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SOUTH AUSTRALIA

Report

of the

Auditor-General

Annual Report
for the
year ended 30 June 2009

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Part C: State Finances and Related Matters

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2009

Report of the Auditor-General
Annual Report for the year ended 30 June 2009

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STATE FINANCES AND RELATED MATTERS

1 INTRODUCTION

This part of the Report 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.

Limitations on audit analysis

Most of the audit analysis in this Report is based on data provided in the Budget Papers, particularly for the 2009-10 Budget, supplemented with information provided by the Department of Treasury and Finance (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 2008-09. 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.

2.2 FISCAL STRATEGY

Since my last Report, the then emerging global credit crunch became the global financial crisis and dramatically ended a run of years of strong economic performance that were characterised by exceptional growth of revenues and expenses. The striking effect on the State's finances and government response to this crisis is illustrated in the changes between the 2008-09 Budget, before the crisis hit, and the 2009-10 Budget, after the crisis took hold. Table 2.1 highlights the main differences of what was estimated for 2009-10 in the two Budgets.

Table 2.1 — Effect of the global financial crisis on estimates for 2009-10

	2009-10 in 2008-09 Budget $'million	2009-10 in 2009-10 Budget $'million	Difference $'million	Difference Percent
Revenue	13 722	14 444	722	5
Expenses	13 366	14 748	1 382	10
Net operating balance	356	(304)	(660)	(185)
Purchases of non-financial assets	1 694	2180	486	29
Less: Sales and depreciation	749	943	194	26
Net acquisition of non-financial assets	945	1 237	292	31
Net lending (borrowing)	(589)	(1 541)	(952)	(161)
Cash surplus	(545)	(1 540)	(995)	183
Net debt	1 154	2 142	988	86
Net debt to revenue (percent)	8.4	14.8	6.4	76
Unfunded superannuation	7 062	9 790	2 728	39
Net financial liabilities	9 996	14 023	4 027	40
Net financial liabilities to revenue (percent)	72.8	97.1	24.3	33
Net worth	23 361	21 741	(1 620)	(7)

As can be seen, all key indicators shown in table 2.1 changed markedly in the year between budgets due to the effect on the local and national economies.

Operating deficits are now estimated for 2008-09 and 2009-10 rather than the previously budgeted operating surpluses. This, together with higher net capital spending, is a key driver of growth in net debt.

In the 2009-10 Budget, the Government advised that its fiscal strategy is to return the State to sustainable surpluses in the medium-term. To achieve this aim, the 2009-10 Budget contains a range of budget improvement measures, particularly from 2010-11. These build on measures announced in the 2008-09 mid-year budget review (MYBR) in December 2008.

The Government's current fiscal targets were set in the 2006-07 Budget.
However, two of the fiscal targets are not expected to be achieved in part of the period of the 2009-10 Budget namely:

- at least a net operating balance in the general government sector in every year. The Government advise this is not a realistic fiscal target in the short-term due to the global financial crisis. Net operating surpluses are not forecast until 2010-11.
- net lending outcomes that ensure the ratio of net financial liabilities[1] to revenue continues to decline towards that of other triple-A rated states. The ratio is forecast to increase across the forward estimates until declining in 2012-13. Most other triple-A rated jurisdictions are also experiencing increases in their ratios.

2.2.1 The State credit rating

Another of the fiscal targets is to ensure that risks to state finances are managed prudently to maintain a triple-A rating.

South Australia has had a triple-A credit rating since September 2004. In June 2009, at the time of the 2009-10 Budget, rating agencies Moody's and Standard & Poor's confirmed the rating was unlikely to change. Key factors to the agencies included:

- an expected only temporary peak in net financial liabilities, partly reflecting changes to discount rates
- savings measures announced which aim to support the operating position, restore budget balance and reduce borrowings
- a history of underspending capital budgets
- the State's positive record of financial performance
- relatively low debt burden.

Another factor underpinning the rating is the stable history of Commonwealth-State relations and the related support system and mechanisms such as the independent Grants Commission.

These factors indicate that despite the onset of the global financial crisis, the State was reasonably placed to meet the crisis and has set out a strategy, with the assistance of the Commonwealth Government, to respond to these difficult times.

Matters that the rating agencies identified they would monitor included the:

- reasonableness of budget assumptions
- Government's commitment to make necessary budget adjustments to improve financial and debt performance.

2.3 CHANGING FINANCIAL POSITION

The following chart shows changes occurring or anticipated in some of the key financial indicators over an 11 year period to 2012-13 for the general government sector.

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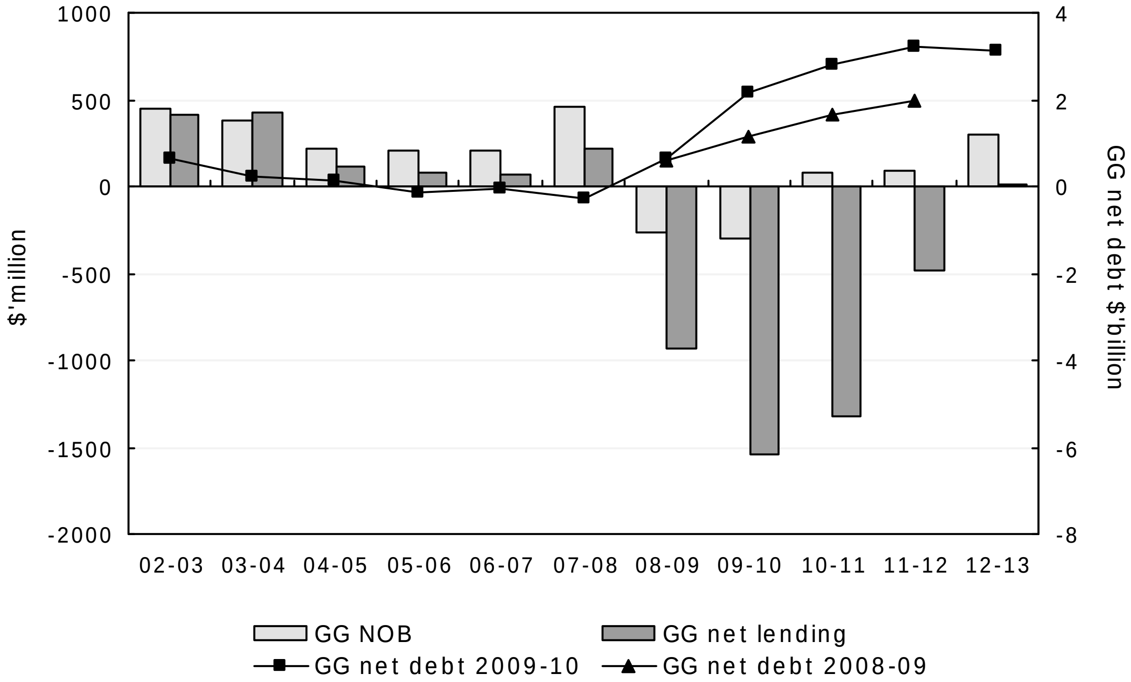
1 See section 4.1.2 of this Report.

Chart 2.1 — General government sector net operating balance (NOB), net lending and net debt



The chart shows the net operating deficits expected for 2008-09 and 2009-10 after six years of surpluses. Net operating surpluses are targeted to resume from 2010-11. Large net borrowing results and steeply rising net debt are projected from 2008-09 to 2011-12.

The Government adopted a strategy of net operating balance surpluses and net borrowing (lending deficits, to finance higher capital spending) in the 2006-07 Budget. This was expected to lead to rising net debt. The strategy was maintained through to the 2008-09 Budget but with net borrowing and net debt expected to increase with each budget in response to escalating capital programs. In fact, general government had net financial assets rather than net debt for the three years to 2007-08.

The GG net debt 2008-09 trend line illustrates what was expected in the 2008-09 Budget. The global financial crisis has led to much higher projected net borrowing for the three years to 2010-11. This adds about $1.2 billion more to net debt in 2011-12 than was estimated in the 2008-09 Budget. At the same time, the 2009-10 Budget, largely with Commonwealth support, provides for significant additional capital spending across the forward years than previously budgeted. This aims to provide a stimulus to the South Australian economy and support job creation.

2.4 OPERATING STATEMENT

2.4.1 Estimated results for 2008-09

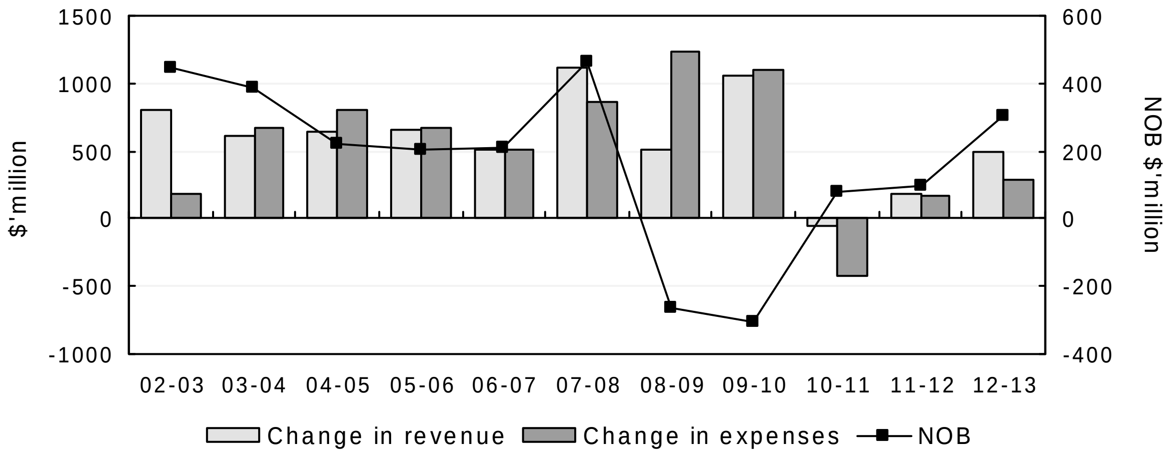
The 2009-10 Budget papers show that financial operations for 2008-09 are estimated to deteriorate by $425 million to an operating deficit of $265 million from the budgeted $160 million net operating balance surplus. This is essentially due to deteriorating Goods and Services Tax (GST) revenue grants and taxation revenue without equivalent reductions in general operating expenses. Overall revenues and expenses exceed budget but this is largely due to other Commonwealth funding arrangements and related flow though spending.

Net borrowing is estimated to be $932 million, compared to budget of $548 million, the difference being due to the fall in the net operating balance. Total net acquisition of non-financial assets is estimated to be slightly under budget.

2.4.2 Budget forecasts 2009-10 to 2012-13

The following chart shows some of the 2009-10 Budget targets against past experience.

Chart 2.2 — Annual change in general government sector revenue, expenses and net operating balance (NOB)



As shown, for the six years to 2007-08, net operating surpluses were achieved with annual expense increases generally matched or exceeded by revenue growth.

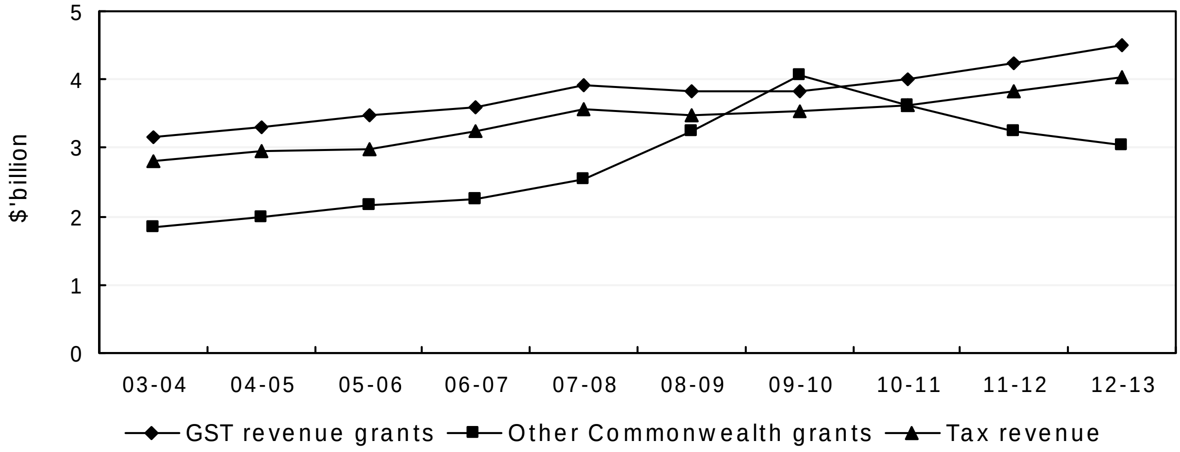
The net operating balance is projected to fall steeply to a deficit in 2008-09, drop further in 2009-10 and then, only two years after the crisis, return to surplus in 2010-11 provided that expenses fall. Revenues also fall, compared to 2009-10. The projected decrease in expenses and revenues in 2010-11 is clearly at variance with what was experienced or estimated in the previous eight years. While the increase in expenses in 2008-09 and 2009-10 and subsequent decrease in 2010-11 is magnified by the flow through effect of Commonwealth stimulus funding, achieving a surplus in 2010-11 by reducing expenses stands out as a key risk to the current budget strategy.

2.4.3 Revenue forecasts 2009-10 to 2012-13

Revenue forecasts for the 2009-10 Budget are characterised by significant, temporary compositional changes. The global financial crisis caused immediate and large reductions in GST revenue grants and taxation revenue. The total reduction over the forward estimates in GST grants since the 2008-09 Budget is $2.9 billion and state taxation $1 billion. The Commonwealth responded to the crisis with economic stimulus and other nation building funding to the States from which this state receives, over the next four years, $1.8 billion in one-off Commonwealth grant funding and a further $1.1 billion in infrastructure funding announced in the Commonwealth budget. Importantly, these monies are required to be spent on projects and are not available as general purpose revenue. 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.

The following chart shows expected trends for the major revenue items in the 2009-10 Budget against the experience of recent years.

Chart 2.3 — General government sector Commonwealth grants and taxation revenue



The chart highlights the break in trend after 2007-08 for the three main revenue lines.

GST revenue grants and taxation revenue are estimated to fall in 2008-09 and remain subdued for 2009-10 before returning to trend by 2012-13.

