence SA	0.6	0.7	1.6	1.5	3.1
Education and Child Development	8.9	28.9	49.9	60.4	110.3
Emergency Services	1.1	3.1	4.4	5.2	9.6
Environment and Natural Resources	5.7	11.2	21.8	29.0	50.8
Environment Protection Authority	0.1	0.4	0.8	1.1	1.9
Further Education, Employment, Science and Technology	11.6	21.9	30.0	38.0	68.0
Heath and Ageing	18.2	63.1	105.6	134.6	240.2
Manufacturing, Innovation, Trade, Resources and Energy	13.2	22.9	28.4	33.4	61.8
Planning, Transport and Infrastructure	7.1	31.7	35.7	44.3	80.0
Premier and Cabinet	1.8	5.6	12.1	20.2	32.3
Primary Industries and Regions	13.4	17.8	22.0	24.9	46.9
SA Police	0.8	2.4	4.5	4.6	9.1
State Emergency Service	0.3	0.3	0.6	0.6	1.2
Tourism	1.1	3.0	4.0	4.6	8.6
Treasury and Finance	31.3	53.5	57.2	67.6	124.8
Water	2.5	3.3	3.8	3.6	7.4
Whole of Government	0.2	28.7	30.9	33.4	64.3
Zero Waste	0.4	0.5	0.4	0.4	0.8
Total savings announced in 2010-11 Budget remaining in the 2012-13 Budget	122.6	320.8	453.0	549.4	1 002.4

Note: Totals may not add due to rounding

DTF advised that generally agencies had achieved their allocated savings targets for 2011-12. There would be a number of cases where agencies did not achieve the specific saving (eg for timing reasons) but found a replacement saving to ensure the overall target was achieved. This is evidenced by the fact that they have not overspent their total budget. DTF has advised that the exception was the Department for Health and Ageing.

Health and Ageing has identified a $54.5 million underachievement of existing savings measures in 2011-12 (predominately associated with outpatients services reforms and efficient price reform). In recognition of these delays the Government provided $167 million (over 2012-13 and 2013-14) to allow for a more even build up of Health's savings task.

8.4.4 Savings identified for 2012-13

The 2012-13 Budget introduced new savings initiatives totalling $430.7 million over the four years of the forward estimates. The two main measures were:

- an increase in the efficiency dividend from 0.25% to 1% of employee expenses. This measure will not be introduced until 2013-14 and is expected to realise savings of $41.5 million in 2013-14, increasing to $129.5 million in 2015-16
- the reduction of a further 1000 FTE staff over the forward estimates, starting in 2013-14 with savings of $25 million and increasing to $86.6 million in 2015-16.

The savings task falls on all portfolios of Government.

8.4.5 Nature of savings initiatives

Table 8.4 shows that the 2010-11 Budget revised savings task for 2011-12 was $320.8 million. Table 8.4 also shows that the savings target increases annually being $453 million in 2012-13 and $549.4 million in 2013-14.

The savings task falls on all portfolios of Government.[17] Details of the new savings initiatives announced in the 2010-11 Budget are included in Budget Paper 6, 2010-11 Budget Measures Statement. This provides a reference for monitoring progress of the new savings program. Given the size of the savings target, individual measures encompass a broad range of activities. To illustrate, the nature of savings included:

- reducing the number of public servants
- savings from efficiency dividends
- departmental efficiencies
- motor vehicle fleet reform
- public sector long service leave arrangements reform
- reducing government advertising
- facilities management savings.

[17] Budget Statement 2010-11, Budget Paper 3, table 2.4.

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

As previous Audit Reports have emphasised, the savings task falls on all portfolios of Government and there has been mixed success over the years in meeting savings targets. The Health and Ageing portfolio has not been able to achieve savings targets or has experienced other service demands that have necessitated additional funding.

Previous Audit Reports have also highlighted that an inherent risk of the saving strategy of government is its sheer size and breadth. Achieving the task requires significant discipline and whilst agencies have experience with implementing savings strategies over recent years the savings targets have not always been achievable by all agencies. A further savings task now includes significant savings identified in the 2012-13 Budget. It presents risks including industrial action, public demand to maintain services and ineffective and inefficient administrative performance.

It is also noted that the efficiency dividend increase in the 2012-13 Budget is a broad savings measure that does not identify specific areas of government activity where savings are expected to be realised. The increase in the efficiency dividend and the broad nature of this savings initiative adds an additional element of flexibility and hence budget management oversight complexity to the overall savings task.

8.4.6 Reduction of full-time equivalents

A key part of the Government's savings strategy is to reduce the number of FTEs. The combined savings measures announced in the 2010-11 Budget were estimated to result in the reduction of 3743 FTEs from the public sector by 2013-14. This reduction will be partially offset by additional FTEs resulting from 2010 election commitments and other expenditure initiatives in the 2010-11 Budget. The net reduction of 1762 FTEs identified in the 2010-11 Budget is around 2% of the general government sector workforce.

Table 8.5 – 2010-11 Budget full-time equivalent impacts of new initiatives in 2013-14

	Savings initiatives	Expenditure initiatives	Total
Health	(957)	1 277	320
Education and Children's Services	(350)	66	(284)
Transport, Energy and Infrastructure	(213)	-	(213)
Justice	(206)	349	142
Primary Industries and Resources	(186)	7	(179)
Further Education, Employment, Science and Technology	(183)	127	(56)
Families and Communities	(108)	140	32
Others	(470)	15	(454)
Total 2010-11 initiative FTEs	(2 673)	1 981	(692)
Previously announced savings requirements			
2009-10 Budget indexation requirements	(342)		
Efficiency dividend	(328)		
FTE reduction target in 2008-09 MYBR	(400)		
Total previously announced savings requirements			(1 070)
			(1 762)

The 1070 FTE savings requirements were allocated to agencies in previous budgets and the 2008-09 MYBR. DTF advises that the FTE savings requirement associated with the 2009-10 Budget Indexation Savings and Efficiency Dividend is indicative only, being based on a standard distribution of the total budget savings between employee expenses and supplies and services. Agencies may implement savings strategies to achieve these measures that results in different FTE outcomes. The 400 FTEs in table 8.5 is the last two years of the FTE reduction target announced in the 2008-09 MYBR.

The 2012-13 Budget introduces savings initiatives to achieve a further 1016 FTE reductions from over the forward estimates[18]. This figure includes both FTE reduction measures and also FTE reductions achieved through other savings. Budget Statement 2012-13, table 2.12 outlines the timetable for achieving these FTE reductions, together with all other FTE reductions announced since the 2008-09 MYBR. All FTE reductions are scheduled to be achieved by 2015-16.

The following table reflects information provided by the agencies and compares the approved FTE cap to the actual level of FTEs (as at the last pay period in June) for key general government sector agencies (excluding a number of small agencies). The FTE caps reflect agency profiling of the cap as at the end of June 2012.

Table 8.6 – Actual and cap FTEs by portfolio as at 30 June 2012

Agency	Actual FTEs	Approved CAP FTEs	Variance FTEs	 %
Attorney-General	1 150	1 203	(53)	(4.4)
Correctional Services	1 641	1 680	(39)	(2.3)
Courts	719	733	(14)	(1.9)
Defence SA	26	29	(3)	(9.6)
Education and Child Development	21 119	21 148	(29)	(0.1)
Electoral Commission of SA	19	22	(3)	(12.4)
Emergency Services	1 184	1 161	22	1.9
Environment and Natural Resources	1 090	1 133	(43)	(3.8)
Environment Protection Authority	218	218	-	-
Communities and Social Inclusion	3 469	3 600	(131)	(3.6)
Further Education, Employment, Science and Technology	3 295	3 270	25	0.8
Health and Ageing	30 355	29 924	431	1.4
Premier and Cabinet	2 033	2 130	(96)	(4.5)
Primary Industries and Regions	943	1 074	(131)	(12.2)
SA Police	5 651	5 765	(114)	(2.0)
Tourism	123	130	(7)	(5.4)
Manufacturing, Innovation, Trade, Resources and Energy	422	429	(7)	(1.7)
Planning, Transport and Infrastructure	3 464	3 617	(154)	(4.2)
Treasury and Finance	530	561	(31)	(5.4)
Water	335	354	(19)	(5.4)
Total	77 789	78 182	394	(0.5)

Note: Actual and approved FTE cap figures provided by DTF. Positive variances indicate over FTE cap.
Totals may not add due to rounding

[18] Budget Statement 2012-13, Budget Paper 3, table 2.11.

The 2012-13 estimate of FTEs for the general government sector as at 30 June 2012 was 82 214[19]. FTE monitoring is limited to key agencies representing the majority of the general government sector.

Explanations, provided by agencies, for the key variances as at the end of June are as follows.

Portfolios above the cap:

- Health and Ageing reported that it was 431 FTEs above its cap at 30 June 2012 primarily as a result of overspending on salaries and wages in health units
- DFEEST reported that it was 25 FTEs above its cap due to the timing of payments for casuals and hourly paid instructors
- Emergency Services was above its cap due mainly to the SAMFS recruitment of additional fire fighters to offset anticipated attrition rates, partly offset by below cap results for SASES and SACFS.

The majority of agencies below the FTE cap reported that they were the result of vacancies, with a number of agencies indicating that this was in anticipation of meeting future savings targets.

Specific responses from portfolios below the cap included:

- PIRSA reported that it was 131 FTEs below the cap primarily due to delays in establishing and finalising contracts with external parties, filling vacancies and uncertainty of funding from research and development corporations
- Police reported it was 114 FTEs below its cap due mainly to unsworn vacancies, lower cadet intake and reduced community constables
- DENR and Water reported that they were 43 and 19 FTEs respectively below their caps primarily from earlier than budgeted completion of seasonal and/or externally funded projects and vacancies across the department
- Education and Child Development reported that it was 29 FTEs below cap due mainly to the timing of payments for temporary replacement teachers and hourly paid instructors.

8.4.7 Targeted voluntary separation program

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

TVSPs became available from November 2010.

DTF advised that, consistent with the FTE reduction initiative in the 2012-13 Budget, TVSPs will continue to be available until 2015-16.

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[19] Budget Statement 2012-13, Budget Paper 3, page 33.

Audit sought a summary of TVSP payments since November 2010 from DTF, as it is responsible for coordinating aspects of the program. Table 8.8 sets out a summary of FTE reductions achieved through TVSP payments (excluding executive reductions) as reported to DTF during the period 1 November 2010 to 30 June 2012.

Table 8.7 –FTE reductions from TVSPs reported by agencies 1 November 2010 to 30 June 2012

	FTE reductions From TVSPs
Arts SA	2.0
Attorney-General's	31.6
Communities and Social Inclusion	1.0
Correctional Services	6.0
Education and Child Development	54.7
Education and Children's Services	52.3
Environment and Natural Resources	77.5
Environment Protection Authority	2.0
Families and Communities	49.2
Further Education, Employment, Science and Technology	79.5
Health and Ageing	210.6
Planning and Local Government	11.8
Planning, Transport and Infrastructure	11.4
Premier and Cabinet	39.0
Primary Industries and Regions	66.0
Rail Commissioner	16.7
SAFECOM	15.0
SA Police	4.0
SA Ambulance Service	7.0
SA Metropolitan Fire Service	3.0
SA Tourism Commission	16.6
Trade and Economic Development	47.0
Transport, Energy and Infrastructure	37.2
Treasury and Finance	26.3
Water	22.2
ForestrySA (non-general government sector)	4.0
Total	893.5

Note: Totals may not add due to rounding

Agencies are centrally reimbursed for TVSP payments made to achieve savings measures announced in the 2010-11 Budget and subsequent budget initiatives.

The 2010-11 Budget provided for $353.8 million over four years for the cost of TVSP payments in support of employee separations. This cost was based on the provision of 3000 TVSPs over the four year period[20]. The 2012-13 Budget[21] states that an additional $60.4 million has been provided over three years for targeted TVSP payments associated with the savings measure in that budget to reduce an additional 1000 FTE's.

[20] Budget Statement 2010-11, Budget Paper 6, page 13.
[21] Budget Statement 2012-13, Budget Paper 3, page 27.

The TVSP scheme is structured to encourage acceptance of an offer within six months of it being made but offers may be accepted beyond that time frame for a lesser amount. Given this timeframe and structure, it may be some time before it is clear what impact the scheme has had in providing incentive for reducing FTE numbers and meeting targeted savings.

The 2012-13 Budget states that FTE reductions can also be achieved in other ways (for example, natural attrition) and that the Government will honour its pledge of a ‘no forced redundancy’ policy for the remainder of this electoral term. Commencing in 2014, a process will be introduced whereby a public sector employee who has been a long-term redeployee would be able to be separated with appropriate financial severance and in accordance with the *Public Sector Act 2009*.

At 30 June 2012 DTF advised there were 312 excess employees on the redeployment list.

8.4.8 Budget monitoring and reporting

Monitoring progress against Budget targets to enable a timely response to any significant issues arising, is a vital element in managing budget risk.

The critical importance of strong monitoring of budget progress has been continually emphasised in previous Audit Reports. DTF has advised Audit of specific measures in place. They include monthly monitoring of financial performance and quarterly monitoring of capital projects, budget initiatives and FTEs. Further, monitoring reports continue to be provided to the SBCC based on information supplied by agencies and analysis prepared by DTF.

DTF advised that the major risks to the fiscal outlook are set out in chapter 6 of Budget Paper 3, 2012-13 Budget Statement. These include the impact of economic activity on household spending patterns and demand for housing, which impact on GST and property taxation, and expenditure risks such as higher than expected wage increases, cost escalations on capital projects and activity growth in hospitals and schools. Budget Paper 3 also highlights potential changes to Commonwealth policy settings for disability services and education. While the Budget identifies the nature of potential expenditure risks, some remain unquantifiable at this time.

Last year, DTF advised that given the magnitude of the Budget improvement measures introduced in the 2010-11 Budget and the importance to the fiscal outlook of the achievement of these measures, an enhanced monitoring process was introduced in 2010-11 to monitor agency progress in achieving the measures and FTE reductions. Processes concluded or introduced since then include:

- Early 2011– monitoring focus was on agency progress in delivering 2010-11 savings and was discussed at the 2011-12 Budget bilateral meetings between the Treasurer and Ministers.

- July/August 2011 – monitoring considered agency progress in delivering savings measures commencing in 2011-12 and plans for delivering measures commencing in 2012-13 and beyond. The Treasurer met with Chief Executives to discuss progress on savings implementation and presented an enhanced monitoring report to the SBCC.

- Early 2012 – focused on progress against 2011-12 savings targets ands identifying issues in achievement of future savings measures. This information was discussed in 2012-13 Budget bilateral meetings between the Treasurer and Ministers.

- July 2012 – focused on verifying achievement of measures budgeted to be implemented in 2011-12, confirming that measures beginning in 2012-13 are on track and ensuring the development of plans to deliver measures beginning in 2013-14 and beyond. The Minister for Finance met with Chief Executives to work through plans and consider agency progress in achieving savings and will present a report to SBCC.

- The Minister for Finance has been delegated responsibility by SBCC for monitoring delivery of savings by agencies. Savings that are considered to be at risk of not being delivered will continue to be monitored and further meetings will be held with Chief Executives each quarter or as required.

9 Balance Sheet

9.1 Introduction

The Balance Sheet sets out the assets, liabilities and net worth (difference between assets and liabilities) of the State. This section provides some commentary of trends and influences in the State public sector financial position.

The information relates principally to data for both the general government sector and also the NFPS, which consolidates the general government and PNFCs (including SA Water and the South Australian Forestry Corporation).[22]

9.2 Overview of the State's financial position

The following summarises the financial position information for South Australia for the general government and NFPSs.

9.2.1 General government sector financial position

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

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

	2008-09 Actual $'million	2009-10 Actual $'million	2010-11 Actual $'million	2011-12 Estimated result $'million	2012-13 Estimate $'million	2013-14 Estimate $'million	2014-15 Estimate $'million	2015-16 Estimate $'million
Financial assets	22 449	25 363	27 516	24 944	24 806	25 314	25 798	26 337
Non-financial assets	18 595	29 680	33 658	34 886	36 004	36 305	36 367	38 965
Total assets	41 045	55 043	61 175	59 830	60 809	61 619	62 165	65 302
Total liabilities	16 898	18 811	20 217	21 672	22 877	24 038	24 172	26 321
Net worth	24 146	36 231	40 958	38 158	37 933	37 582	37 993	38 981
Net financial worth	5 551	6 551	7 299	3 272	1 929	1 277	1 626	16
Net debt	475	1 402	2 930	4 282	5 329	6 398	6 508	8 755

Note: Totals may not add due to rounding.

Of note is the expectation that:

- financial assets increase by $1393 million across the forward estimates. This is due mainly to investments in other public sector entities, up $1373 million
- non-financial assets increase by $4079 million over the forward estimates. This is due mainly to the purchase of buildings and improvements, including the recognition of the new Royal Adelaide Hospital in 2015-16

[22] Budget Statement 2012-13, Budget Paper 3, appendix D details agencies within the respective sectors.

- net worth (assets less liabilities) is estimated to decrease in 2012-13 and 2013-14 and then modestly increase over the remaining forward estimates

- net debt increases across the forward estimates to $8755 million in 2015-16 due mainly to increased borrowing to fund major capital investment programs.

9.2.2 Non-financial public sector financial position

The following table provides time series data for the NFPS.

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

	2008-09 Actual $'million	2009-10 Actual $'million	2010-11 Actual $'million	2011-12 Estimated result $'million	2012-13 Estimate $'million	2013-14 Estimate $'million	2014-15 Estimate $'million	2015-16 Estimate $'million
Financial assets	4 316	5 143	5 638	2 614	2 452	2 431	2 400	2 413
Non-financial assets	39 067	53 228	59 359	61 450	62 590	63 457	64 073	67 195
Total assets	43 384	58 371	64 997	64 064	65 043	65 888	66 473	69 609
Total liabilities	19 237	22 140	24 040	25 906	27 110	28 306	28 480	30 628
Net worth	24 146	36 231	40 958	38 158	37 933	37 582	37 993	38 981
Net financial worth	(14 921)	(16 997)	(18 402)	(23 292)	(24 658)	(25 875)	(26 080)	(28 215)
Net debt	2 872	4 487	6 541	8 410	9 684	10 781	10 849	13 011

This table highlights that:

- non-financial assets dominate the financial position

- the value of non-financial assets is estimated to increase by $2091 million in 2011-12 to $61.45 billion. The value of non-financial assets is estimated to increase by $5745 million by 2015-16. This increase mainly arises from the purchase of new assets offset by asset sales and depreciation

- net financial worth is negative as liabilities exceed financial assets and is estimated to generally deteriorate over the forward estimates period

- net debt is estimated to increase across the forward estimates by $4601 million. The recognition of the new Royal Adelaide Hospital impacts on the increases in 2015-16 and also increases non-financial assets and total liabilities in 2015-16.

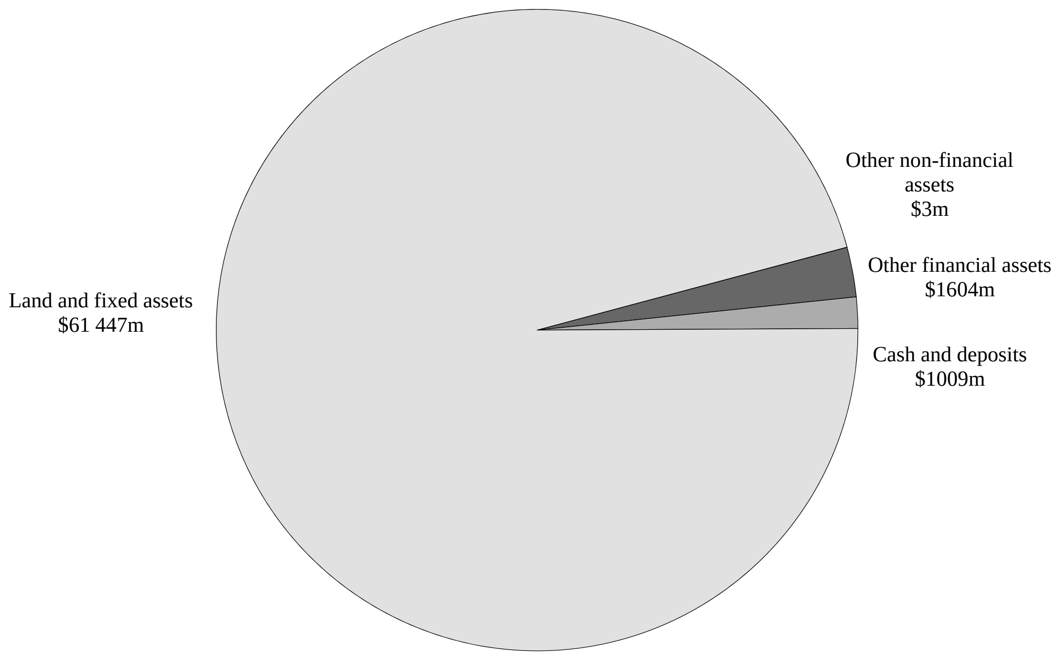
9.3 Assets

Table 9.2 shows that the State's asset position is growing from year to year because of major asset acquisitions. This position is similar to interstate jurisdictions, where similar trends are noted.