Other Commonwealth grants increase markedly in 2008-09 and 2009-10 mainly due to the Commonwealth Government's Nation Building — Economic Stimulus Plan and Nation Building Plan for the Future capital grants. The additional grants cease in 2012-13. The grants are mainly on-passed to recipients as grant expenses or are used for capital spending.

2.4.4 Expense forecasts 2009-10 to 2012-13

The following chart shows expected trends for total expenses, split into four main categories, in the 2009-10 Budget against the experience of recent years.

Chart 2.4 — General government sector expenses

All categories of expenses are expected to increase in 2008-09 and 2009-10. As GST revenue grants and taxation revenue fall simultaneously, net operating deficits result in those years. The rise in grant expenses is largely from on-passed grants associated with Commonwealth financial arrangements. These grant expenses fall away in line with reducing related additional grant revenues and cease by 2012-13.

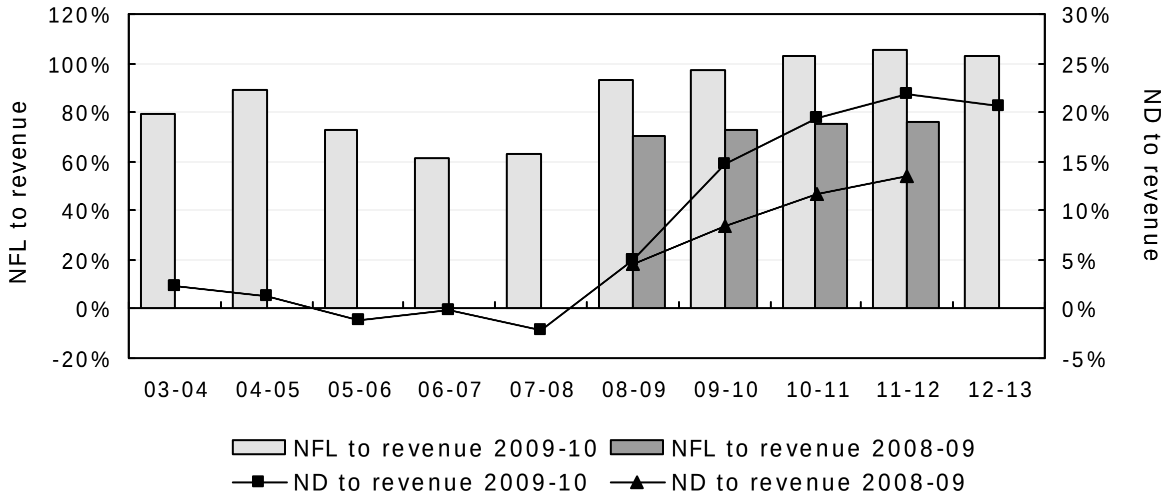
The chart highlights the projected fall in employee expenses and other operating expenses in 2010-11 as savings targets are brought to account. The savings are a cornerstone of the 2009-10 fiscal strategy to return the State to sustainable surpluses in the medium-term. As mentioned earlier, this is a major change in trend and a key challenge to achieve.

2.4.5 Ratios of net financial liabilities to revenue and net debt to revenue

As noted, a fiscal target is 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. A further factor considered by rating agencies was the State's low level of debt.

Chart 2.5 shows the estimated outcomes for the ratios of net financial liabilities and net debt to revenue for recent years and for the 2008-09 and 2009-10 Budgets.

Chart 2.5 — General government sector ratios of net financial liabilities to revenue and net debt to revenue



The chart shows that both the ratios of net financial liabilities to revenue and net debt to revenue were projected to increase in the 2008-09 Budget. This reflected the policy to increase capital expenditure, financed in part by borrowings. Net financial liabilities were also influenced by an increase in the value of unfunded superannuation liabilities in 2008-09.

The impact of the global financial crisis is to increase those ratios beyond previous expectations. Both ratios are expected to peak in 2011-12 and then reduce.

The Government acknowledges the outcome for the ratio of net financial liabilities to revenue is not consistent with its fiscal target, stating that the increase in the ratio reflects the Government's major infrastructure program. Chart 10.3 in section 10 of this Report sets out the five year trend to 2012-13 for other states. Most states expect increases in this ratio.

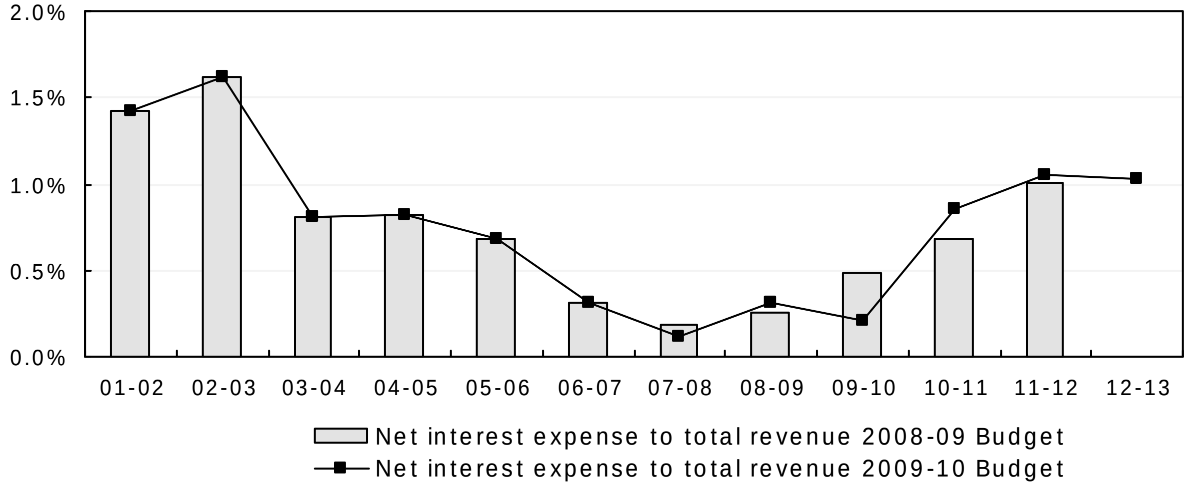
The 2009-10 Budget shows that reducing the ratios in 2012-13 depends on achieving a net operating surplus that exceeds net capital spending in that year with a consequent return to net lending, the first time since 2007-08. Net financial liabilities are also affected by the value of unfunded superannuation liabilities as discussed later.

2.4.6 Ratios of interest to revenue

The projected increase in net debt leads to increased interest rate risk. The Budget papers note that higher than expected interest rates could adversely affect the general government and public non-financial corporations sectors' budget position through increased interest payments.

Chart 2.6 shows the outcomes for the general government ratio of net interest to revenue for recent years and as estimated in the 2008-09 and 2009-10 Budgets.

Chart 2.6 — General government sector interest to revenue ratio



This chart shows that while rising steeply from 2007-08 to 2011-12, on current projections the ratio of net interest to revenue is only marginally higher in the forward years than was estimated for the 2008-09 Budget. The ratio begins to decline in 2012-13. Although net debt rises over the period of the forward estimates to 2012, interest rates are lower than in 2008-09, indeed falling to emergency low levels during early 2009 and consequently forecast interest expense is in line with previous budget projections.

Even so, exposure to rising interest rates is heightened through the increase in net debt. The Budget notes that a 1 percent increase in the average interest rate applying to general government sector debt would increase net interest expense by approximately $14 million in 2009-10 rising to $32 million in 2012-13. This would increase the ratio of net interest to revenue in 2012-13 to 1.2 percent but still well below the level of 2001-02 and 2002-03.

2.4.7 Interstate comparison

The 2009-10 Budget compares key budget aggregates across jurisdictions. In 2009-10, SA, NSW, ACT and Queensland are forecasting general government net operating balance deficits. Most jurisdictions are predicting net borrowing (lending deficits). Most jurisdictions are budgeting to invest significant funds into infrastructure projects.

2.5 NON-FINANCIAL PUBLIC SECTOR BALANCE SHEET[2]

The State's balance sheet is expected to strengthen over the four years of the 2009-10 Budget as measured by net worth after initially suffering a substantial fall in 2008-09. Net financial worth, however, declines due to the growth of financial liabilities.

2.5.1 Estimated position for 2008-09 and forward years

Chart 2.7 shows the trend of outcomes for some major balance sheet categories for recent years and as estimated in the 2009-10 Budget.

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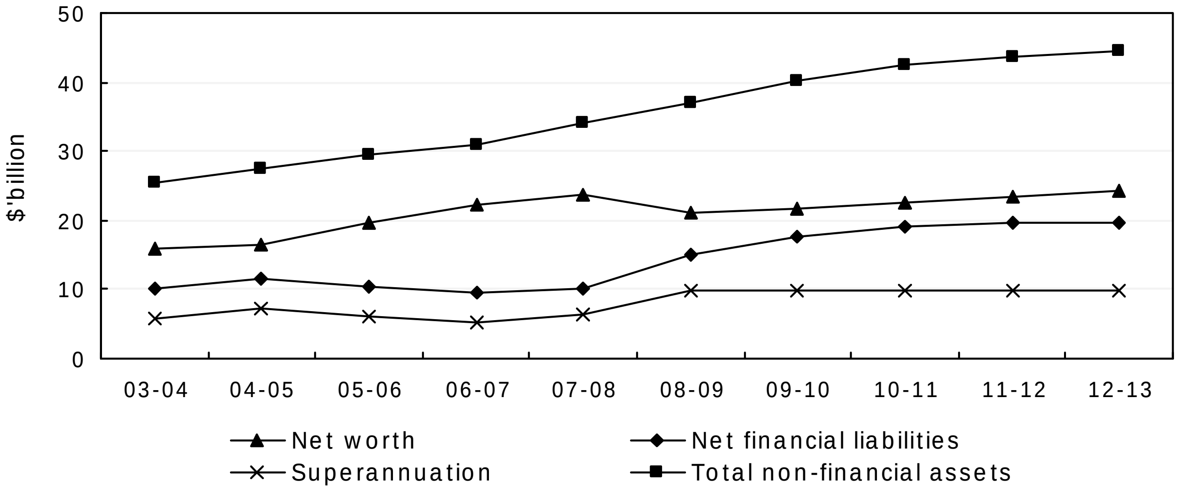
2 Balance sheet data is for the non-financial public sector unless otherwise stated due to the high value of non-financial assets in public non-financial corporations.

Chart 2.7 — Non-financial public sector balance sheet items



The chart shows that net worth is projected to fall in 2008-09. This is the combined effect of a steep rise in net financial liabilities offset by increases in non-financial assets.

Net worth is then estimated to rise steadily over the forward estimates adding $3.2 billion to reach $24.4 billion by 2012-13 with the growth of assets outstripping liability growth.

2.5.2 Assets

Total assets are estimated to increase by over $2.5 billion in 2008-09 to $41 billion and are expected to continue to rise over the forward estimates to $51.2 billion by 2012-13. Through the major infrastructure program, non-financial assets increase by $2 billion due to acquisitions. Revaluations are estimated to add a further $1.5 billion. These increases are offset by depreciation.

Rising property values have had a marked positive influence on the balance sheet over a number of years. Growth in the value of rental properties of the South Australian Housing Trust alone has contributed $2.2 billion over the four years to 2008-09.

Total financial assets are expected to fall $365 million in 2008-09 to $3.9 billion but then increase annually to $6.6 billion in 2012-13. Included in financial assets is the value of the Government's interest in Public Financial Corporations (PFC's) including the Motor Accident Commission and WorkCover Corporation of South Australia (WorkCover) . The value, a combined estimate of the net worth of PFC's, is projected to remain negative for the period of the forward estimates but could improve as investment markets recover.

The majority of the Government's financial assets are managed by the Superannuation Funds Management Corporation (Funds SA). Funds SA incurred a net loss from investing activities in 2008-09 of $2 billion due to the major decline experienced in the financial markets during the year. As the majority of managed funds are superannuation assets, most of this loss is reflected in an increase in the unfunded superannuation liability.

Another impact of the negative market returns was a further deterioration in the Motor Accident Commission's statutory solvency level, calculated in accordance with a formula determined by the Treasurer. As at 30 June 2009 the Commission had net assets of $70 million, despite two years of poor investment markets. However, the assets of the compulsory third party fund as at that date were 91.3 percent of the target level of solvency compared to 101.5 percent the previous year.

WorkCover also incurred a loss on investments that contributed to increase its net liability position to $1.1 billion despite an improved operating result. Its funding ratio declined from 60.8 percent to 56.7 percent, compared to the WorkCover Board approved target funding range of 90 to 110 percent.

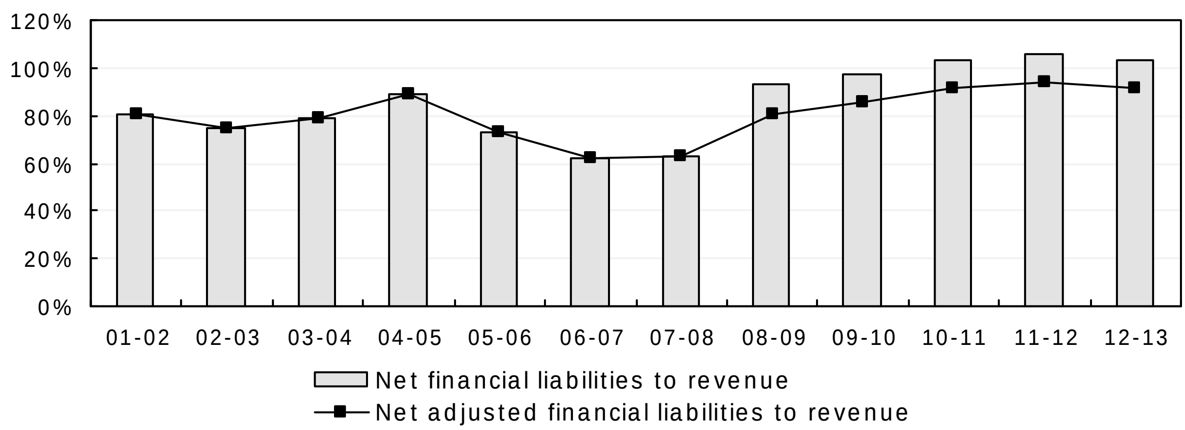
2.5.3 Liabilities

A major component of liabilities, unfunded superannuation liabilities, is estimated to increase $3.3 billion to $9.7 billion for the year to 30 June 2009. This is a liability to current and past members of now closed defined benefit superannuation schemes. The Budget records that although the value of the liability has increased, there is no material change in the actual expected payments to beneficiaries. While the value can be expected to change from year to year, this increase is extraordinary and it is essential to understand the causes.

$2 billion of the increase is due to the collapse of interest rates in response to the global financial crisis. As required by Australian Accounting Standards, 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 (the May 2021 bond was used). A discount rate of 5.2 per cent (effective annual rate) was used for the 2009-10 Budget, compared with 6.3 per cent for the 2008-09 Budget. Should interest rates increase in the future, the value of the liability will reduce. A 1 percent rise in the discount rate is estimated to decrease the superannuation liability by $1.6 billion.

The value of the unfunded superannuation liability is significant to the ratio of net financial liabilities to revenue. Chart 2.8 highlights the effect on the ratio of an increase in interest rates of 1 percent above the rate used in the 2008-09 Budget.

Chart 2.8 — General government sector net financial liabilities to revenue ratio



As shown, the decrease in interest rates of 1 percent would bring the ratio back under 100 percent, without any other change.

A further $1.3 billion of the increase in unfunded superannuation liabilities is due to the negative returns being experienced in investment markets. The estimate is based on an estimated earnings rate of negative 17 per cent for 2008-09. This earnings rate is well below the long-term assumed earnings rate of 7 per cent.

The effect of the increase in liabilities is to add in the order of $70 million per year to the related nominal superannuation interest expense in 2009-10. Cash contributions toward funding past service superannuation liability are also forecast to increase over the forward estimates.

With the increase to cash payments and assuming that the long-term target earnings rate will be achieved in the future, the Government reports it remains on track to fully fund the superannuation liability by 2034.

Borrowing becomes the major component of liabilities over the period of the forward estimates. Net debt, mainly borrowings less cash and deposits, is estimated to rise by $1471 million to $3.1 billion at 30 June 2009 and to $6.6 billion by 2012-13. The general government sector net debt increases to $659 million at 30 June 2009. From 30 June 2009, net debt for the general government and non-financial public sectors is reduced by the Government's motor vehicle fleet being transferred to the SAFA which is part of the PFC. This is an inter-sector transfer, not an improvement in the whole-of-government position. The cost of running the fleet, including interest on borrowings, will be recovered through lease fees to the other sector agencies. The value of Fleet SA borrowings at 30 June 2009 was $235 million.

2.6 RISKS AND MANAGEMENT TASKS FOR THE 2009-10 BUDGET

Last year I commented that I believed prevailing economic events and the nature of some aspects of recent budgets elevated some of the risks to the 2008-09 Budget and beyond. I noted accordingly, these risks warranted the highest attention for monitoring, reporting and management of budget spending and revenues.

The events that ultimately unfolded in the latter part of 2008 and early 2009 were well beyond what virtually anyone expected and are now considered the worst since the Great Depression.

The 2009-10 Budget is the second part, after the MYBR, of the Government's response to these circumstances. It incorporates the Commonwealth Government's stimulus and nation building spending. A return to net operating balance surpluses is projected for 2010-11 which then continues through to 2012-13. A strengthening balance sheet is also anticipated although high levels of net borrowing are also forecast together with growing net debt.

The Budget Papers[3] explain there are many budget risks to monitor and manage. The heightened risk flowing from the global financial crisis is set out in detail. Also acknowledged is the difficulty of forecasting financial outcomes in the present economic environment. This section focuses on just some of those risks.

2.6.1 Net operating balance

Underlying the expected deficits in 2008-09 and 2009-10 is the loss of GST and taxation revenues from the rapid contraction of economic activity. Expenses previously funded by those revenues are not required to reduce at the same rate for those two years. The target of resuming surpluses by 2010-11, only two years after an exceptionally severe fall in economic activity may be considered ambitious given the uncertainty of these times.

In the past I have observed that maintaining net operating balance surpluses represents overall good financial planning, providing some flexibility and buffer against unfavourable influences and events that may affect Budget outcomes. Given deficits are expected for 2008-09 and 2009-10 there is no buffer from that source for those years.

Buffers built into the budget are contingency provisions and headroom. These are built into the budget to a similar extent to previous years. Beyond this and other changes in spending or taxation policies, unfavourable outcomes will flow to the net operating deficit and to net debt.

[3] Budget Statement 2008-09, Budget Paper 3, Chapter 7.

2.6.2 Operating revenues

As expected, the 2009-10 Budget is constructed on falling general purpose revenues for 2008-09 and subdued growth for the next two years. The main revenue lines, GST and taxation revenue, fall in real terms for 2009-10.

GST revenue in 2009-10 is estimated at $3.8 billion, representing 26 percent of total revenue. It has shown high sensitivity to deteriorating economic conditions. GST revenue estimates were revised down firstly at the time of the 2008-09 MYBR and again in the 2009-10 Budget. It has consistently exceeded budget in past years. An agreement for the States and Territories to receive a guaranteed minimum amount (GMA) from GST funding expires at the end of 2008-09. Consequently, the State becomes totally reliant on actual GST revenues from 2009-10 and will have a greater exposure to variations in national economic activity. Under the GMA, estimated transitional assistance funding is $34.2 million in 2008-09.

GST and taxation revenue are expected to grow strongly again from 2011-12. For GST revenue, this partly reflects distribution impacts from the new financial arrangements.

Over the past six years the State has received large amounts of unbudgeted revenues that enabled net operating surpluses while also funding significant spending initiatives and pressures. This experience does not give a guide to likely revenue outcomes for this budget. Current circumstances at least suggest a low likelihood of receiving favourable revenue outcomes. The Government acknowledges that the risks to revenue are currently much greater than those identified in previous state budgets, because the global economic environment deteriorated so rapidly and unpredictably.

Growth in 2009-10 of other Commonwealth grants reflects revised financial arrangements and additional stimulus money. The Budget assumes that South Australia will satisfy all reward funding requirements and receive full payments. Most of these funds are not available as general purpose revenue but are for related specific purposes.

2.6.3 Operating expense variations

Last year I commented that a possible risk attaching to the consistent record of net operating balance surpluses was that the State may have developed a culture of expecting growing revenues to continue to support increasing expenses. I noted that this may prove to be the case, but deteriorating economic events at the time in Australia and internationally, gave reason to pause and consider this likelihood. As mentioned there is now much uncertainty about revenue outcomes.

Recent years have seen hundreds of millions added annually to expenditure from parameter effects and policy measures. Essentially, within 12 months there is more pressure on how to control expenses than has existed for many years. This is likely to test the public sector's commitment and/or ability to control expenses.

Salaries and wages remains the main public sector operating cost. The Government advises it will seek to limit future wage outcomes to 2.5 per cent per annum aiming to provide a real wage increase to public sector employees, prevent job losses, and ensure the sustainability of the State's finances. Outcomes in the past four years, while in strong economic times have generally exceeded this target, with some sectors receiving much more.

The Budget reports that if public sector wide wage outcomes for new enterprise agreements vary by 1 percent per annum from allowances in the forward estimates, the budget impact will be approximately $250 million in 2012-13.

2.6.4 Savings initiatives

Setting large value savings targets is a feature of past Budgets.

The MYBR, completed in the early stages of the global financial crisis, resulted in announced operating savings of $250 million up to 2011-12 including a reduction of 1600 full time equivalent (FTE) public servants not directly involved in the delivery of frontline services over three years, 1200 in 2009-10.

To assist agencies achieve the 2009-10 FTE reductions, a targeted voluntary separation program (TVSP) was approved. DTF advised that at the end of August 2009, 951 TVSP offers were made and 400 accepted. Employees had until the end of September 2009 to accept an offer.

The 2009-10 Budget identifies further operating savings of $830.7 million over four years but essentially not commencing until 2010-11. As part of this amount, $75 million was removed from agency budgets for 2012-13 taking, with previously announced savings targets, the total savings expected in that year to $225 million. The majority of the 2009-10 Budget savings target, $750 million of savings, is scheduled as $150 million in 2010-11, $250 million in 2011-12 and $350 million in 2012-13 pending recommendations by the Sustainable Budget Commission through reviewing revenues, operating and capital expenditures and asset sales. The Government estimates that up to $290 million of this would be saved in 2012-13 from the proposed 2.5 percent wage cap over four years.

As set out in table 8.2, a large saving target remains for 2009-10 from previous budgets. A number of issues arise that are relevant to achieving these and future savings.

Audit review of savings in this and past years shows that DTF is reporting a high proportion of the value of targeted savings for 2008-09 being achieved. Even so, in some areas savings are more difficult to deliver than originally estimated. Last year I reported savings not being achieved for the shared services initiative in the timeframes estimated. Review in 2008-09 indicates that there remain timing and other pressures on these savings targets. The shared services initiative is discussed in Part A of this Report. The Department of Health was also not expected to achieve target savings and also has received additional resources in 2008-09.

Saving targets are also typically directed at administrative services not directly involved in the delivery of frontline services. Over time the ability to draw all or most savings primarily from one section of the workforce will diminish. There may also be unintended consequences from reducing capacity in support services that mean a range of those activities are impeded or stopped.

2.6.5 Capital payments

The 2009-10 Budget, with the combined influence of state and Commonwealth spending initiatives, elevates general government sector estimates to extraordinarily high levels. Purchases of non-financial assets are $1.4 billion higher over the three years to 2010-11 than estimated at the MYBR. Spending peaks in 2009-10 and 2010-11 with both years targeting capital spending of $2.2 billion. This is $833 million or 62 percent more than estimated for 2008-09 and double what is estimated to be spent by 2012-13.

Last year I noted there may be a heightened risk to the proper management and control of higher capital outlays. This situation remains and is elevated by the value of spending.

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. I note nation building funding requires states to ensure that there is no substitution of capital expenditure effort in the targeted areas. State coordinators are appointed to oversee implementation and progress is reported quarterly to the Commonwealth Treasurers' Ministerial Council.

There is pressure to engage contractors quickly to facilitate completing the program. There is also a propensity for large amounts of capital spending to occur in the later part of the financial year. Both these periods are potentially when decision making and due process may come under pressure. Notably, should spending targets not be reached, net lending and net debt will improve.

2.6.5.1 Public private partnership projects

Anticipated investing spending on new schools and the New Royal Adelaide Hospital in the four years of the 2009-10 Budget is in the order of $360 million. The State's new prisons and secure facilities PPP project was cancelled in response to the global financial crisis. In September 2009 the Government announced a new facility for juvenile offenders would be constructed, mainly funded from the sales of land.

The Education Works - New Schools PPP project reached financial close in July 2009 with a total reported value of $323 million including the cost of construction and management and maintenance of the schools over a thirty year period. Notably, this PPP model was nearly $9.2 million (3 percent) more expensive than a traditional build. The Government reported it had the successful consortium's commitment to meet a tight timetable for delivery of the schools at a fixed price.

2.6.6 Budget monitoring

Past Audit Reports have consistently emphasised the need for strong monitoring of budget progress. The events of 2008-09 make this a critical risk management activity.

Audit review in 2008-09 confirmed that the Government has a range of budget monitoring and reporting procedures in place, a summary of which is included in this Report. With the onset of the global financial crisis I asked DTF for details of any changes to capital and operating expenditure monitoring processes for 2008-09. DTF advised that no significant changes were planned to monitoring processes for 2009-10. Consistent with previous years, budget initiatives monitoring will continue to include initiatives (expenditure and savings) from previous budgets that are not complete.

I also inquired if any substantial changes were made or were planned in the way the DTF operates to meet its responsibilities for policy analysis and advice and budget financial management. DTF responded that it had not substantially changed its approach. DTF continued its approach of evaluating an updated budget position on a regular basis. DTF noted that given the unpredictable nature of the economy, revenue and expense projection updates were sought regularly during 2008-09 and changes were factored into forward projection models. This allowed DTF to provide up-to-date advice on budget financial management.

DTF also advised that the short to medium impact of the global financial crisis within its forward prediction models showed that the net operating balance position would continue to be challenged once the initial impact of the global financial crisis had passed.

Audit review of monitoring reports for 2008-09 showed that the overall end of year net operating projection for 2008-09 was mainly affected by the Department of Health which at April 2009 estimated a significant year-end deterioration in the order of $90 million. This position was subject to review under the chief executive accountability framework. Of planned savings, $129 million was expected to be achieved as at 31 March 2009 but a shortfall of $38 million was likely, essentially due to the Department of Health where health service reforms and operations savings would not be achieved. Reporting noted that the Department of Health was slow to identify that savings would not be achieved and there was inadequate time to identify and implement alternatives.

Of $45 million of centrally held savings, essentially shared services, $27.9 million was allocated to agencies and delays were experienced in delivering the remaining $17 million. Savings from printing and publications and advertising were not proceeding or were deferred.

Capital projects were expected to underspend but only marginally compared to the approved budget of $1.3 billion. Critically, to achieve the expected result depended on agencies more than doubling expenditure in the last four months of the year compared to the average for the year to date. The need for such a dramatic acceleration was noted as a concern and suggested the likelihood of agencies requesting significant carryovers.

Importantly, our review showed that DTF regarded there was an improvement in data quality with the majority of agencies rated as medium and high on a high to low scale.

2.7 CONCLUDING OBSERVATIONS

The 2009-10 Budget was prepared in extraordinary times and to respond to the global financial crisis that challenges all governments. It ambitiously aims to return to a net operating surplus in 2010-11. It has the welcome benefit of nearly $3 billion in one-off infrastructure grant funding, from the Commonwealth policy to stimulate the national economy because of the crisis.

Compared to the past six years of sustained strength in both the local and national economy with resultant unbudgeted revenue gains, the risks to revenue are currently much greater than those identified in previous state budgets. Spending cuts to match the revenue losses are deferred to 2010-11 with the result that net operating deficits are incurred in 2008-09 and 2009-10 and net lending and net debt increases beyond that previously projected.

Any unfavourable outcomes to the revenue and expense budget targets will add directly to a deficit in 2009-10 and to net debt. Governments have not operated in an environment such as this for many years.

The capital program, in excess of $4 billion over the next two years and well beyond the magnitude of any in many years, brings with it control risks to manage over the next two years to maintain accountability and take full advantage of the value of the proposed outlays.