9.3.1 Non-financial public sector assets

The following chart shows the estimated composition of assets under the control of the State as at 30 June 2012 for the NFPS.

Chart 9.1 – Non-financial public sector assets at 30 June 2012



Other financial assets include equity of $491 million. This comprises $774 million in other investments offset by a negative $283 million equity investment in other public sector agencies.

Non-financial assets represent the vast majority of State assets being 96% of the total. The State's non-financial or physical assets comprise mainly plant, equipment and infrastructure (including roads and water infrastructure) and land and improvements. These assets are divided between the general government and PNFC sectors.

In accordance with the Treasurer's Accounting Policy Statements, major assets are subject to regular revaluation. Valuation of public sector assets, particularly general government sector assets, is a subjective process. Valuations will reflect the specific circumstances of individual government entity operations. The general purpose is to provide users of financial reports with an understanding of the extent of assets employed by government agencies in their operations. Most assets are not realisable.

9.3.1.1 Revaluation of non-financial assets

Revaluations of non-financial assets will generally have the most influence in the improvement of the State's net worth. To illustrate, the following chart summarises actual asset value changes over the four year period 2008-09 to 2011-12 for the major agencies in the general government and PNFC sectors.

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

	2008-09 $'million	2009-10 $'million	2010-11 $'million	2011-12 $'million	Total $'million
General government	1 142	9 702	387	715	11 946
PNFCs	1 723	1 170	1 460	353	4 706
Total	2 865	10 872	1 847	1 068	16 652

Revaluation of the assets of the major agencies added $16.7 billion to the total value of non-financial assets over the four year period to 2011-12.

During 2009-10 the value of the State's road network increased by $9.1 billion and reflects an internal revaluation undertaken by the Department of Planning, Transport and Infrastructure. The Department accounts for 66% of total non-financial asset revaluations during 2011-12. A key assumption of the revaluation model adopted by the Department is that the road network would be replaced by a modern equivalent asset rather than replacing the existing 'as constructed' network. Further commentary is included under 'Department of Planning, Transport and Infrastructure' in Part B of this Annual Report to Parliament.

9.3.2 Financial assets

The majority of the Government's financial assets are held by Funds SA. This includes funds of MAC and SAFA. The following table shows Funds SA's holdings of investment assets as at 30 June 2011 and 30 June 2012:

Table 9.4 – Funds SA's investments (actuals) (a) (b)

	Domestic equities $'million	International equities $'million	Fixed interest $'million	Other investments $'million	Total $'million
2011-12	3 698	3 631	1 938	8 507	17 774
2010-11	4 413	3 640	1 924	6 897	16 874

(a) Market values have been used in determining the above amounts.
(b) Excludes WorkCoverSA

As shown above, a large proportion of the State's investment assets are placed in both domestic and international equities. Investments of this type and nature are managed through the development of agency specific investment strategies, which are ratified by the relevant agencies' boards. International and domestic equity investments are subsequently managed by external fund managers on behalf of Funds SA.

Funds SA incurred a net gain from investing activities in 2011-12 of $537 million reflecting the modest ongoing recovery of financial markets during the year. As the majority of managed funds are superannuation assets, much of this gain is reflected in an improvement in the unfunded superannuation liability. This net gain is lower than the prior year gain of $1628 million and results from poor returns on equity investments, in particular Australian equities.

Reduced revenue from investing activities and an increase in the outstanding claims liability contributed to a deterioration in MAC's statutory solvency level, calculated in accordance with a formula determined by the Treasurer. As at 30 June 2012 MAC had net assets of $397 million. The assets of the compulsory third party fund as at that date were 100.8% of the target level of solvency compared to 103.6% in the previous year.

WorkCoverSA reported a comprehensive loss result of $437 million in 2011-12. This compares to a comprehensive profit result of $30 million in 2010-11. The significant deterioration in the comprehensive profit was mainly due to an increase in the outstanding claims liability.

Lower discount rates required to be used in the calculation of the outstanding claims liability have significantly contributed to the increase in the liability for both MAC and WorkCoverSA.

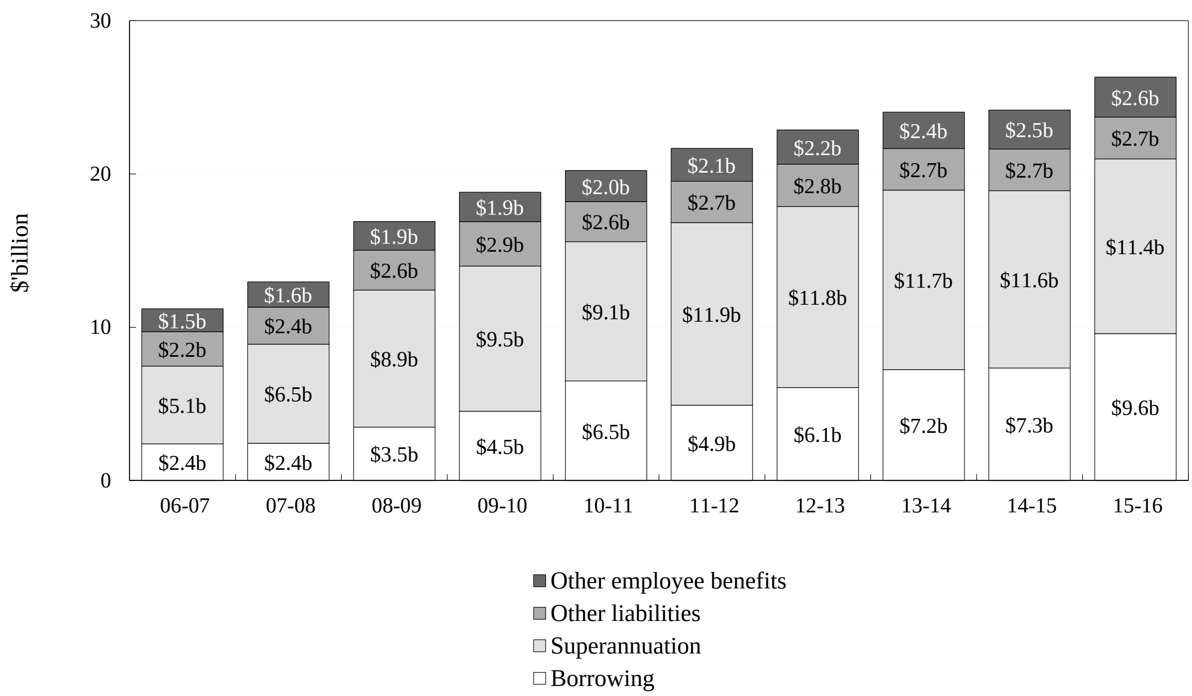
Further commentary is included under 'Motor Accident Commission', 'South Australian Government Financing Authority', 'Superannuation Funds Management Corporation of South Australia' and 'WorkCover Corporation of South Australia' in Part B of this Annual Report to Parliament.

9.4 Liabilities

9.4.1 General government sector liabilities

The following chart shows trends in the main elements of total liabilities for the 10 years to 2015-16.

Chart 9.2 – General government sector liabilities (nominal terms)



There was a structural break in 2011-12 – From 2011-12 borrowings are presented net of the Treasurer's deposits with SAFA

Total liabilities are estimated to increase by $1455 million or 7.2% to $21.67 billion in 2011-12. This is due mainly to increases in the unfunded superannuation liability partially offset by a decrease in borrowings. The variability in the unfunded superannuation liability in the five years to 2011-12 is due mainly to movements in earnings, actuarial assumptions and the discount rate used to estimate the value of the liability.

Total liabilities are expected to increase by $4649 million or 21.4% to $26.32 billion over the period of the forward estimates. This is due mainly to increases in borrowings, up $4675 million over the four years to 2015-16.

9.4.2 Non-financial public sector liabilities

The trends and composition of liabilities for the NFPS are consistent with those of the general government sector.

Total liabilities are expected to increase by $4721 million or 18.2% to $30.63 billion over the period of the forward estimates. A $1866 million or 7.8% increase in total liabilities in 2011-12 is due to an increase in superannuation liabilities, up $2812 million or 30.9% partly offset by borrowings, down $1100 million or 10.9%. Borrowings have decreased due mainly to a change in the presentation of borrowings in 2011-12, which are now presented net of the Treasurer's deposits with SAFA (an entity outside the NFPS).

9.5 Unfunded superannuation

9.5.1 Background to unfunded superannuation liabilities

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

Superannuation liabilities are determined on long-term estimates of total liabilities. This is a liability to current and past members of closed defined benefit superannuation schemes. They are not liabilities that will be called on in total in the immediate future - thus there is the ability to seek to fund them over many years. This State has a long-term funding strategy in place.

In estimating the liabilities, a range of variable factors and assumptions are taken into account. Also important are the scheduled past service contributions by the Government. The superannuation liability may change periodically as assumptions and earnings experience change and, because of discounting, as the Government bond rate changes and the period of settlement approaches. This is an accepted fact for this type of liability.

9.5.2 Estimated unfunded superannuation liability at 30 June 2012

Unfunded superannuation liabilities are estimated to increase by $2812 million to $11908 million as at 30 June 2012 compared to the value at 30 June 2011. This increase is explained in table 9.5 and includes the impact of a decrease in the discount rate used to measure the liability of $2801 million, past service superannuation payments of $409 million and lower than expected returns on investment of $173 million.

A discount rate of 4% (effective annual rate) was used for the 2012-13 Budget compared with 5.6% for the 2011-12 Budget. This decrease in the discount rate resulted in a $2801 million increase in the liability over the year compared to the estimate as at 30 June 2011 and highlights the sensitivity of the valuation of the superannuation liability to movements in the discount rate. Should interest rates increase in the future, the value of the liability will decrease as discussed later.

The following table sets out the major elements that comprise the movement from the estimated unfunded superannuation liabilities at 30 June 2011 to the 30 June 2012 estimated liability.