To return to an operating surplus in the medium term, the Government identifies operating savings of $830.7 million over four years essentially commencing in 2010-11. How most of these savings are achieved depends on future recommendations by the Sustainable Budget Commission. Experience with past savings targets is that it is apparent that some savings are difficult to achieve and/or to achieve within the desired timeframes. Where this occurs, agencies will need to quickly identify where savings are at risk to allow time to identify and implement alternatives if the Government is to meet its targets.

I also note there is a risk to continually seeking to draw savings from the administrative part of the workforce, given past and current programs and there may be unintended consequences from reducing the capacity of support services too far.

At the time of this report, the immediate effects of the global credit crisis including extraordinary volatility of financial markets, tight capital markets, falling interest rates and loss of confidence appear to have been checked. The times remain uncertain and challenging as economies work their way through this period.

Factors including, having a number of years of net operating surpluses, general government having net financial assets rather than net debt for the three years to 2007-08 and others identified by credit rating agencies, indicate that the State was reasonably placed to meet the global financial crisis. The Government has set out a strategy, with the assistance of the Commonwealth Government, to respond to these difficult times. There is inherent uncertainty about the outcomes given the economic environment and the timeframes for some of the budget strategy.

Responses to my inquiries about any changes to processes in response to the global financial crisis display confidence in the existing mechanisms of regular review and providing up-to-date advice on budget financial management. As always, strong and effective controls based on sound information systems, reporting integrity and effective monitoring are needed to support achieving the Budget targets.

3 REPORTING FRAMEWORK

3.1 INTRODUCTION

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

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

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

3.2 UNIFORM PRESENTATION FRAMEWORK (UPF)

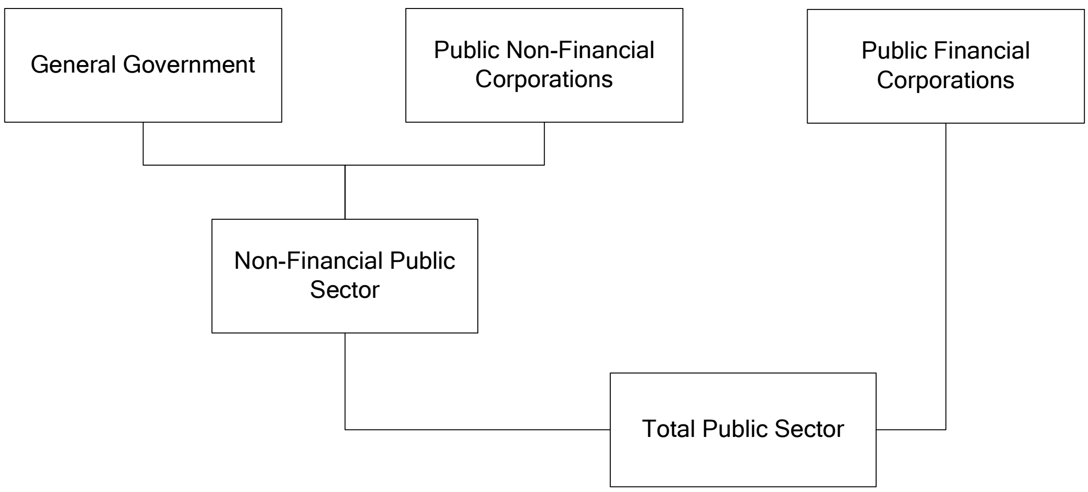
3.2.1 Background

The UPF is a reporting standard based on the ABS's accrual-based Government Financial Statistics (GFS) framework. As a result of a project to harmonise generally accepted accounting principles and the GFS (discussed later), the Commonwealth, States and Territories agreed to update the UPF. This would continue to provide a common core of financial information in budget papers and comparable data amongst jurisdictions while maintaining the current level of transparency. All jurisdictions agreed to adopt the revised UPF by no later than 2009-10 budget reports.

In South Australia, the Budget is prepared using the GFS framework.

The GFS accrual reporting has many similarities to the AAS framework. GFS framework excludes revaluations from the GFS Operating Statement, 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 make-up of the three primary sectors is as follows.

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

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

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

The Budget Papers include the following GFS financial statements:

- general government sector operating statement and balance sheet
- public non-financial corporation sector operating statement and balance sheet
- non-financial public sector operating statement and balance sheet
- cash flow statements for these sectors.

The public financial corporations sector data is not published in the Budget Papers. Although data is produced and published for this sector by the ABS, it is not available until some months after the collation of the Budget Papers.

3.2.1.1 Key GFS 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.[4]

3.2.2 Scope of audit review of GFS financial statements

This Report primarily covers commentary on GFS based information. Although Audit seeks to have a comprehensive understanding of the budget preparation process, the data and assumptions are not subject to audit. Work performed on the 2009-10 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.

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

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

3.3 AUSTRALIAN ACCOUNTING STANDARDS (AASB)

The AASB 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 AASB.

3.3.2 AAS whole-of-government financial report

Whole-of-government financial reports for South Australia up to 2007-08 were prepared by DTF pursuant to Accounting Standard AAS 31 'Financial Reporting by Governments'. A summary of information prepared on this basis is provided in section 12 of this Report.

For 2008-09, the whole-of-government financial report will be prepared pursuant to Accounting Standard AASB 1049 'Whole of Government and General Government Sector Financial Reporting'. AASB 1049 specifies requirements for whole-of-government financial reports and General Government Sector (GGS) financial reports of each government. The Standard requires compliance with other applicable AAS 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 GFS and Australian Accounting Standards

The AASB issued ED 174 'Amendments to Australian Accounting Standards to facilitate GAAP/GFS Harmonisation for Entities within the GGS [AASB 101, 107 and 1052]' in January 2009. ED 174 was issued as part of the second, and final, phase of the AASB's implementation of the FRC's GAAP/GFS harmonisation broad strategic direction.

The objective of harmonising generally accepted accounting principles and the GFS is to achieve a single standard to produce comparable government budgets and financial statements that are auditable and comparable.

In June 2009 the AASB announced it 'was persuaded by the strong views expressed by many that, based particularly on perceptions of the needs of a range of users, it would not be appropriate to impose GAAP/GFS harmonisation requirements in the manner proposed in ED 174 on the general purpose financial statements of entities within the GGS. Accordingly, the Board directed staff to prepare a paper to help facilitate future discussions with the FRC before progressing the project further.'

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

The Treasurer's Statements are prepared pursuant to the requirements of the *Public Finance and Audit Act 1987* and reported as an Appendix in Part B of the Auditor-General's 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 2009-10 Budget Papers[5] indicate that the Government is committed to the following fiscal targets:

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

4.1.1 General government net operating balance

One of the Government's fiscal targets is to achieve net operating balances every year. This means that revenues are covering expenses, including interest and depreciation.

The Government state in the 2009-10 Budget papers that achieving a net operating balance has ceased to be a realistic fiscal target in the short-term due to the global financial crisis. South Australia is forecasting net operating deficits in 2008-09 and 2009-10 before returning to a surplus in 2010-11.

4.1.2 General government ratio of net financial liabilities to revenue

Another of the Government's fiscal targets is 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. Net financial liabilities is a broader measure than net debt as it includes significant liabilities other than borrowings, such as unfunded superannuation and long service leave entitlements.

The ratio is forecast to increase across the forward estimates. However this reflects the major infrastructure program. Most other triple-A rated jurisdictions are also experiencing increases in their ratios.

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5 Budget Statement 2009-10, Budget Paper 3, p 1.6.

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 in the following table.

Jurisdiction	Budget fiscal objective/strategy [(a) (b)]
Commonwealth	Achieving a budget surplus, on average, over the medium term. Keeping taxation as a share of GDP on average below the level for 2007-08. Improving the Government's net financial worth over the medium term.
NSW	Reduce the level of general government net financial liabilities as a share of GSP to 7.5 percent or less by 30 June 2010. Maintain general government underlying net debt as a share of GSP at or below its level as at 30 June 2005.
VIC	Short Term: Target Operating Surplus of at least $100 million in each year. Long Term: Maintain a substantial budget operating surplus that allows for the delivery of the Government's infrastructure objectives.
QLD	In the General Government Sector, meet all operating expenses from operating revenue (where operating revenue is defined as total revenue from transactions and operating expends are defined as total expenses from transactions less depreciation). Achieve a General Government net operating surplus as soon as possible, but not later than 2015-16.
WA	Achieve operating surpluses for the general government sector.
TAS	By 2014-15, achieve, on average, a Net Operating Surplus for the General Government Sector over four year rolling period. By 2014-15, achieve a modest Fiscal Surplus.
ACT	Achieve a general government sector Net Operating Surplus. Maintain Operating Cash Surpluses.
NT	Growth in general government operating expenses to be less than growth in revenue, excluding tied Commonwealth revenue, over the economic cycle thereby achieving a sufficient balance to fund general government capital spending.

(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. New South Wales is the only other state to give specific focus to net financial liabilities.

Like South Australia, other jurisdictions have framed budgets against the backdrop of the global financial crisis. The Commonwealth, Victoria, Queensland, Tasmania and the Northern Territory have changed their strategy from last year to include a more medium term focus than prior years.

5 ESTIMATED RESULTS FOR 2008-09

5.1 OVERVIEW

The following section summarises the estimated operating results for 2008-09.

5.2 2008-09 ESTIMATED RESULTS

5.2.1 General government sector

The estimated result for the year was a net operating deficit of $265 million (budget $160 million surplus) and net borrowing result of $932 million (budget $548 million).

The following table shows 2007-08 financial year data and differences between the estimated result and budget for 2008-09.

Table 5.1 — General government budget comparisons 2007-08 to 2008-09

	2007-08 Actual $'million	**2008-09 Budget $'million**	**2008-09 Estimated result $'million**	Difference to Budget $'million	Difference to Budget Percent
Revenue					
Taxation revenue	3 570	3 615	3 478	(137)	(4)
Grants:					
Current	6 294	6 526	6 610	84	1
Capital	322	380	589	209	55
Sales of goods and services	1 572	1 601	1 711	110	7
Interest income	203	200	120	(80)	(40)
Dividend and income tax equivalent income	429	441	348	(93)	(21)
Other	490	491	529	38	8
Total revenue	12 879	13 255	13 385	130	1
Less: **Expenses**					
Employee expenses	5 268	5 539	5 684	145	3
Superannuation expenses:					
Superannuation interest cost	276	370	383	13	4
Other superannuation expenses	546	577	602	25	4
Depreciation and amortisation	525	593	595	2	-
Interest expenses	218	234	161	(73)	(31)
Other operating expenses	3 246	3 382	3 501	119	4
Grants	2 337	2 400	2 724	324	14
Total expenses	12 414	13 094	13 650	556	4
Net operating balance	464	160	(265)	(425)	(266)
Less: **Net acquisition of non-financial assets**					
Purchases of non-financial assets	875	1 396	1 347	(49)	(4)
Less: Sales of non-financial assets	108	94	85	(9)	(10)
Less: Depreciation	525	593	595	2	-
Total net acquisition of non-financial assets	242	709	667	(42)	(6)
Net lending (borrowing)	222	(548)	(932)	(384)	(70)

Note: Totals may not add due to rounding.

As shown in the table, when compared to 2007-08, the 2008-09 Budget anticipated a reduction of the net operating balance from higher growth in expenses than in revenues, and higher purchases of non-financial assets leading to net borrowing.

The estimated result for 2008-09 is much weaker than budgeted. The reason for the changes from the original 2008-09 budget was the immediate and striking impact of the global financial crisis. A summary of the main items is as follows:

- ***Taxation revenue*** — property taxes are expected to be $155 million (9.8 percent) below budget as property market activity slowed significantly in 2008-09. In particular, residential and non-residential property turnover was weaker than expected.
- ***Current grants*** — GST revenue, including transitional assistance, is expected to be $353 million below budget as the total GST pool is expected to contract in 2008-09 due to the global financial crisis, compared to the Commonwealth's original budget estimate of growth of 6.2 percent. This is expected to be offset by a $421 million increase in other Commonwealth current grants.
- ***Capital grants*** — up $209 million on budget, of which $173 million was for new National Partnership grants.
- ***Expenses*** — up $556 million on budget, of which $324 million was grants mainly related to new Commonwealth funding and $145 million was employee expenses.

5.2.1.1 Net acquisition of non-financial assets

The 2008-09 estimated result for purchases of non-financial assets is slightly less than budget, down $49 million. The 2008-09 budget of $1396 million for purchases of non-financial assets, included a slippage allowance of $120 million to allow for likely project delays. Table 5.2 shows the estimated result is influenced by the reduction of the slippage allowance (reflecting the reduced uncertainty of projections) whereas gross purchases are estimated to be $84 million lower than budget.

Table 5.2 — Purchases of non-financial assets budget to estimated result comparison 2008-09

	2008-09 Budget $'million	**2008-09 Estimated result $'million**	Difference to Budget $'million
Gross purchases of non-financial assets	1 516	1 432	84
Less: Slippage	120	85	35
	1 396	1 347	49

The Budget Papers[6] show the estimated result for most portfolios was lower than budgeted. The majority of under expenditure qualifies for carry over into future budgets. Investing carryovers from 2008-09 to 2009-10 and future years are $86.6 million[7] ($154 million), in part reflecting the size of the capital program.

5.2.2 Non-financial public sector

The non-financial public sector (consolidating the general government and public non-financial corporations sectors) estimated result for the year was a net borrowing result of $1474 million, which is $644 million greater than budget for the year.

[6] Budget Statement 2009-10, Budget Paper 3, Table 2.20.

[7] Budget Statement 2009-10, Budget Paper 3, p 1.14.

The following table summarises the position.

Table 5.3 — NFPS Budget comparisons 2007-08 to 2008-09

	2007-08 Actual $'million	**2008-09 Budget $'million**	**2008-09 Estimated result $'million**	Difference to Budget $'million	Difference to Budget Percent
Revenue	13 634	13 997	14 096	99	1
Less: **Expenses**	13 065	13 872	14 370	498	4
Net operating balance	569	125	(275)	(400)	(320)
Less: **Net acquisition of non-financial assets**	303	955	1 199	244	26
Net lending (borrowing)	266	(830)	(1 474)	(644)	78

Note: Totals may not add due to rounding.

The decline in net borrowing of $644 million comprises the weakening of the general government result by $384 million and the public non-financial corporations sector's result by $260 million.

The public non-financial corporations sector's[8] net operating balance is estimated to improve $26 million from budget to a deficit of $10 million. Total net acquisition of non-financial assets increases by $286 million compared to budget due to originally unbudgeted purchases of non-financial assets of $200 million, and an increase in inventories of $93 million. The combination of these results causes a deterioration of $260 million in net borrowing to $542 million.

[8] Budget Statement 2009-10, Budget Paper 3, Table A.2.

6 BUDGET 2009-10 OVERVIEW

6.1 OVERVIEW

The following commentary focuses on the trends arising from the 2009-10 Budget tabled in Parliament in June 2009. It provides an overview of:

- the Budget for 2009-10 having regard to the estimated result for 2008-09
- a longer term view of the forecast results going forward to 2012-13.

The analysis deals only with the accrual-based GFS framework.

6.1.1 Matters of significance to the 2009-10 Budget

The tumultuous events of the global financial crisis permeate the 2009-10 Budget. Tax based revenues are reduced from a severe downturn in economic activity and slowing property market activity. Other Commonwealth revenues jump temporarily due to the Commonwealth Government's economic stimulus and other nation building funding in response to the crisis. Further, the budget includes the effects of changes in the Commonwealth's financial relations with the States which modify the timing and composition of Commonwealth revenues.

The nature and composition of spending is temporarily altered. Grant expense increases flow from related Commonwealth revenues. Capital spending reaches historic heights due to combined state and Commonwealth infrastructure initiatives.

In the balance sheet, liabilities climb from historic low debt levels to exceed past projections of growing net debt and depressed financial and capital markets lead to a sharp rise in the reported value of unfunded superannuation liabilities. Non-financial assets grow rapidly as a result of the accelerated capital program.

Overall the 2009-10 Budget is prominent when compared to others over the long term as it reflects governmental responses to a turn in the economic cycle now observed as the most severe downturn in global economic growth since the Great Depression.

Some specific items to note in the 2009-10 Budget estimates years are:

- new operating and investing initiatives totalling $4 billion over the next four years[9]

- targeted savings and revenue offsets totalling $958 million over four years[10]

- expenditure restraint compared to revenue growth is projected to lift the net operating balance to $304 million by 2012-13

- higher capital investment leads to general government sector net debt increasing by $2.46 billion to $3.1 billion between June 2009 and June 2013.

Budgeted total revenues and expenses for 2009-10 are significantly higher than was budgeted in 2008-09.

[9] Budget Statement 2009-10, Budget Paper 3, Table 2.1.

[10] Budget Statement 2009-10, Budget Paper 3, Table 2.1.

Total revenue for 2009-10 is now budgeted at $14.4 billion, $722 million or 5.3 percent more than was estimated for 2009-10 in the previous, 2008-09 Budget. Expenses for 2009-10 are now budgeted at $14.7 billion, $1382 million or 10.3 percent higher than was estimated at the time of the 2008-09 Budget.

As a consequence of these changes, a net operating balance deficit of $340 million is now budgeted, down from the estimated $356 million 2009-10 surplus result projected in the 2008-09 Budget and not achieving the fiscal objective of at least a net operating balance for the general government sector.

6.2 GENERAL GOVERNMENT SECTOR – OPERATING STATEMENT

Table 6.1 sets out the differences between the 2009-10 Budget and the estimated results for 2008-09.

Table 6.1 — GFS - General government sector budget comparison of 2008-09 estimate results and 2009-10 Budget

	2008-09 Estimated result $'million	2009-10 Budget $'million	Difference $'million	Difference Percent
Revenue				
Taxation revenue	3 478	3 526	48	1.4
Grants:				
Current grants	6 610	6 466	(144)	(2.2)
Capital grants	589	1 598	1 009	171.3
Sales of goods and services	1 711	1 834	123	7.2
Interest income	120	144	24	20.0
Dividend and income tax equivalent income	348	388	40	11.5
Other	529	489	(40)	(7.6)
Total revenue	13 385	14 444	1 059	7.9
Less: **Expenses**				
Employee expenses	5 684	6 035	351	6.2
Superannuation expenses:				
Superannuation interest cost	383	444	61	15.9
Other superannuation expenses	602	623	21	3.5
Depreciation and amortisation	595	601	6	1.0
Interest expenses	161	174	13	8.1
Other operating expenses	3 501	3 728	227	6.5
Grants	2 724	3 145	421	15.5
Total expenses	13 650	14 748	1 098	8.0
Net operating balance	(265)	(304)	(39)	(14.7)
Less: **Net acquisition of non-financial assets**				
Purchases of non-financial assets	1 347	2 180	833	61.8
Less: Sales of non-financial assets	85	343	258	303.5
Less: Depreciation	595	601	6	1.0
Total net acquisition of non-financial assets	667	1 237	570	85.5
Net lending (borrowing)	(932)	(1 541)	(609)	(65.3)

Note: Totals may not add due to rounding.

As shown, the differences for the 2009-10 year are due mainly to:

- increased capital grants income (mainly National Partnership grants from the Commonwealth)
- increased employee expenses (including targeted separation costs)
- increased other operating expenses

- increased grants expenses
- an increase purchases of non-financial assets for 2009-10 is $833 million (after allowing for a capital slippage provision of $200 million)
- increased sale of non-financial assets.

More detail of the factors influencing the 2009-10 Budget is considered in the context of the longer-term trends discussed later in this Report.

6.2.1 Reconciliation of variations since 2008-09 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 categorise 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 2008-09 Budget that affect the net operating balance and provisions used to offset some of those changes.[11]

Table 6.2 — Reconciliation of general government sector net operating balance

	2008-09 Estimated result $'million	2009-10 Budget $'million	2010-11 Estimate $'million	2011-12 Estimate $'million
2008-09 Budget	**160**	**356**	**434**	**424**
Parameter and other variations				
Revenue - taxation	(138)	(211)	(288)	(262)
Revenue - other	234	767	345	11
Operating expenses	(526)	(546)	(401)	(449)
Net effect of parameter and other variations	**(430)**	**10**	**(344)**	**(700)**
Policy measures				
Revenue - taxation	-	38	71	68
Revenue - other	-	16	17	17
Revenue offsets - other	35	112	4	10
Operating expenses	(296)	(1 111)	(374)	(47)
Net effect of policy measures	**(261)**	**(945)**	**(282)**	**48**
Use of provisions set aside in the 2008-09 Budget and the 2008-09 MYBR				
Operating expenses	265	276	268	325
2009-10 Budget	**(265)**	**(304)**	**78**	**96**

Note: Totals may not add due to rounding.

11 Budget Statement 2009-10, Budget Paper 3, Table 1.6.

6.2.1.1 Revenue variations

The table highlights the expected overall fall in taxation revenue across the forward estimates and increases in other revenues primarily from Commonwealth funding changes since the 2008-09 Budget.

The following table shows the components of revenue parameter changes.[12]

Table 6.3 — Revenue parameter changes

	2008-09 Estimated result $'million	**2009-10 Budget $'million**	**2010-11 Estimate $'million**	**2011-12 Estimate $'million**
Commonwealth Specific Purpose and National Partnership grants:				
Capital	170	1 112	782	352
Current	415	205	136	215
Commonwealth contributions	105	170	114	116
GST revenue grants and transitional assistance	(353)	(634)	(617)	(648)
Property related taxes	(155)	(190)	(242)	(227)
Dividends and income tax equivalents	(93)	(7)	(51)	(69)
Interest income	(80)	(55)	(11)	28
Other	87	(45)	(54)	(18)
Total	96	556	57	(251)

Table 6.3 shows clearly the massive compositional changes to total revenues that are estimated to follow the global financial crisis.

6.2.1.2 Operating expense variations

Table 6.2 shows that parameter effects are estimated to add $1.9 billion to operating expenses over the four years to 2011-12.

Policy spending decisions add a further $1.8 billion to operating expenses over the four year period of which $296 million is for 2008-09.[13] The following table shows the value of policy measures taken after each of the past four Budgets.

Table 6.4 — Policy spending decisions

	2005-06 $'million	2006-07 $'million	2007-08 $'million	2008-09 $'million
Policy measure operating expenses	217	163	274	296

Table 6.4 shows that $950 million was added to spending for the four years. In past years, increases reflected an established practice of discretionary expenditure decisions being taken after Budgets were announced. This was generally enabled by favourable revenue outcomes. By comparison to past years, expense adjustments since the 2008-09 budget, as shown in table 6.2, mainly arise from governmental response to the global financial crisis and changed inter-government financial arrangements. Additional expenses peak in 2009-10 and 2010-11 as current stimulus arrangements end by 2012-13.

12 Budget Statement 2009-10, Budget Paper 3, Table 1.8 and 2008-09 Mid Year Budget Review, Table 1.10.

13 Policy details are in Budget Statement 2009-10, Budget Paper 3, Tables 2.3-2.15.

6.3 PUBLIC NON-FINANCIAL CORPORATION SECTOR – OPERATING STATEMENT

A net operating surplus of $300 million is budgeted in 2009-10 ($10 million deficit), the improvement due to increases in revenues from grants and sales of goods and services. The net borrowing result of $970 million ($542 million 2008-09) is higher than 2008-09 due to a $740 million increase in budgeted purchases of non-financial assets. The differences between the two years are set out in the following table.

Table 6.5 — GFS - PNFC budget comparison 2008-09 and 2009-10

	2008-09 Estimated result $'million	2009-10 Budget $'million	Difference $'million	Difference Percent
Revenue				
Sales of goods and services	1 378	1 542	164	11.9
Other	913	1 116	203	22.2
Total revenue	2 291	2 658	367	16.0
Less: **Expenses**				
Employee expenses	146	160	14	9.6
Depreciation and amortisation	282	303	21	7.4
Interest expenses	182	192	10	5.5
Other property expenses	332	379	47	14.2
Other operating expenses	1 251	1 242	(9)	0.7)
Other expenses	106	83	(23)	(21.6)
Total expenses	2 300	2 358	58	2.5
Net operating balance	(10)	300	310	-
Less: **Net acquisition of non-financial assets**				
Purchases of non-financial assets	988	1 728	740	74.9
Less: Sales and depreciation	548	518	(30)	(5.5)
Add: Change in inventories	93	59	(34)	(36.6)
Total net acquisition of non-financial assets	533	1 270	737	138.3
Net lending (borrowing)	(542)	(970)	(428)	79.0

Note: Totals may not add due to rounding.

6.4 NON-FINANCIAL PUBLIC SECTOR – OPERATING STATEMENT

The consolidated result for the non-financial public sector is net borrowing of $2511 million, a deterioration of $1037 million from the 2008-09 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

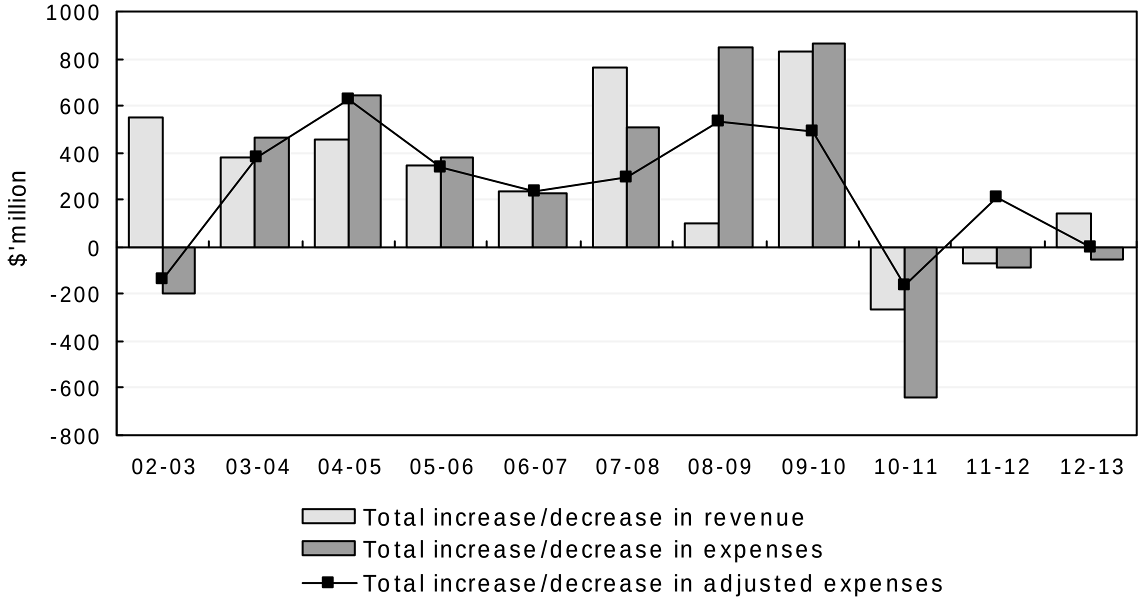
	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10	2010-11	2011-12	2012-13
						Estimated				
	Actual	Actual	Actual	Actual	Actual	result	Budget	Estimate	Estimate	Estimate
Revenue	$'million	$'million	$'million	$'million	$'million	$'million	$'million	$'million	$'million	$'million
Taxation revenue	2 806	2 941	2 979	3 250	3 570	3 478	3 526	3 623	3 832	4 046
Grants:										
Current	4 906	5 206	5 556	5 715	6 294	6 610	6 466	6 547	6 927	7 211
Capital	167	200	210	254	322	589	1 598	1 200	668	461
Sales of goods and services	1 165	1 244	1 333	1 464	1 572	1 711	1 834	1 852	1 940	2 011
Interest income	172	161	147	167	203	120	144	206	261	321
Dividend and income tax equivalent income	468	455	575	450	429	348	388	450	398	459
Other	272	386	441	456	490	529	489	519	560	570
Total revenue	9 955	10 592	11 242	11 757	12 879	13 385	14 444	14 397	14 585	15 079
Less: **Expenses**										
Employee expenses	3 903	4 220	4 644	4 933	5 268	5 684	6 035	5 942	6 052	6 147
Superannuation expenses:										
Superannuation interest cost	354	351	344	316	276	383	444	441	437	433
Other superannuation expenses	410	429	480	506	546	602	623	630	644	657
Depreciation and amortisation	435	453	454	498	525	595	601	657	703	770
Interest expenses	253	248	223	204	218	161	174	328	414	476
Other operating expenses	2 348	2 742	2 874	3 021	3 246	3 501	3 728	3 613	3 792	3 838
Grants	1 866	1 925	2 021	2 069	2 337	2 724	3 145	2 709	2 448	2 454
Total expenses	9 570	10 368	11 040	11 547	12 414	13 650	14 748	14 319	14 489	14 775
Net operating balance	385	224	202	209	464	(265)	(304)	78	96	304
Less: **Net acquisition of non-financial assets**										
Purchases of non-financial assets	530	695	717	771	875	1 347	2 180	2 199	1 528	1 132
Less: Sales of non-financial assets	124	119	144	134	108	85	343	140	246	75
Less: Depreciation	435	453	454	498	525	595	601	657	703	770
Add: Change in inventories	(10)	(18)	-	-	-	-	-	-	-	-
Total net acquisition of non-financial assets	(38)	105	119	139	242	667	1 237	1 402	579	287
Net lending (borrowing)	424	119	83	71	222	(932)	(1 541)	(1 324)	(483)	17

Note - Totals may not add due to rounding.