Table 9.5 – Estimated unfunded superannuation liabilities as at 30 June 2012

	$'million	$'million
Estimated unfunded liability 30 June 2011 (2011-12 Budget)		8 734
Add: Difference between actual and expected returns	68	
Movement in discount rate	294	
Total changes		362
Actual at 30 June 2011		9 096
Add: Superannuation interest cost	407	
Past service superannuation payments	(409)	
Lower than expected returns on investments	(173)	
Movement in discount rate	2 801	
Effect of actuarial review on the SA Superannuation Scheme	(17)	
CPI assumptions	(49)	
Variance between actual and expected experience	62	
Other movements	190	
Total changes		2 812
Estimated closing balance June 2012		11 908

Note: Totals may not add due to rounding.

9.5.2.1 Superannuation discount rate

As required by AASs, the unfunded superannuation liability is estimated at a point in time by discounting future superannuation benefit payments by a discount rate that reflects the risk-free interest rate. The reference rate used is the longest dated Commonwealth Government nominal bond. Due to the high value of the expected payments to beneficiaries and the long-term nature of the liabilities, valuation of the superannuation liability is sensitive to movements in the discount rate. The following table provides examples of the possible values by varying the discount rate from the current rate of 4%.

Table 9.6 – Sensitivity analysis of unfunded superannuation liabilities to discount rate movements as at 30 June 2012

Discount rate %	Unfunded superannuation liability $'billion	Increase (Decrease) $'billion
5	9 908	(2 000)
4	11 908	-
3	14 408	2 500

Table 9.6 shows how significantly the value of the liability can change with movements in interest rates alone. For example, should the longest dated Commonwealth Government nominal bond rate increase to 5%, the value of the unfunded liability will reduce by $2 billion. The Budget records that while financial market volatility in the recent past has resulted in multibillion dollar revisions to the value of the liability recorded on the Balance Sheet, there has been no material change in the actual expected payments to beneficiaries underlying the liability.

9.5.2.2 Superannuation funding

In 2012-13, DTF advised that total superannuation funding (including the fully funded Southern State Superannuation Scheme) is expected to be $1304 million (up $47.3 million on 2011-12). It is a significant part of cash outlays. Payments comprise amounts paid from agencies as contributions to current employment for new service and contributions reflecting lack of funding for current employment in previous years ('past service' contributions) prior to the full funding policy.

The past service superannuation liability cash payments are affected by a number of factors including the long-term earning rate on superannuation assets. Where investment performance exceeds the assumed rate, it is possible to reduce the level of past service payments required to fully fund superannuation liabilities by 2034. Additional funding contributions are required, however, to compensate for reduced earnings to remain on target.

The past service superannuation liability cash payment for 2012-13 is estimated to be $438 million.[23] This estimate is $13 million higher than that included in the 2011-12 Budget.

9.5.2.3 Earnings

Funds SA is responsible for managing the investment of superannuation assets. Investment earnings on superannuation assets are highly susceptible to economic conditions, financial markets and Funds SA's investment strategy. Further detail on investment performance is provided under 'Superannuation Funds Management Corporation of South Australia' in Part B of this Annual Report to Parliament.

An earnings rate of 2.2% was estimated for 2011-12 at the time of the 2012-13 Budget.

9.5.3 Long-term funding of superannuation liabilities

The commitment to fully fund unfunded liabilities was reaffirmed by the Government in the 2012-13 Budget, with the position as at 30 June 2012 remaining consistent with the plan to eliminate unfunded superannuation liabilities by 2034.

Past service superannuation liability cash payments are forecast to reduce until 2028 and increase for the next seven years to 2034. Assuming no change in the discount rate and a return to long-term earnings, unfunded liabilities are expected to peak in the 2011-12 period. It is estimated that benefit payments will peak in 2026-27.

[23] Budget Statement 2012-13, Budget Paper 3, table 4.7.

The Government's target to fully fund superannuation liabilities by 2034 is on track based on these estimates. Based on current data and estimates, in 2034 the liability will be fully funded by equivalent assets of $7.8 billion.

9.6 Net debt

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

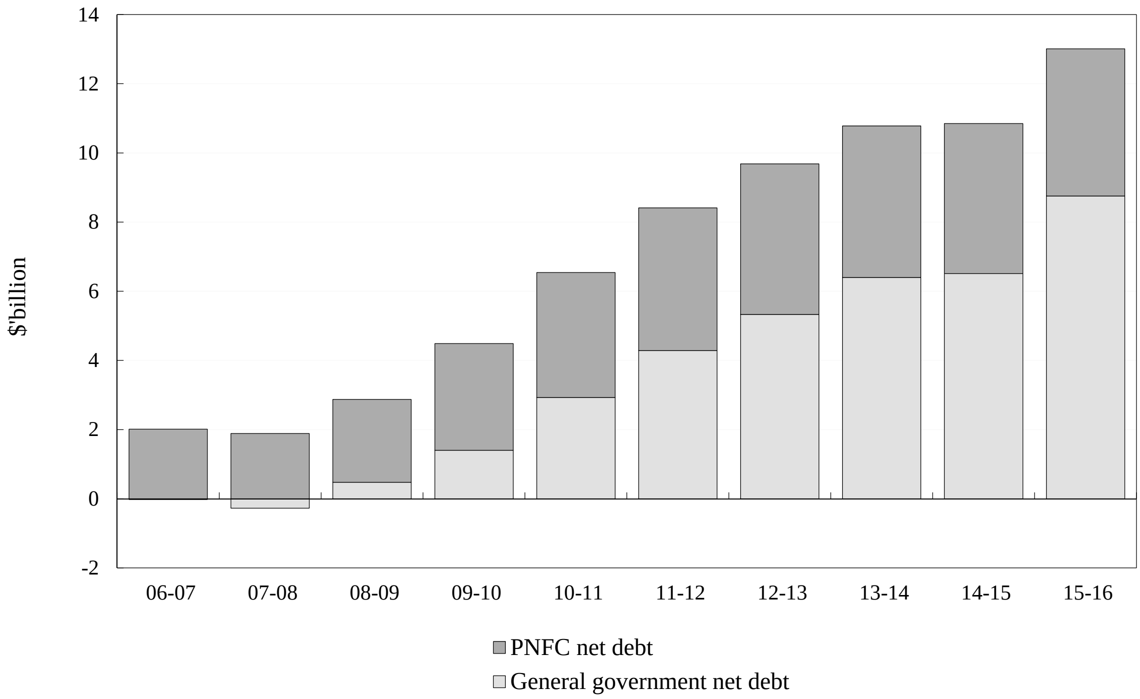
9.6.1 Definition of net debt

Net debt[24] equals certain financial liabilities (the sum of deposits held, advances received and borrowing) minus financial assets (the sum of cash and deposits, advances paid, and investments, loans and placements) as defined in the GFS framework.

9.6.2 Longer term trends in the level of debt

The following chart shows data on a long-term basis to the end of the forward estimates. Non-financial public sector net debt has increased by $4552 million to $6541 million (7.3% of South Australia's GSP) in the period 2006-07 to 2010-11. In 2011-12 net debt has increased by $1869 million to $8410 million (9% of South Australia's GSP). Forward estimates show that net debt is projected to rise to $13011 million in 2015-16 (11.2% of South Australia's GSP).

Chart 9.3 – South Australian non-financial public sector net indebtedness 2006-07 to 2015-16



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

The general government sector is estimated to have net debt of $4282 million at the end of 2011-12. Over the forward estimates net debt increases in this sector by $4473 million to $8755 million. The increase in general government debt is mainly due to the Government's significant investment program, including the new Royal Adelaide Hospital, resulting in a net lending deficit until 2015-16.

Net debt of the PNFCs increases by $128 million over the same period to $4256 million.

Chart 9.3 highlights that in 2011-12 debt in the general government sector increases to levels consistent with that found in the PNFC sector. From 2012-13 debt in the general government sector is estimated to grow at a higher rate than the PNFC sector.

The main holder of debt in the PNFC sector is SA Water. SA Water is a commercial business servicing its debt from business revenues.

SA Water's debt is mainly attributable to water security projects including the building of the $1824 million Adelaide Desalination Plant and the $403 million North-South Interconnection System. These projects are forecast for completion in 2012-13. In 2011-12, SA Water will account for around 86.2% of the total PNFC sector net debt. SA Water's net debt is forecast to decline in 2013-14 and increase by 2015-16 to $3679 million.

The 2012-13 Budget Papers state that the PPP (capital component) arrangement for the new Royal Adelaide Hospital is to be recognised as a finance lease in the Balance Sheet and consequently have an impact on net debt and net financial liabilities. Further detail is provided in sections 8.2.9 and 9.6.3 of this Report.

Table 9.7 explains the expected movements in net debt for the general government sector at the time of the 2011-12 Budget.

Table 9.7 – Reconciliation of movements in general government net debt as at the 2011-12 Budget

	2011-12 Estimated result $'million	2012-13 Budget $'million	2013-14 Budget $'million	2014-15 Budget $'million	2015-16 Budget $'million
Opening general government net debt	**2 930**	**4 282**	**5 329**	**6 398**	**6 508**
General government cash surplus/deficit	-1 240	-1 952	- 1 101	- 103	581
Add: Net cash flows from equity transactions	-101	900	24	-13	-16
Less:					
Assets acquisition under finance leases	-2	-	-	-	-2 820
Other adjustments	-9	5	8	6	8
Improvement/deterioration to general government net debt	**-1 352**	**- 1 047**	**- 1 069**	**- 110**	**- 2 247**
Closing general government net debt	**4 282**	**5 329**	**6 398**	**6 508**	**8 755**

Note: Table may not add due to rounding

9.6.3 Debt affordability and servicing

Chart 9.3 highlights the increase in public sector net debt over the period 2011-12 to 2015-16. At the end of 2011-12 total non-financial public sector net debt is estimated to represent 9% of GSP compared to 11.2% in 2015-16.

The Budget records that the net debt increase includes the financial obligations for the new Royal Adelaide Hospital lease liability, which will appear on the general government Balance Sheet for the first time in 2015-16. This is estimated to add $2.8 billion to net debt at that time.

9.6.4 Debt management policy

SAFA has been delegated the responsibility for managing the debt of the South Australian Treasurer.

A portion of this debt is actively managed within limits authorised by the Treasurer, while other debt (CPI indexed debt and Commonwealth State Housing debt) is managed on a passive basis. Any losses or gains made on the settlement of these transactions is to the Treasurer's account, resulting in either an increase or decrease in the amount owed by the Treasurer. SAFA's debt management performance is measured against benchmarks approved by the Treasurer.

The Treasurer's approved policy for benchmark duration applied during the 2011-12 financial year is between one to 1.5 years. Lower duration benchmarks offer lower average interest costs over the long-term but with possible higher short-term budget volatility.

During 2011-12 SAFA's funding task, after the budget and MYBR, was forecast at $4.5 billion comprising:

- $1.6 billion for the SA public sector
- $2.9 billion to refinance existing debt.

During 2011-12 SAFA issued two new Select Lines, effectively lengthening the State's refinancing profile. In September 2011 SAFA issued $1.25 billion of a new May 2021 Select Line and in April 2012 SAFA issued $750 million of a new August 2019 Select Line. These new lines were predominately used to fund loans to the Treasurer and SA Water.

Additional commentary on the maturity profile of SAFA's Select Lines is included under the heading 'Further commentary on operations' in the section titled 'South Australian Government Financing Authority' in Part B of this Annual Report to Parliament.

9.7 Other non-financial public sector liabilities

Other NFPS liabilities estimated as at 30 June 2012 comprise other employee benefits ($2211 million), payables ($1132 million), other liabilities ($914 million), advances received ($590 million) and deposits ($186 million).

Other employee benefits include long service leave provisions ($1541 million estimated result for 2011-12), annual leave liabilities ($497 million estimated result for 2011-12) and salaries and wages liability ($148 million).

Significant individual balances in liabilities include amounts that are subject to estimation processes similar to that applying to the estimation of superannuation liabilities. They include:

- estimated long service leave provisions amounting to $1541 million as at 30 June 2012 and budgeted to increase to $1609 million by 30 June 2013. Long service leave is calculated by an estimation process in accordance with AASs

- estimated workers compensation provisions totalling $388 million are estimated as at 30 June 2012, increasing to $398 million at 30 June 2013.

9.8 Contingent liabilities

As reported in the Budget Papers[25] contingent liabilities are those that have not been recognised in the Balance Sheet, but rather are disclosed in notes to the accounts.

Reasons for this are:

- there is significant uncertainty as to whether a sacrifice of future economic benefits will be required

- the amount of the liability cannot be measured reliably

- there is significant uncertainty as to whether an obligation presently exists.

Contingent liabilities of the Government can arise from:

- legislative provisions requiring the Government to guarantee the liabilities of public sector organisations, eg financial institutions

- the ordinary activities of the Government might give rise to disputes and litigation that remain unresolved at any given balance date.

Guarantees and contingent liabilities of the Government of South Australia as at 30 June 2011 were valued at $848 million ($842 million as at 30 June 2010). Guarantees are valued at nominal values without adjustment for the probability of actual liabilities occurring.

9.8.1 Service risks and contingent liabilities

Agencies must continue to properly manage against incurring long-term liabilities arising from the inherent risks in the delivery of public services such as health, welfare, education, corrections, public housing and how duty of care responsibilities are exercised. Matters that have arisen over a number of years highlight the importance of public sector entities understanding the nature of risk in their circumstances and having relevant controls and processes in place to mitigate and monitor identified risks.

[25] Budget Statement 2012-13, Budget Paper 3, pages 112-113 provides a summary of contingent liabilities.

9.9 Natural Disaster Relief and Recovery Arrangements

The Australian Government provides funding to states and territories through the NDRRA to help pay for natural disaster relief and recovery costs. The amount of NDRRA reimbursement for natural disaster costs for each State or Territory is dependent on set thresholds.

These arrangements apply to the following natural disasters:

- bushfire
- earthquake
- flood
- storm
- cyclone
- storm surge
- landslide
- tsunami
- meteorite strike
- tornado.

The NDRRA do not apply to drought, frost, heatwave, epidemic or events resulting from poor environmental planning, commercial development or personal intervention.

The NDRRA are based on terms and conditions in the NDRRA Determination.

During 2010-11 the Australian Government amended these arrangements, introducing a requirement for each state and territory government to have regular, independent assessments of their insurance arrangements and provide these assessments to the Commonwealth for review.

During 2011-12 SAFA engaged an external consultant to review its catastrophe reinsurance program in accordance with a Determination under the NDRRA. The final report was submitted to the Commonwealth in September 2011 and an independent review of this Report was released by the Commonwealth in March 2012.

The Commonwealth's review provided the following conclusions on South Australia's annual reinsurance renewal process:

- The State's submission demonstrates that it has explored an appropriate range of insurance options available to it.

- The State has assessed options for non-road assets on a cost-benefit basis.

- The low level of support provided by the Commonwealth to the State under the NDRRA indicate that the State's arrangements have been cost effective to the Commonwealth. However the Commonwealth were unwilling to draw a firm conclusion on this matter as the past efficacy of the reinsurance arrangements was not presented in the State's submission.

- It would appear that the State has attempted to minimise the financial exposure borne by taxpayers for assets covered by SAFA.

The Commonwealth's review highlighted that the State had not provided cost-benefit assessments for its decision on terrorism cover or the absence of reinsurance coverage for road assets.

The Commonwealth's review recommended that SAFA:

- resubmit information to the Commonwealth once it has completed a cost-benefit analysis for the reinsurance of road assets
- present cost-benefit analysis to support its decision on terrorism coverage in its next submission
- present cost-benefit analysis of past reinsurance arrangements for its next annual submission to support the cost effectiveness of the reinsurance arrangements
- in its next submission, include all assets that it considers could be classified as essential public assets and covered by the NDRRA and therefore excluded from its reinsurance arrangements.

10 Comparison with other states

10.1 Some observations

The purpose of this analysis is to draw attention to trends for this State over time and the relative differences between jurisdictions. No suggestions are made as to what is regarded as optimal. However, significant variations or negative trends would warrant consideration as to the related implications.

Across jurisdictions these indicators are influenced by varying valuation approaches for both assets and liabilities, differences in the type and level of infrastructure, as well as higher state debt levels. Infrastructure can also be provided through the private sector and therefore not be included in government data.

Prior to forming conclusions it is critical that any assessment made incorporates a sound understanding of the prevailing, specific circumstances in each state. Audit has not sought to provide all of the relevant information in this Report. Rather the opportunity is taken to show what each state is forecasting through to 2015-2016.

The following table shows 2012-13 budgeted total revenue for each state.

Table 10.1 – 2012-13 Budgeted general government total revenue by state

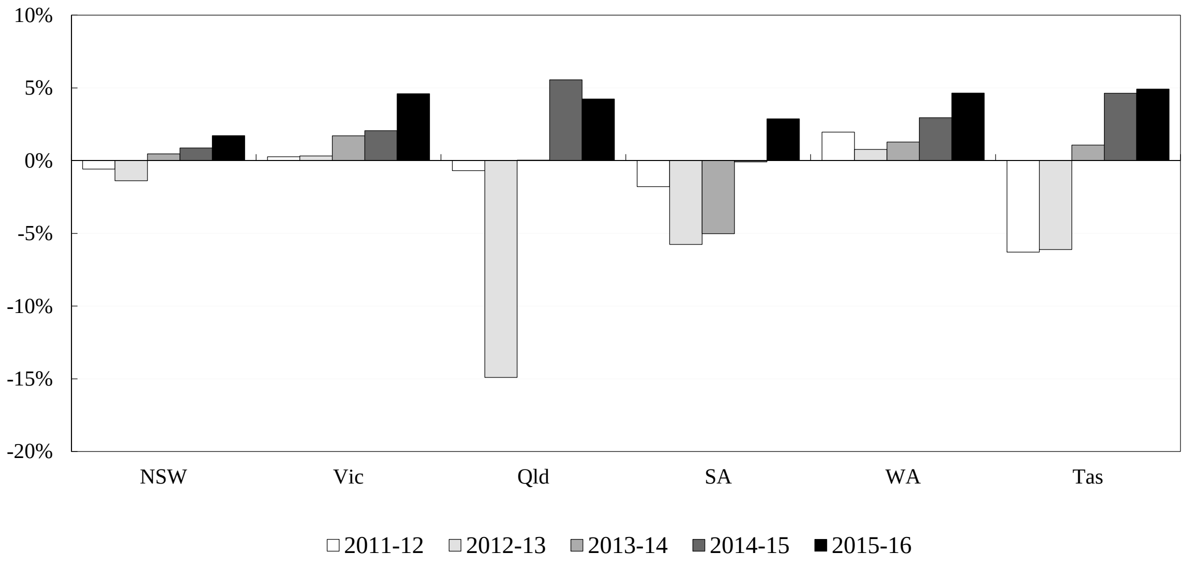
State	NSW	Vic	Qld	WA	SA	Tas
	$'million	$'million	$'million	$'million	$'million	$'million
Total revenue	59 727	48 357	42 224	25 477	15 059	4 632