6.5.2 Net operating balance influences

Achieving net operating balances is a fiscal target. The following chart shows the increase or decrease, in real terms, of total revenue and total expenses to the previous year for the 10 years to 2012-13.

Chart 6.1 — Increase/decrease of total revenue and total expenses to previous year [a]



(a) Estimated June 2009 values.

Chart 6.1 starkly demonstrates the short and medium term responses to the global financial crisis. 2008-09 and 2009-10 show the highest growth in revenues over the period due to additional Commonwealth stimulus money. The medium term begins with 2010-11 where, on current projection both expenses and revenues fall in real terms but for some different reasons.

Revenues fall as the very large Commonwealth stimulus grants wind down. Part of the decrease in expenses is the matching fall in related grant expenses in 2010-11 and 2011-12. The trend line adjusted to exclude grant expenses shows the significance of movements in grant expenses over the 3 years to 2010-11.

Expenses, excluding grants, also decrease or are constrained from proposed savings strategies and general expenditure control. It can be seen that this projection, even after allowing for grant expenses, is at variance with every other year charted except 2002-03. While the circumstances in the previous years differed, the task of decreasing spending stands out as a challenge.

7 REVENUE

Trend data in charts in this section is in real terms at estimated June 2009 values unless otherwise stated.

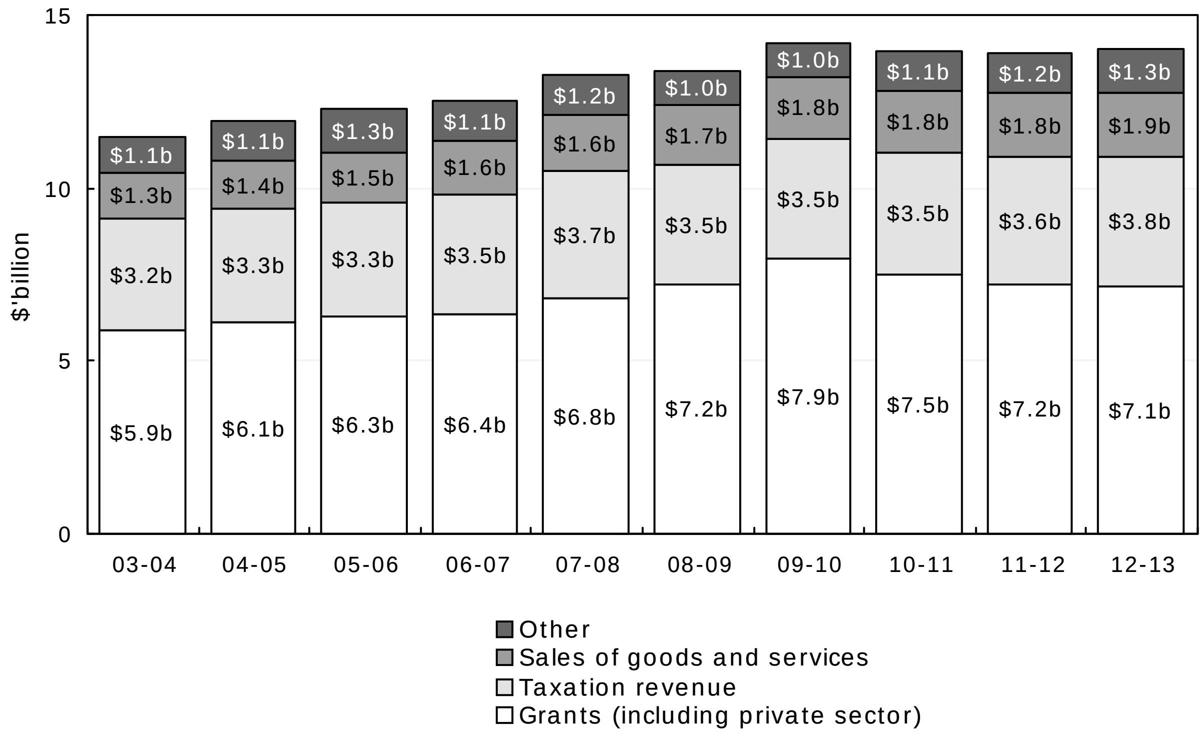
7.1 REVENUE OVERVIEW

The global financial crisis combined with changes to Commonwealth and States financial arrangements cause a temporary change in the composition of total revenue over the period 2008-09 to 2012-13. Essentially projections show the Government expects it will take about four years for revenues to return to longer term trends. Total general government sector revenues are estimated to be $14.4 billion in 2009-10, an increase of $1059 million (7.9 percent) over the previous year's estimated result, a real increase of $828 million or 6.2 percent. The substantial increase reflects Commonwealth stimulus funding.

Total revenue is then estimated to fall in real terms in 2010-11 and 2011-12, before rising to $15.1 billion in 2012-13.

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

Chart 7.1 — General government sector total revenue



As shown the amount of taxation revenue falls in 2008-09 and remains subdued to 2012-13. Grants, mainly from the Commonwealth, vary over the period from 2007-08.

Chart 7.1 highlights the importance of Commonwealth grants to the State's revenues. Over most years Commonwealth grants represent about 50 percent of total revenue. This increases over the three years to 2010-11, peaking in 2009-10 at 54.7 percent of total revenue. While a relatively small change in percentage terms, this represents many hundreds of millions when total revenues are in the order of $14 billion 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 2009-10.

7.2 COMMONWEALTH GRANTS

Total estimated Commonwealth grant funding to the State for 2009-10 is $7.9 billion. Funding in 2012-13 is estimated at $7.6 billion reflecting the cessation of Commonwealth stimulus funding.

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

7.2.1 Changes to financial relations with the Commonwealth

From 1 January 2009, the 'Intergovernmental Agreement on Federal Financial Relations' (IGA) came into operation. The IGA provides a new framework for the Commonwealth's financial relations with the States and Territories. Accompanying the reform process was a rationalisation of the Commonwealth–State payment structure.

2008-09 is a transitional year, so Commonwealth funding to the State comprised payments under both the previous financial arrangements (mainly first half of 2008-09) and the new arrangements. Table 7.1 shows the current and capital components of Commonwealth grants for the 2009-10 Budget years.

Table 7.1 — Commonwealth grants 2008-09 to 2012-13 (nominal)

	2008-09	2009-10	2010-11	2011-12	2012-13
	$'million	$'million	$'million	$'million	$'million
GST revenue grants	3 817	3 819	4 013	4 246	4 501
Other current grants	2 677	2 511	2 436	2 581	2 610
Capital grants	558	1 567	1 181	650	443
Total grants	7 052	7 897	7 630	7477	7 554

Table 7.1 highlights the large capital grants expected in 2009-10 and 2010-11.

7.2.2 GST revenue grants

GST revenue grants for 2008-09 are expected to be $386.9 million lower than budgeted due to the sharp deterioration in economic conditions from the global financial crisis. The total GST pool is expected to contract by 3 percent in 2008-09, compared to the Commonwealth's original budget estimate of growth of 6.2 per cent.

For the first time since 2002-03, South Australia is estimated to require transitional assistance in 2008-09 available under an original Guaranteed Minimum Amount (GMA) commitment from the Commonwealth Government under the move to GST funding. The assistance is estimated to amount to $34.2 million. The new IGA does not provide for GMA provisions, meaning that after 2008-09 States and Territories now have no recourse for additional budget assistance from the Commonwealth if GST grants fall and jurisdictions are worse off compared to the financial arrangements in place prior to the introduction of the GST.

GST revenue grants are distributed according to the principle of horizontal fiscal equalisation (HFE). The principle of HFE is based on Australia's commitment to ensuring that each State has the capacity to provide public services at a similar standard and level of efficiency as the other states for a comparable revenue-raising effort.

Over the forward estimates, GST revenue grants are expected to grow from $3.8 billion in 2009-10 to $4.5 billion in 2012-13, a real increase of $402 million from 2008-09.

7.2.3 Specific purpose payments

Specific purpose current and capital payments (SPPs) are provided under section 96 of the Constitution for both recurrent and capital expenditure purposes. The reform of Federal financial relations resulted in a significant rationalisation in the number of SPPs, effective from 1 January 2009. Previously, the allocation of SPPs was based on many approaches, including Commonwealth discretion, historical allocation and formula-based allocation. Under the new IGA, allocations will largely be made on a per capita basis, to be phased in over a number of years. The change in the distribution of SPPs will, over time, result in broadly offsetting changes in GST revenue grants.

Over the forward estimates, SPPs are expected to increase from $2.1 billion in 2009-10 to $2.3 billion in 2012-13, a real decrease of $391 million from 2008-09.

7.2.4 National Partnership Commonwealth grants

National Partnership current and capital payments (NPP) are a new form of time limited payment under the new Federal-state funding arrangements to fund specific projects and to facilitate and/or reward states that deliver on nationally significant reforms.

Over the five years to 2012-13, total NPP revenue from initiatives agreed in 2008-09 is projected to be $1011 million. A number of NPPs require states to make a corresponding co-investment. Expenditure of $1182 million over the period to 2012-13 is to be allocated to ensure that the reform objectives agreed by the Council of Australian Governments are achieved in this state.

NPPs are projected to increase substantially in 2009-10, and remain at high levels to 2011-12 due to the timing of payments for infrastructure projects under the Commonwealth Government's Nation Building – Economic Stimulus Plan (announced in February 2009) and Nation Building Plan for the Future (announced as part of the Commonwealth budget) under which the State receives $1.8 billion and $1.1 billion respectively. Over the forward estimates, NPPs are expected to decrease from $1.96 billion in 2009-10 to $732 million in 2012-13 as nation building funding ceases.

7.2.5 Monitoring of specific purpose funding

Under the new Commonwealth-State financial arrangements, SPPs and NPPs will be reviewed by Treasurers not less than every five years, to ensure that funding is adequate to meet expenditure demands. The reporting of outcomes will also be monitored to identify issues that might trigger earlier consideration of funding adequacy.

7.3 TAXATION REVENUE

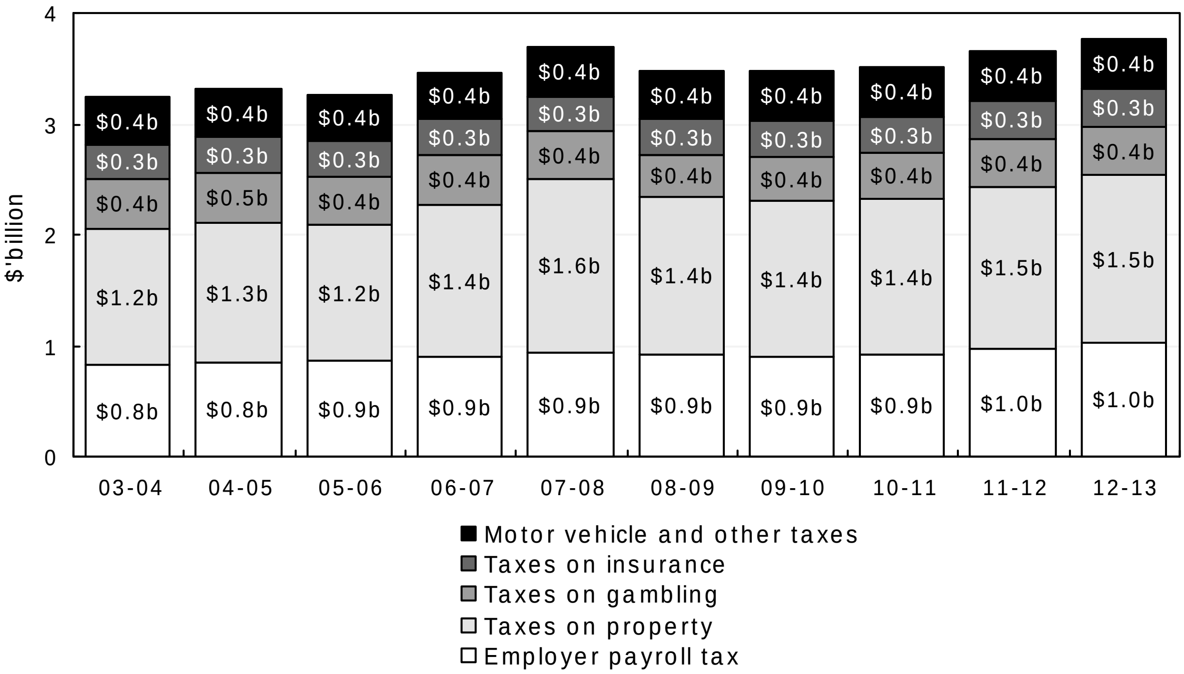
Taxation revenue is the second largest source of revenue to the State and represents approximately 26 percent of revenues in 2008-09. It comprises a diverse range of activities, including payroll, property, motor vehicles and gambling activities.

The Government has a fiscal strategy to ensure the State has an effective tax regime having regard to the Government's social and economic objectives. Considerations for the State's capacity to raise taxation revenue include the capacity of taxpayers to pay and the State's relative tax effort compared to other States and Territories.[14]

The following chart examines the trend in the components of taxation receipts (in real terms) over the 10 year period to 2012-13.

[14] Budget Statement 2009-10, pp 3.15-3.16 discusses South Australia's relative taxation effort.

Chart 7.2 — Taxation revenue



Total taxes, in real terms, fall in 2008-09 and again slightly in 2009-10 before rising over the remaining forward estimates period. Chart 7.2 demonstrates that throughout this time series, variations in taxation revenue are primarily due to property taxes.