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

10.2 Operating Statement

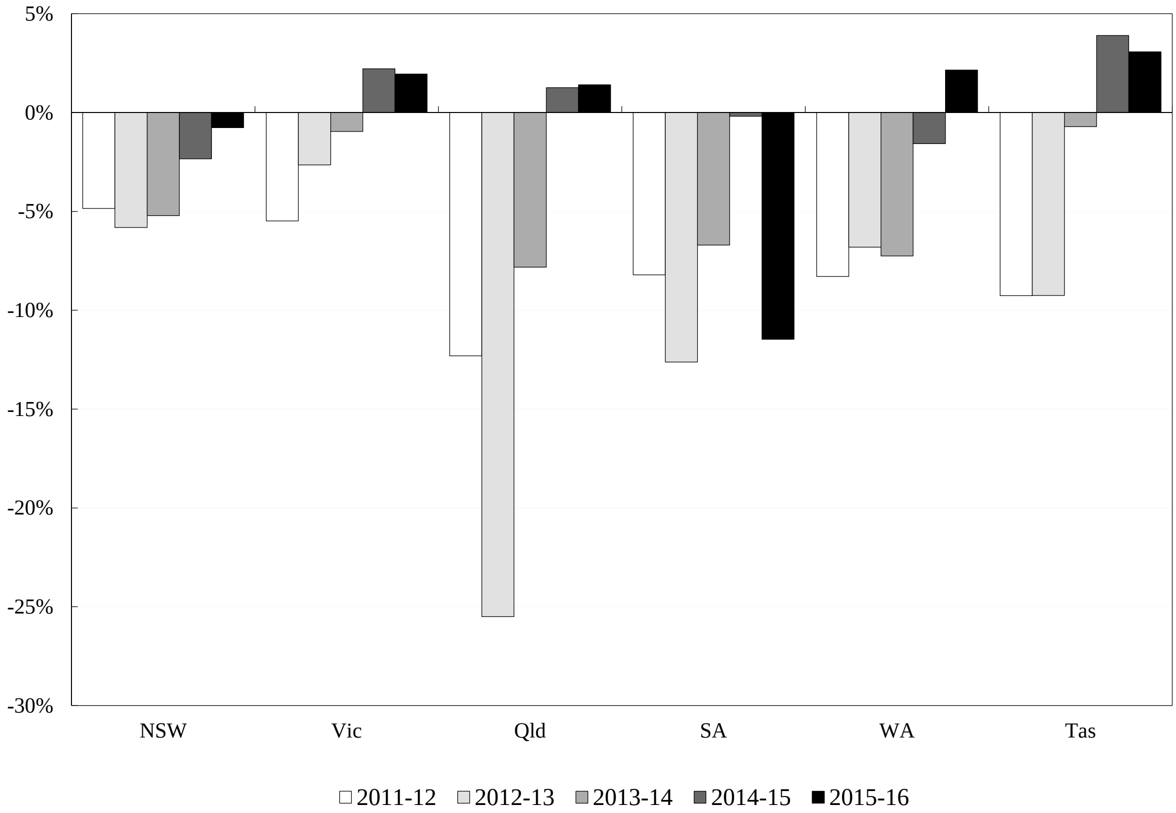
The following charts compare some trends in the GFS information with other states using 2012-13 Budget data.

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



All states except Victoria and Western Australia have projected negative ratios for the 2012-13 financial year. Chart 10.1 also shows that all states except Victoria and Western Australia have net operating deficits budgeted for 2012-13. Across the forward estimates operating results vary widely between jurisdictions.

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



As detailed in chart 10.2, all states are estimating net lending deficits until 2013-14, with New South Wales and South Australia showing deficits continuing until 2015-16. South Australia's forecast net lending deficit of $2045 million in 2015-16 reflects the impact of the new Royal Adelaide Hospital. Financial reporting for the new Royal Adelaide Hospital is commented on in section 8.2.9.1 of this Report.

Chart 10.2 shows that, with the exception of 2015-16, the trend in South Australia's net borrowing as a proportion of total revenues is reasonably consistent with other states over the four years.

10.3 Balance Sheet

10.3.1 Ratio of net financial liabilities to revenue

The Government has established a new debt fiscal target - a maximum ratio of net debt to revenue of 50%. This differs to a broader measure used in previous years of net financial liabilities to revenue. Net financial liabilities include the present value of the unfunded superannuation liability, which can fluctuate significantly from year to year depending on the discount rate used to calculate the liability. The rate used by each State in presenting their Budget varies, making direct comparison problematic.

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

Chart 10.3 – Ratio of net financial liabilities to revenue

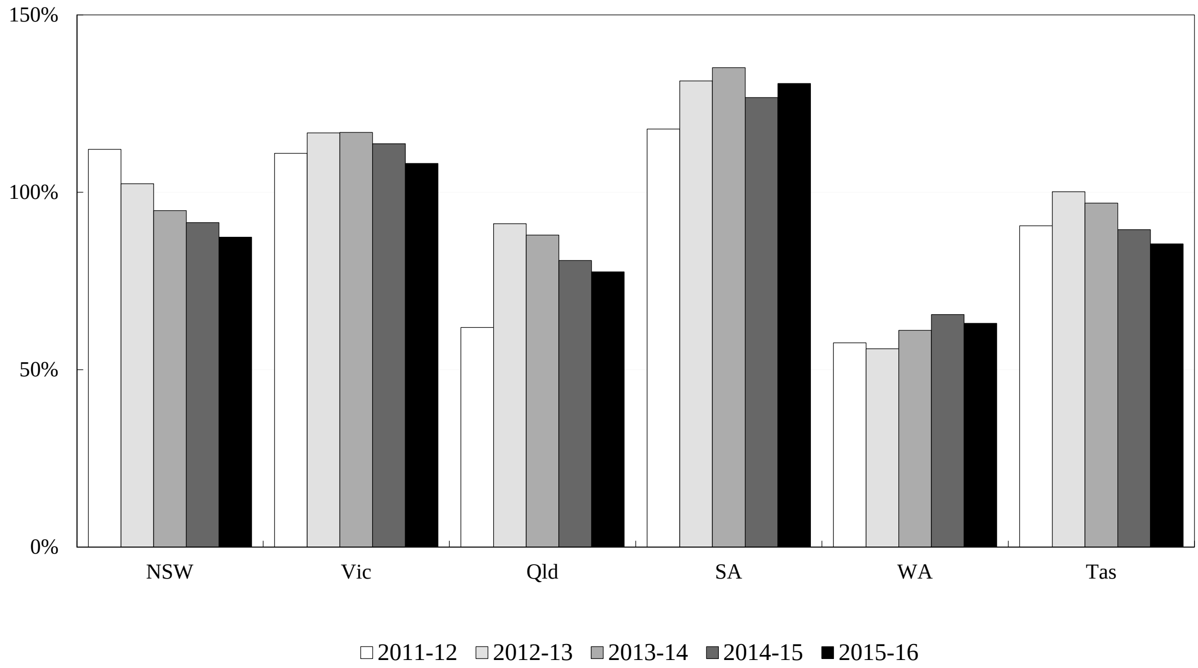


Chart 10.3 shows the 2012-13 Budget settings result in the ratio for South Australia fluctuating slightly over the next four financial years to 2015-16. It is evident that Western Australia, New South Wales, Victoria, Queensland and Tasmania are showing a general decline over the forward estimates to 2015-16.

South Australia's ratio has been impacted by a significant:

- increase in the unfunded superannuation liability due to the required use of lower discount rates to calculate the liability
- deterioration in GST and taxation revenue estimates.

11 Treasurer's Statements

11.1 Treasurer's Statements - *Public Finance and Audit Act 1987*

The Treasurer's Financial Statements are prepared pursuant to the PFAA to report on transactions and balances in the public accounts.

The main public accounts are the Consolidated Account and special deposit accounts and deposit accounts established pursuant to the PFAA.

A high proportion, but not all, of public monies are received and expended through the Consolidated Account. The main receipts to the Consolidated Account are State taxation and Commonwealth general purpose grants to the State.

Special deposit accounts and deposit accounts are used by almost all agencies as their main operating account. The Treasurer's Financial Statements report only the closing balances of these accounts. Detail of agency transactions are in the individual general purpose financial statements of agencies.

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

The Treasurer's Financial Statements are reported, in full, in the appendix to Part B of this Annual Report to Parliament.

11.2 Scope of audit of the Treasurer's Statements

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

- testing of appropriations from the Governor's Appropriation Fund, Contingency Funds and other payments
- establishment and changes to Treasurer's special deposit accounts and deposit accounts
- updating and recording of the Treasurer's loans
- maintenance of the central general ledger.

The results of audit work undertaken identified certain areas where improvements could be made. Review findings are provided under the 'Audit findings and comments' heading in the section titled 'Department of Treasury and Finance' in Part B of this Annual Report to Parliament.

11.3 The Consolidated Account outcome

The following table sets out total appropriation authority and actual payments for the Consolidated Account in 2011-12.

Table 11.1 – 2011-12 appropriation authority and payments

	Appropriation authority $'million	Actual payments $'million
Appropriation Act 2011	12 740.3	12 546.4
PFAA, section 15	42	42
Governor's Appropriation Fund	374.5	151.2
Specific appropriations authorised in various Acts	119.4	117.5
Total	13 276.2	12 857.1

The result on the Consolidated Account and variations from budget for 2011-12 were as follows.

Table 11.2 – 2011-12 Consolidated Account result

	2011-12 Budget $'million	2011-12 Actual $'million	Variation $'million
Total receipts	11 553.1	11 382.4	(170.7)
Total payments	12 859.7	12 857.1	(2.6)
Consolidated Account financing requirement	(1 306.6)	(1 474.7)	(168.1)

The deficit of $1474.7 million ($1779.4 million deficit in 2010-11) is reflected in an increase in net debt serviced from the Consolidated Account as shown in Statement J of the Treasurer's Statements.

The key differences between actual and budgeted amounts were:

- ***Receipts*** – main items exceeding budgetary expectations (increase against budget) included the return of cash to Consolidated Account – Cash Alignment Policy ($346.5 million from a zero estimate), Defence SA equity contribution repayment ($178 million), SA Water dividend ($79.9 million or 57.8%), Adelaide Convention Centre equity contribution repayment ($22.3 million from a zero estimate) and interest recoveries from non-commercial public trading enterprises ($16.4 million or 103%).

  These were offset by lower than anticipated (decrease against budget) South Australian Housing Trust repayment of advances ($219.5 million or 74.3%), GST revenue grants from the Commonwealth ($213.0), stamp duties ($164.3 million or 11.3%) and the absence of a budgeted $58.7 million dividend from the Land Management Corporation.

- ***Payments*** – lower than anticipated budgeted expenditure noted for the Department of Planning, Transport and Infrastructure ($66.5 million or 9.5%), Department of Further Education, Employment, Science and Technology ($25.8 million or 6.3%), and the Department of the Premier and Cabinet ($17.3 million or 13.3%). These were primarily offset by higher than anticipated expenditure amounts for the administered items for DTF ($154.9 million or 8%).

Consistent with the prior year, in 2011-12 significant amounts were appropriated to agencies as equity. The main equity contributions were to the Department for Transport, Energy and Infrastructure ($524.3 million) and the Department for Health and Ageing ($214.7 million). Equity funding is credited directly to an agency's Statement of Financial Position, not through the Statement of Comprehensive Income. For further comment see section 11.6 of this Report. Details of the Budget and actual data are presented in Statement A – Comparative Statement of the Estimated and Actual Payments from the Consolidated Account of the Government of South Australia.

11.4 Appropriation flexibility

Flexibility in appropriation authority arises from the provision of sources of funds for additional/new initiatives or unforeseen cost pressures that can be used without a requirement to return to Parliament for additional appropriation authority. This flexibility is provided by a combination of legislative provisions and budget practices.

The following table sets out relevant items for 2011-12.

Table 11.3 – Appropriation flexibility

	Authority/ budget $'million	Actual payments $'million
Governor's Appropriation Fund	374.5	151.2
Contingency provisions in administered items for DTF	570.4	376.0
PFAA, section 15	42	42
Total flexibility	986.9	569.2

Use of these provisions requires the Treasurer's approval. Use of contingency provisions does not affect the Budget result as they are already figured into that result.

11.4.1 Governor's Appropriation Fund and contingency provisions

Section 12 of the PFAA provides for the Governor's Appropriation Fund (GAF). Generally the GAF is used to fund new Government initiatives or to meet unexpected expenditure needs.

Details of the purpose of appropriations from the GAF are provided in Statement K – Governor's Appropriation Fund of the Treasurer's Statements. The main items were as follows.

Table 11.4 – Main Governor's Appropriation Fund payments

Agency	Purposes	Actual payments $'million
Department of Treasury and Finance	Additional appropriation being the source of funds for the equity contribution to the Urban Renewal Authority.	$112.948
Attorney-General's Department	Represents additional appropriation that the department would have received for the Office of Recreation and Sport if not for machinery of government changes.	$10.150
Department of Education and Child Development	Reprofiling of PPP arrangements and additional support for Families SA to meet growth in number of children in state care.	$7.904

11.4.2 Contingency provisions

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

Details of payments from the contingency funds are provided in Statement L – Statement of Other Transfers from the Administered Items for the Department of Treasury and Finance. Payments are transfers of additional funding to agencies.

The main items were as follows.

Table 11.5 – Main contingency provision payments

Agency	Total payments $'million
Department of Planning, Transport and Infrastructure	161.757
Department for Health and Ageing	72.293
South Australia Police	26.341
Administered Items - Attorney-General's Department	24.618
Department of Education and Child Development	21.807
Department for Communities and Social Inclusion	14.987

11.4.3 Appropriation by the Treasurer for additional salaries, wages etc

Section 15 of the PFAA provides that the Treasurer may appropriate from the Consolidated Account an amount sufficient to cover increases in public sector salaries, wages, allowances, payroll tax or superannuation contributions arising by reason of the award, order or determination of a court, tribunal or other body empowered to fix salaries, wages or allowances.

As with the Governor's Appropriation Fund, use of this provision adds to the amount appropriated by Parliament each year and may affect the Budget result where these are unbudgeted expenses.

In 2011-12 $42 million was appropriated by the Treasurer pursuant to section 15. This amount was added to the line 'Administered Items for Department of Treasury and Finance'. Payments are reflected against that line. In 2010-11 the amount appropriated by the Treasurer was $28.53 million.

11.4.4 Appropriation transfers

In addition to the preceding provisions, appropriation can be transferred between agencies. Section 13 of the PFAA provides authority where excess funds exist for one agency and are necessary for another.

Section 5 of the *Appropriation Act* provides authority where restructuring of an agency occurs so that appropriation related to transferring functions may in turn be transferred. No section 13 transfers occurred in 2011-12. Section 5 transfers are detailed in Statement A of the Treasurer's Statements.

11.5 Special deposit accounts and deposit accounts

Most appropriation from the Consolidated Account is transferred to special deposit accounts and deposit accounts established pursuant to the PFAA. Under related provisions, monies credited to those accounts can be spent without further appropriation from Parliament. This is of significance in that monies appropriated in one year and transferred to a deposit account need not actually be expended in that year, that is, they may be carried over into the next year unless required by the Treasurer to be paid to the Consolidated Account.[26]

Table 11.6 shows that over $3370.8 million are held in special deposit accounts and deposit accounts as at 30 June 2012, up $452.4 million from the previous year.

Table 11.6 – Special deposit accounts and deposit accounts

	2010-11 $'million	2011-12 $'million	Increase/ (decrease) $'million
Special deposit accounts	2 324.6	2 686.7	362.1
Deposit accounts	593.8	684.1	90.3
Total	2 918.4	3 370.8	452.4

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 Statements F, F(1), F(2) and G.

The largest balances at 30 June 2012 were:

- ***Special deposit accounts*** – Accrual Appropriation Excess Funds ($413 million), Highways Fund ($349 million), Treasury and Finance Administered Items – Intergovernmental Agreement on Federal Financial Relations ($309 million).
- ***Deposit accounts*** – South Australian Housing Trust ($138 million), Agents Indemnity Fund ($54 million), Rail Transport Facilitation Fund ($45 million) and SAFECOM Operating Account ($39 million)

Account balances are subject to the Treasurer's cash alignment policy that aims to minimise balances as discussed below.

11.5.1 Accrual Appropriation Excess Funds Account

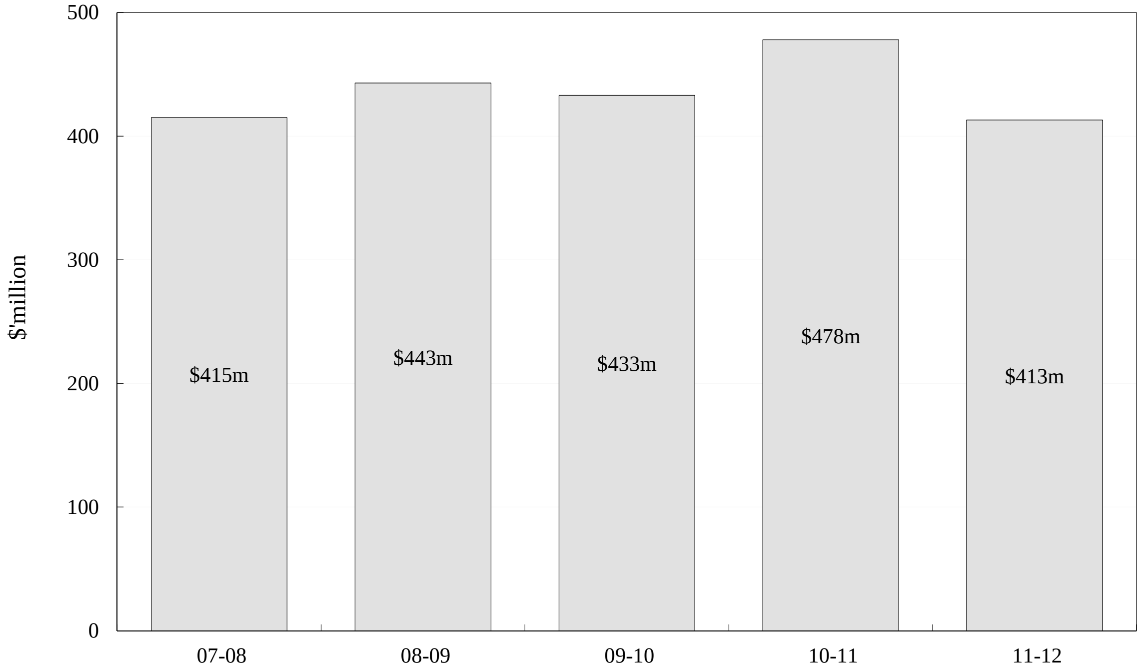
The approved purpose of the Accrual Appropriation Excess Funds Account is to record all receipts and payments associated with surplus cash balances generated in agencies by the shift to accrual appropriations.

Accrual appropriations are made to agencies for accruing leave liabilities (the value of the

[26] PFAA section 8(5) - Any surplus of income over expenditure standing to the credit of a special deposit account must, at the direction of the Treasurer, be credited to the Consolidated Account.

leave entitlement accruing to employees for the year rather than just the amount paid to employees taking leave in the year) and depreciation expenses.

Chart 11.1 – Accrual Appropriation Excess Funds Account



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

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

The operations of the Account are included in the DTF administered financial statements, which are included in Part B of this Annual Report to Parliament. The balance in the Account at 30 June 2012 was $309 million. This entire balance is committed to various South Australian Government agencies to fulfil requirements under the Intergovernmental Agreement on Federal Financial Relations agreements.

11.5.3 Cash alignment policy

The Government has a cash alignment policy to align agency cash balances with appropriation and expenditure authority. Pursuant to the policy, payments are required to be made to return surplus cash to the Consolidated Account. All special deposit accounts are reviewed at least annually to determine whether there was surplus cash in an account. The policy supports the Treasurer's discretionary power to require surplus funds in special deposit accounts to be paid to the Consolidated Account.

A total of $346.523 million ($96.6 million in 2010-11) of surplus cash was returned to the Consolidated Account during 2011-12. The main amounts were as follows.

Table 11.7 – Cash alignment policy repayments

Agency	**Total payments $'million**
Department of Treasury and Finance – Administered Items	244.925
Department of Education and Child Development	29.519
Department of Communities and Social Inclusion	17.938
Department of Premier and Cabinet	14.320
Defence SA	13.585
Department of Communities and Social Inclusion - Administered Items	8.060
Department of Primary Industries and Regions	6.865
South Australia Police	5.666
Department of Manufacturing, Innovation, Trade, Resources and Energy	5.054
Department of Correctional Services	0.591

11.6 Equity contributions

Equity contributions to agencies are provided based on a DTF policy that provides guidance on budgeting for employee entitlements, depreciation, investing payments and appropriation, and for the operation of the Accrual Appropriation Excess Funds Account (AAEFA). Under the policy, agencies are provided with sufficient operating appropriation to fund their net operating expenses, including depreciation and employee entitlements.

Most investing payments are funded out of the appropriation provided to agencies for depreciation. In cases where net investing payments are less than the appropriation provided for depreciation, the surplus appropriation will be deposited into the AAEFA for future use. If the net cash requirement for investing payments exceeds depreciation, the cash shortfall is funded from the AAEFA or via an equity contribution if the balance in the AAEFA is not sufficient.

Treasurer's Instruction 3 'Appropriation' provides that where the First Schedule to the *Appropriation Act* requires that money be appropriated to a public authority as a contribution of equity, as a loan or for program funding, the Treasurer acquires a financial interest in the net assets of the public authority concerned. Monies issued or applied from the Consolidated Account pursuant to this instruction are not to be reported by the public authority as revenues in the period in which they are received, but are to be shown separately in the public authority's statement of financial position, as a contribution of equity by the Government of South Australia.

Total equity contributions as at 30 June 2012 were $3401 million. Details of equity contributions provided to agencies are set out in the Treasurer's Statements – Statement I Indebtedness of the Treasurer.

12 Whole-of-government/General government consolidated financial report

AASB 1049 Whole of Government and General Government Sector Financial Reporting requires the preparation of both Whole-of-Government (WHOG) and general government sector financial reports. Accordingly, both WHOG and general government sector financial reports form one CFR and are required to be issued at the same time as the final budget outcome by DTF.