Taxation revenue for 2009-10 is estimated to be $3.5 billion, a nominal increase of $48 million over the estimated result for 2008-09. It is expected to be $4 billion in 2012-13, a real increase of $285 million compared to $3.5 billion in 2008-09.

7.3.1 Property taxes

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

Property taxes for 2009-10 are estimated to be $1.4 billion, a real decrease of $17 million from the estimated result for 2008-09. They are expected to be $1.6 billion in 2012-13, a real increase of $88 million compared to 2008-09. Chart 7.3 shows the trend in property taxes (in real terms).

Chart 7.3 — Taxes on property

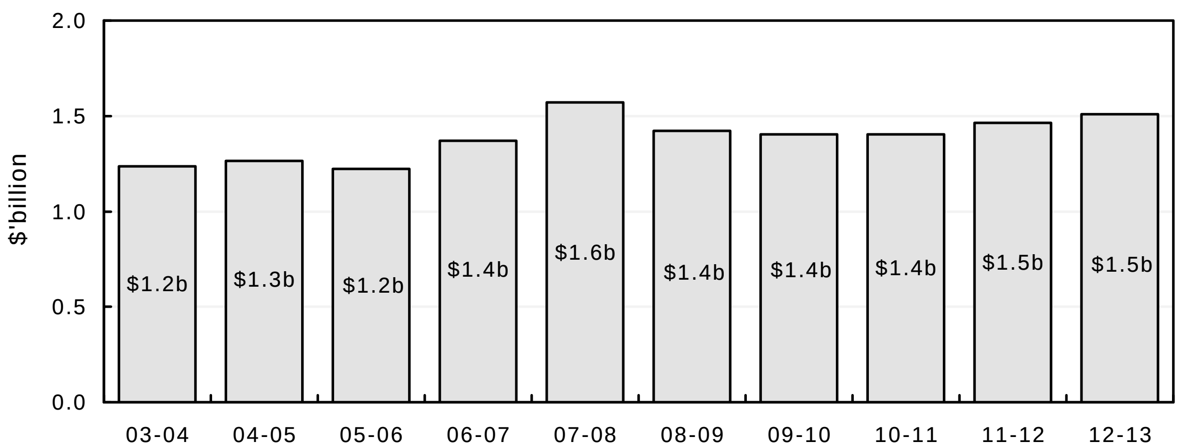


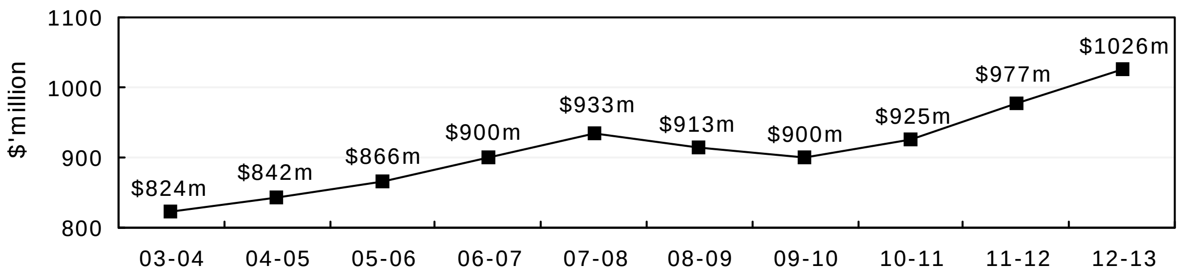
Chart 7.3 reflects the significant slowing of property market activity in 2008-09, the projection in 2009-10 for continuation of subdued property market conditions before return to modest growth in 2012-13.

The Budget papers note that property tax revenues are affected by IGA tax policy reforms that take effect over the forward estimate period. These reforms will depress property tax growth in 2009-10 (final phase of abolition of mortgage and rental duty) and 2012-13 (when stamp duty on non-quoted, marketable securities and non-real property transfers is abolished).

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



Payroll taxes for 2009-10 are estimated to be $915 billion, a real decrease of $13 million from the estimated result for 2008-09. The payroll tax threshold will be increased from $552 000 to $600 000 from 1 July 2009. In addition, the payroll tax rate will be reduced from 5 percent to 4.95 percent from 1 July 2009.

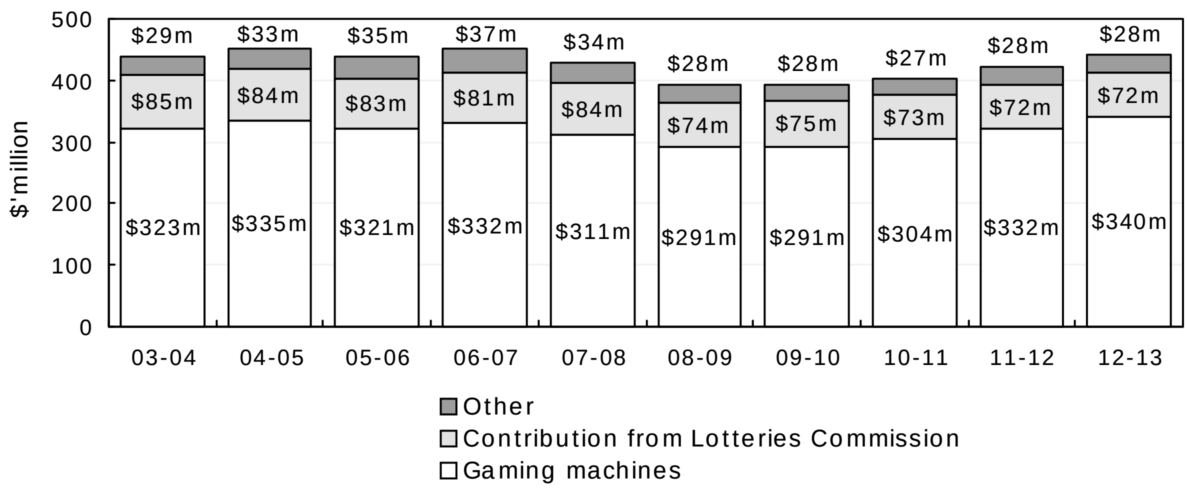
Payroll taxes are expected to be $1103 million in 2012-13, a real increase of $113 million compared to 2008-09.

7.3.3 Gambling taxes

Gambling taxes for 2009-10 are estimated to be $400 million, a real decrease of $1 million from the estimated result for 2008-09. Gambling taxes are expected to be $472 million in 2012-13, a real increase of $47 million compared to 2008-09.

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

Chart 7.5 — Gambling taxes



Gaming machine revenue falls in 2008-09 reflecting the full year effect of smoking bans in gaming venues (including the casino), which came fully into effect on 31 October 2007. These revenues, which account for 74 percent of 2008-09 gambling taxes, are expected to be $366 million in 2012-13, a real increase of $49 million compared to 2008-09.

7.4 SALES OF GOODS AND SERVICES

Revenue from sales of goods and services represented about 13 percent of estimated total revenues in 2008-09. Sales of goods and services by the general government sector include Government fees and charges most of which increase by 4.2 percent from 1 July 2008 reflecting the annual indexation of fees.

Revenue from sales of goods and services are expected to be $2 billion in 2012-13, a real increase of $159 million compared to 2008-09.

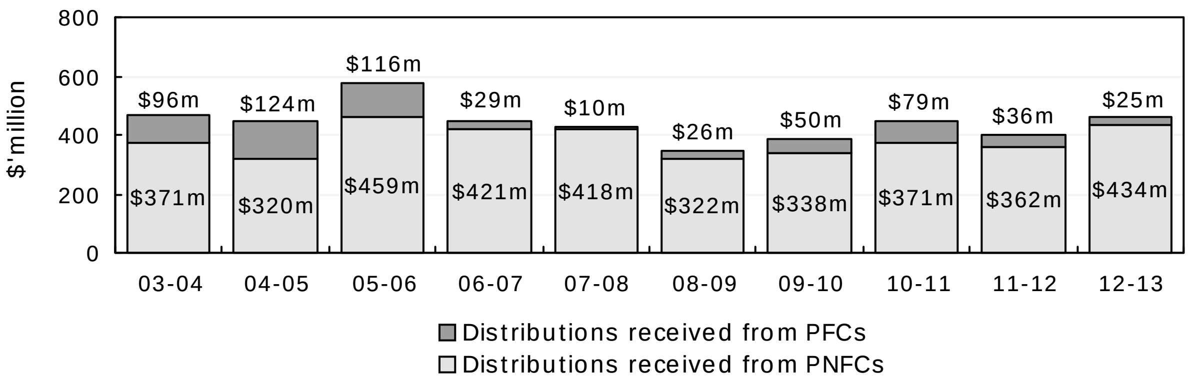
7.5 DIVIDEND AND INCOME TAX EQUIVALENT INCOME

Dividend and income tax equivalent income are the distributions received from public non-financial corporations (PNFCs) and public financial corporations (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 2012-13.

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



The chart shows variability in distributions across the time series. The Budget papers note an estimated distribution from SAFA in 2010-11 is higher, reflecting a return of projected excess capital. Also, estimated SAAMC distributions in 2009-10 are higher than in other years reflecting the return of accumulated retained profits that are no longer required by SAAMC, as the contingent liabilities that may have led to a call on SAAMC's capital resources were eliminated.

7.5.1 Public non-financial corporations

In 2008-09, distributions received from PNFCs are estimated to amount to $322 million, a decrease of $96 million (23 percent) from the previous year's result and $97 million (23 percent) below budget. The decrease from budget mainly reflects lower than expected distributions from the SA Water Corporation, Land Management Corporation and Forestry SA.

7.6 OTHER REVENUE

Other revenue mainly comprises royalties, fines and penalties and schools fundraising revenue. Other revenue is expected to be $570 million in 2012-13, no real increase compared to 2008-09.

7.7 RISKS TO REVENUE

The Budget papers provide quite 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 percent in state taxation revenue equates to about $35 million per annum.
- ***GST revenue grants*** — a variance of 1 percent in GST revenue growth has a revenue impact of $38 million per annum.

  Commonwealth GST revenue grants are the vehicle for horizontal fiscal equalisation (HFE). The methodology and data underlying the HFE process is determined by the Commonwealth Grants Commission (CGC). Methodology changes may impact on the State, either positively or adversely.

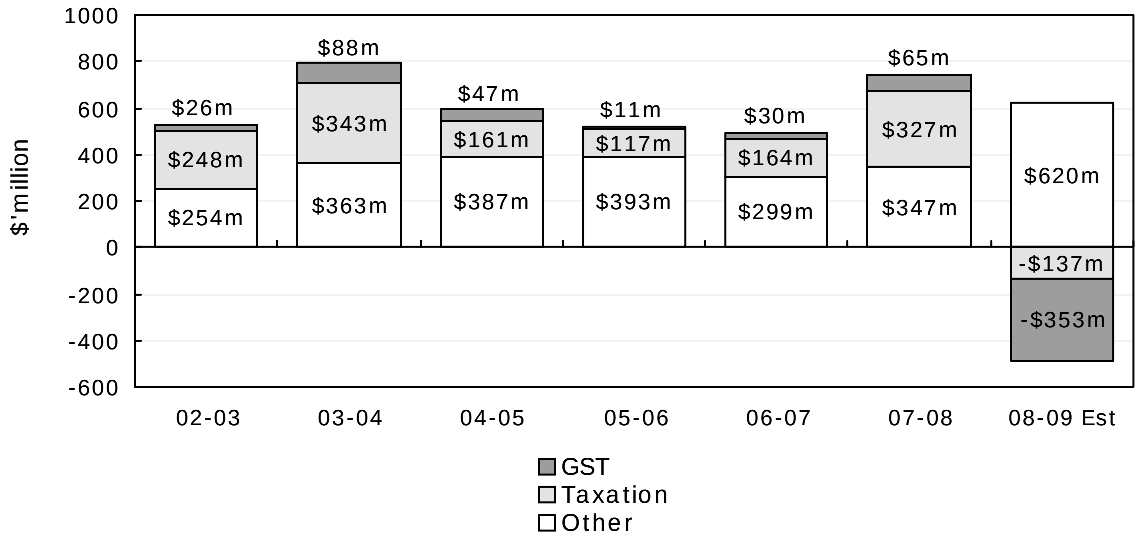
  A 0.01 change in South Australia's CGC relativity, results in a change in GST revenue grants of $28 million.
- ***Commonwealth specific purpose grants*** — Payments for specific purposes from the Commonwealth account for about 19 percent in 2008-09 (15 percent thereafter) of state government revenues. Variations in their level or the conditions applying to these payments pose a risk to the budget.

Readers are referred to the Budget Statement 2009-10, Budget Paper 3, Chapter 7 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 revenue for the past seven years.

Chart 7.7 — Difference between budget and actual revenues (nominal)



The chart highlights the very large favourable variations from budget that have been enjoyed up to 2007-08 and the estimated unfavourable variations in GST and taxation revenue in 2008-09. In 2008-09, the favourable and unfavourable variations offset, resulting in a net $130 million improvement from budget.