At present there is no requirement under the PFAA or other South Australian legislation to provide an independent audit opinion on the preparation of WHOG or general government sector financial reports.

Due to the timing of the preparation of the CFR, the last completed report relates to the year ended 30 June 2011, therefore the following commentary has been kept purposely brief.

12.1 AASB 1049 key concepts

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

The CFR is not a general purpose financial statement. As such it is unique, and is influenced by two significant matters that affect the form and content of the report. Firstly, it is a requirement to prepare a financial report for the general government sector. Secondly, AASB 1049 requires use of a different accounting framework than that used by agencies when preparing their general purpose financial statements.

AASB 1049 requires financial reports to be prepared consistent with the principles and rules in the ABS publication 'Australian System of Government Financial Statistics: Concepts, Sources and Methods' (GFS Manual).

12.2 AASB 1049 and the reporting entity concept

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

12.3 Scope of consolidated financial report audit

Consistent with previous years there is presently no requirement under the PFAA or other legislation to provide an independent audit opinion on the preparation of the CFR. Therefore, unless relevant legislative provisions are passed, I will not issue a formal independent audit opinion on the CFR.

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. Consequently, sufficient work has been undertaken in order to provide observations to DTF with respect to the CFR annually since 1999.

The key features of the CFR audit include a review of:

- the principles adopted in defining the economic entity for CFR purposes
- the adequacy and reliability of the Hyperion database as a medium for the preparation of the CFR
- processes for the preparation of the CFR
- compliance with appropriate legislation and accounting frameworks, in particular AASs, Urgent Issue Group Consensus Views, Treasurer's Instructions, and other professional reporting requirements in Australia.

Limitations still exist with the current reporting process. Notwithstanding these limitations, the usefulness and importance of the report in providing an understanding of the broad structure of the State's financial position is recognised as a key reporting tool of the Government.

12.3.1 Audit findings and comments

Following the Audit review of the financial report for 2010-11, a management letter was forwarded to DTF in December 2011 that contained reporting and operational considerations that would need to be addressed in order to provide an unqualified audit opinion for the CFR. This would, of course, require legislation changes requiring such an opinion to be issued. The audit management letter was reproduced in full in the CFR report published by DTF.[27]

The matters raised included:

- completeness and accuracy of CFR items
- inclusion of unaudited data in the preparation of the CFR
- non-disclosure compliance with key AASB standards, some of which were associated with material balances reported within the CFR.

Departmental response

DTF responded to Audit's comments specifying that they were noted, and would be reviewed to determine whether required disclosures were able to be included in the 2011-12 CFR.

12.4 Consolidated financial report financial performance

The following discusses the financial performance for the WHOG as detailed in the CFR as at 30 June 2011. As previously discussed, data for the current year (due to the time needed for preparation) is not available at the time of this Report. The data below provides the opportunity to observe the financial result of the Government using a full accrual accounting basis, and the consolidation of all sectors. The consolidation process means that all inter-sector transactions are eliminated.

[27] Government of South Australia, CFR for the year ended 30 June 2011.

The following table summarises the WHOG financial performance per the CFR for the year ending 30 June 2011, with comparative amounts included for the prior year only. This table reflects the reporting and presentation requirements of AASB 1049.

Table 12.1 – CFR financial performance

	2011 $'million	2010 $'million
Revenue from transactions		
Taxation revenues	**3 478**	3 335
Grant revenue	**8 524**	9 224
Charges for goods and services	**4 366**	4 274
Interest income	**854**	613
Dividends and income tax equivalents	**42**	44
Other revenues	**673**	602
Total revenues from transactions	**17 937**	18 092
Expenses from transactions		
Employee expenses	**6 534**	6 345
Superannuation interest cost	**427**	455
Other superannuation expenses	**653**	631
Depreciation and amortisation	**1 077**	1 009
Use of goods and services	**4 288**	4 112
Interest expenses	**1 036**	784
Grant expenses	**2 359**	2 659
Other operating expenses	**1 478**	1 409
Total expenses from transactions	**17 851**	17 404
Net result from transactions - Net operating balance	**86**	688
Other economic flows - included in net result		
Net foreign exchange gains	**409**	428
Net gain/loss on sale of non-financial assets	**25**	39
Net gain/loss on financial assets or liabilities at fair value	**(117)**	(2)
Net actuarial gains (losses) of superannuation defined benefit plans	**403**	(490)
Other net actuarial gains (losses)	**(305)**	(194)
Other economic flows	**(68)**	(52)
Total economic flows included in net result	**347**	(271)
Net result	**433**	416
Other economic flows - other non-owner movements in equity		
Changes in property, plant and equipment ARR	**2 411**	11 592
Net gain on financial assets at fair value	**5**	12
Prior period adjustments	**7**	2,265
Total other economic flows - non-owner movements in equity	**2 423**	13 870
Comprehensive result - change in net worth	**2 856**	14 286
Total change in net worth	**2 856**	14 286

Key fiscal aggregates		
Net operating balance	**86**	688
Less: Net acquisition of non-financial assets	**1 904**	2 584
Net lending/borrowing	**(1 818)**	(1 896)

The main variations in revenues in 2010-11 were as follows:

- ***Grant revenue*** – decreased by 7.6% or $700 million. This decrease was mainly driven by a decline in both current and capital Commonwealth national partnership grants of $300 million and $742 million respectively. Offsets included a $138 million increase in current Commonwealth specific purpose grant receipts, as well as a $276 million increase in general purpose grants.

- ***Interest income*** – increased by 39.3% or $241 million. The increase was mainly driven by higher interest returns generated by SAFA ($170 million) as well as agency interest earnings principally from bank deposits ($63 million).

The main variations in expenses in 2010-11 were as follows:

- ***Employee expenses*** **–** increased $189 million or 3%. This increase was due mainly to rising salary and wages costs of $215 million offset by a reduction in TVSPs payments of $82 million.

- ***Interest expenses*** **–** increased $252 million or 32.1%. This increase was due mainly to an increase in borrowings of $244 million.

- ***Grant expenses*** **–** decreased $300 million or 11.3%. This decrease was mainly due to a decline in both subsidies ($103 million) and capital transfer payments ($128 million) issued.

12.5 Consolidated financial report financial position

The following table summarises the WHOG financial position result per the CFR for the year ending 30 June 2011, with a comparative amount included for the prior year only. This table reflects the reporting and presentation requirements of AASB 1049.

Table 12.2 – CFR financial position

	2011 $'million	**2010 $'million**
Assets		
Financial assets		
Cash and deposits	**838**	583
Receivables	**2 045**	862
Advances paid	**2 212**	1 842
Investments, loans and placements	**7 097**	8 266
Investments - other	**14 729**	12 698
Interest in joint venture	**721**	727
Total financial assets	**27 643**	26 218
Non-financial assets		
Produced assets:		
Inventories	**432**	429
Machinery and equipment	**2 525**	2 682
Buildings and structures	**42 071**	38 854
Heritage assets	**1 129**	864
Biological assets	**723**	769
Intangibles	**134**	115
Non-financial assets held for sale	**55**	43
Other non-financial assets	**166**	132

	2011 $'million	2010 $'million
Non-produced assets:		
Land	**12 464**	11 500
Intangibles	**158**	134
Non-financial assets held for sale	**109**	46
Total non-financial assets	**59 966**	55 569
Total assets	**87 609**	81 787
Liabilities		
Deposits held	**248**	275
Borrowing	**12 331**	11 136
Payables	**2 361**	2 421
Employee benefits	**2 110**	2 010
Superannuation	**9 096**	9 478
Superannuation fund deposits	**14 303**	12 405
Provisions (other than employee benefits)	**5 572**	5 270
Other liabilities	**874**	933
Total liabilities	**46 894**	43 928
Net assets (liabilities)	**40 714**	37 859
Equity		
Retained earnings	**4 192**	3 497
Reserves:		
Asset revaluation reserve	**35 724**	33 507
Other reserves	**783**	843
Financial assets available for sale reserve	**15**	13
Total equity (Net worth)	**40 714**	37 859

The main variations in assets in 2010-11 were as follows:

- ***Cash and deposits*** – increased $255 million or 44%. This was driven by an increase in cash and cash equivalent holdings of $255 million with term deposits remaining steady.

- ***Investments, loans and placements*** – decreased $1169 million or 14%. This decrease is due mainly to a decline in marketable debt security holdings of $1469 million, offset by increases in other investments of $271 million.

- ***Investments – other*** – increased $2031 million or 16%. This increase is due mainly to a rise in government equity holdings in listed and unlisted entities of $1208 million and $824 million respectively.

- ***Buildings and structures*** – increased $3217 million or 8%. This increase is due mainly to increases in buildings at fair value of $1077 million, and water, sewerage and drainage assets at fair value of $1302 million.

The main variations in liabilities in 2010-11 were as follows:

- ***Borrowing*** – increased $1195 million or 11%. This increase is due mainly to an increase in debt security holdings $1064 million.

- ***Superannuation fund deposit liabilities*** – increased $1898 million or 15%. This reflects an increase in the liability of Funds SA to all superannuation plans.

Appendix

Acronyms used in this Report

Acronym	Description
AAS	Australian Accounting Standard[1]
AASB	Australian Accounting Standards Board
ABS	Australian Bureau of Statistics
CFR	Consolidated financial report
CPI	Consumer price index
DTF	Department of Treasury and Finance
FTE	Full-time equivalent
GAAP	Generally accepted accounting principles
GFS	Government Financial Statistics
GSP	Gross state product
GST	Goods and services tax
HFE	Horizontal fiscal equalisation
MYBR	Mid-year budget review
NDRRA	Natural Disaster Relief and Recovery Arrangements
NFPS	Non-financial public sector
NPP	National Partnership current and capital payment
PFAA	*Public Finance and Audit Act 1987*
PFC	Public financial corporation
PNFC	Public non-financial corporation
PPP	Public Private Partnership
SAFA	South Australian Government Financing Authority
SAHP	SA Health Partnership
SBCC	Sustainable Budget Cabinet Committee
SPP	Specific purpose current and capital payment
TVSP	Targeted voluntary separation package
UPF	Uniform presentation framework
WorkCoverSA	WorkCover Corporation of South Australia

[1] 'Australian Accounting Standards' means accounting standards issued by the Australian Accounting Standards Board that are in force in relation to the reporting period to which the financial report relates.