8 EXPENSES

8.1 EXPENSES OVERVIEW

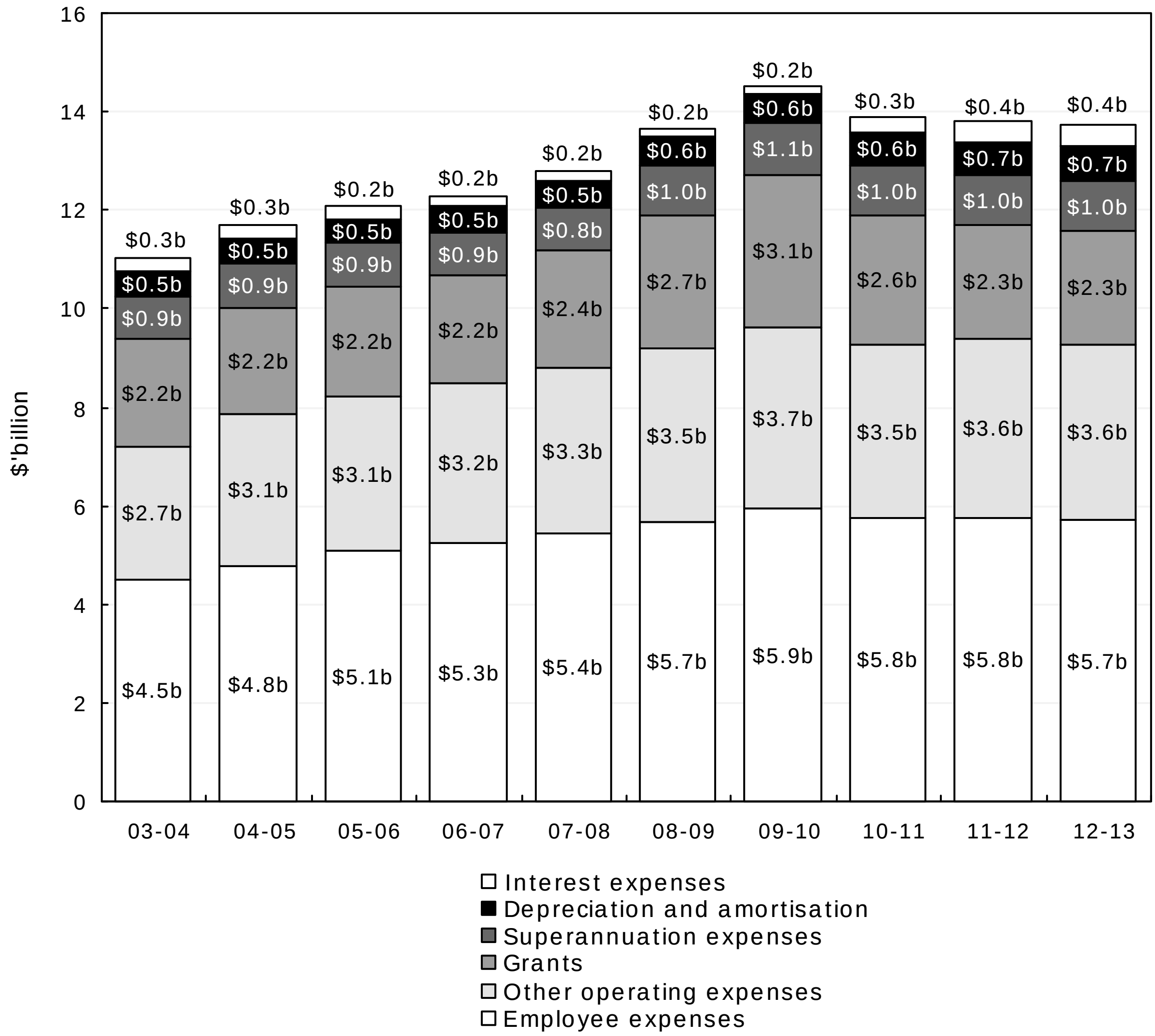
As with revenue, the global financial crisis combined with changes to Commonwealth and states financial arrangements cause a temporary change in the composition of total expenses over the period 2008-09 to 2012-13 as grants expense is influenced by the flow through of Commonwealth grant revenue.

For 2008-09 estimated expenses total $13.7 billion and exceed budget by $556 million or 4.2 percent. Unbudgeted grants expense make up $324 million of the increase.

Total expenses for 2009-10 are budgeted to be $14.7 billion, $1.1 billion or 8 percent higher than 2008-09 and grow to $14.8 billion in 2012-13.

The following chart highlights the trends in expenses (in real terms) that have emerged since 2003-04.

Chart 8.1 — General government sector - expenses



The chart shows expenses grow annually from 2003-04 to 2009-10, fall in 2010-11 and are projected to remain relatively stable thereafter.

The following discussion focuses on some of the major components that make up expenses. Detailed comments on expenditure are provided in Budget Statement 2009-10, Budget Paper 3, Chapter 2.

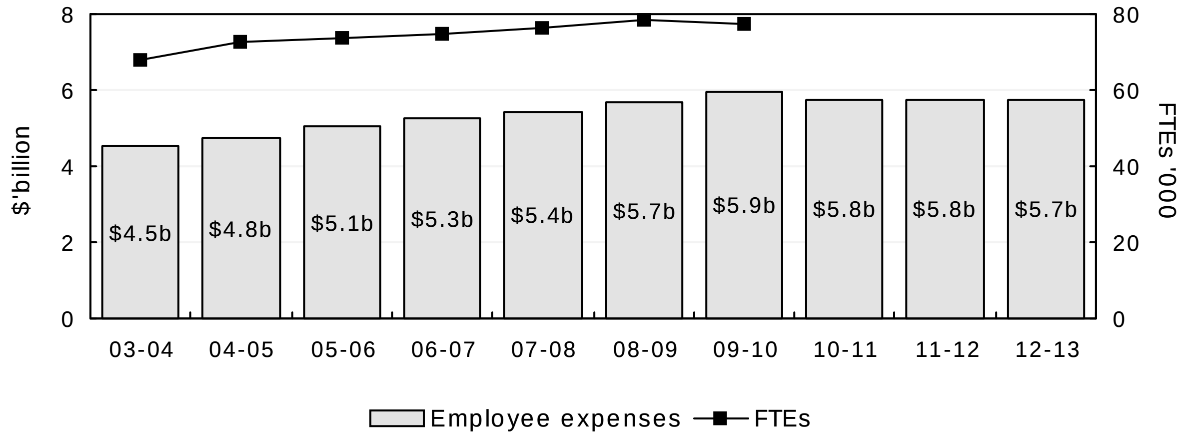
8.2 EXPENSES BY TYPE

8.2.1 Employee expenses

Employee expenses (an estimated $5.7 billion in 2008-09) represent the highest proportion (42 percent) of total expenses. They are estimated to increase by 6.2 percent in 2009-10 and about 0.6 percent per year to 2012-13.

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

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



(a) 2003-04 to 2006-07 are actual FTEs provided by OPE.
(b) 2007-08 to 2009-10 are DTF estimates.

The chart highlights the real terms growth in employee expenses until 2009-10. This growth is consistent with FTE numbers up to 2008-09.

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

In the four years to 2008-09 employee expenses grew by an average of 7.7 percent per year. The 2009-10 Budget shows employee expenses growing in real terms on an average of 0.2 percent, a much lower rate than in prior years. This is mainly 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 2009-10.

The 2009-10 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.

The main enterprise agreements to be renegotiated at the time of presentation of the 2009-10 Budget are for:

- wages parity group (salaried and weekly paid employees)
- SA Ambulance Service employees
- Parliament House and electoral office employees.

Proceedings are continuing in the Industrial Relations Commission of South Australia regarding an arbitrated award for teachers and TAFE lecturers.

The Government has indicated it will seek to limit future wage outcomes to 2.5 percent per annum in an effort to provide real wage increases to public sector employees and prevent further job losses being required. Enterprise agreements generally extend over about three years with annual increases/outcomes within agreement sometimes differing from year to year. Outcomes in the past four years, while in strong economic times, have in some periods been within this limit but generally exceed the Government's current target, with some sectors receiving much more.

Examples of some annual outcomes (excluding non-wage items) within agreements are: teachers and lecturers – 1 October 2007 4 percent; visiting medical specialists and wages parity (salaried) – 1 October 2008 – 3.5 percent; wages parity (weekly paid) – 1 October 2008 – 4 percent; police – 1 January 2008 – 5.2 percent, 1 July 2009 3.5 percent; nurses – 1 October 2009 – 4.5 percent; firefighters – 1 January 2009 – 8.2 percent salaried medical officers and clinical academics – 14 April 2008 – 14.7 percent, 14 April 2009 – 3.5 percent. Circumstances for the respective groups naturally differ, but all these examples were beyond the Government's current target and vary across groups.

8.2.2 Other operating expenses

Other operating expenses include general purchases of goods and services.

These expenses are estimated to be $3.7 billion for 2009-10, an increase of $227 million or 6.5 percent in nominal terms from 2008-09. The projection for the forward years to 2012-13 is for a real terms increase of 1.9 percent from 2008-09 to 2012-13.

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 two years to 2009-10.

Table 8.1 — Contingency provisions

	2008-09 Budget $'million	2008-09 Estimated result $'million	2009-10 Budget $'million
Employee entitlements	70	210	**207**
Investing contingencies	54	31	**42**
Supplies and services	210	123	**218**
	334	364	**467**

The 2009-10 Budget includes contingency amounts totalling $467 million, $133 million more than the previous Budget. While allocating sums to each of the categories for presentation purposes, contingency funds may also be transferred from other lines where available. This is demonstrated in table 8.1 where the 2008-09 estimated result for employee entitlements is $140 million higher than the original budget.

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

As mentioned, 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 $2.7 billion for 2008-09, that is, $324 million or 13.5 percent above budget.

Grants are estimated to increase by $421 million to a peak of $3.1 billion in 2009-10 largely due to payments to non-government schools and to the South Australian Housing Trust under the National Building – Economic Stimulus Plan.

8.2.5 Superannuation expenses

8.2.5.1 Superannuation interest cost

In 2009-10 and across the forward estimates, superannuation interest cost is expected to be higher than estimated in the 2008-09 Budget, in the order of $70 million each year. This reflects the effect of increases in the unfunded superannuation liability across the forward estimates, primarily as a result of lower than expected returns on investments in 2008-09 and a lower discount rate used to value the unfunded superannuation liability.

As the estimate of the liability is not final at the time of the Budget, it may be further adjusted for actual earnings on superannuation assets in 2008-09. The Budget Papers note that a 1 percent lower than expected return on superannuation assets invested by Funds SA would increase estimated unfunded superannuation liabilities by around $52 million. An increase in unfunded superannuation liabilities of this magnitude would increase superannuation interest cost, decreasing the net operating balance result by around $4 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 $602 million in 2008-09 and are projected to increase to $657 million in 2012-13, a real increase of 1.5 percent.

8.2.6 Depreciation and amortisation

Estimated depreciation and amortisation expenses were $595 million in 2008-09 and are projected to increase by 29 percent to $770 million in 2012-13. The increase reflects the growth in the value of fixed assets through purchases and revaluations.

8.2.7 Interest expense

Estimated interest expense in 2008-09 was $161 million and is projected to increase by 196 percent to $476 million in 2012-13 as a result of projected increased borrowing to fund capital programs.

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

8.2.8 Capital payments

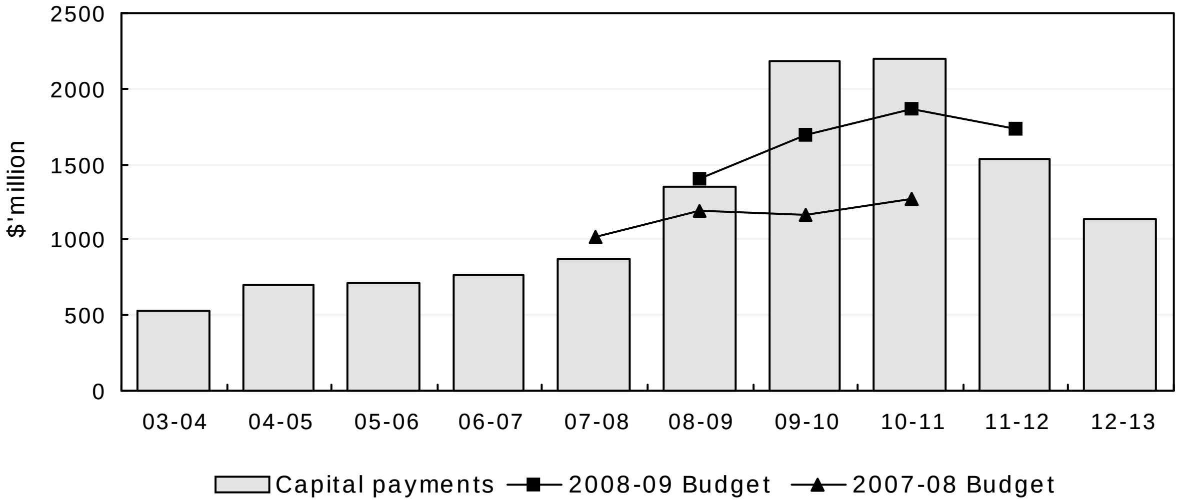
Capital payments are represented by the value of purchases of non-financial assets in the General Government Sector Operating Statement.

The 2009-10 Budget, with the combined influence of state and Commonwealth initiatives, elevates general government sector capital spending to extraordinarily high levels. Purchases of non-financial assets are $1.4 billion higher over the three years to 2010-11 than estimated at the MYBR.

Purchases of non-financial assets are estimated to be $1.3 billion in 2008-09. Spending peaks in 2009-10 and 2010-11 with both years targeting capital spending of $2.2 billion. This is $833 million or 62 percent more than estimated for 2008-09 and double what is estimated to be spent by 2012-13, $1.1 billion.

The following chart shows purchase of non-financial assets over the 10 year period to 2012-13, overlayed with budgeted purchases from the 2007-08 and 2008-09 Budgets.

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



The chart shows the variability of the expenditure, both historically and in the forward estimates and the large increases projected for the 2009-10 Budget, particularly compared to that estimated for the 2007-08 Budget. 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 2009-10 is $38 million.

In my last report I noted there may be a heightened risk to the proper management and control of higher capital outlays. This situation remains and is elevated by the value of spending.

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. I note nation building funding requires states to ensure that there is no substitution of capital expenditure effort in the targeted areas. State coordinators are appointed to oversee implementation and progress is reported quarterly to the Commonwealth Treasurers' Ministerial Council.

There is pressure to engage contractors quickly to facilitate completing the program. There is also a propensity for large amounts of capital spending to occur in the later part of the financial year. Both these periods are potentially when decision making and due process may come under pressure. Notably, should spending targets not be reached, net lending and net debt will improve.

Capital payments exclude private sector capital expenditure for public purposes discussed in the next section.

8.2.9 Public private partnerships (PPP)

In the 2006-07 Budget, the Government announced substantial PPP projects for the provision of correctional and educational infrastructure for use by the public sector. Work commenced on procuring education (lead agency Department of Education and Children's Services), prisons (lead agency Department for Correctional Services) and youth detention infrastructure (lead agency Department for Families and Communities) in 2006-07.

Comments on these projects during 2008-09 are contained in the sections of Part B of this Report titled 'Department for Correctional Services' and 'Department of Education and Children's Services'.

In December 2007, the Government announced that the New Royal Adelaide Hospital would be delivered under a public private partnership procurement model.

The State's new prisons and secure facilities was deferred in the MYBR. The Government subsequently cancelled the planned PPP project in response to the global financial crisis. The project was to provide for new a men's and women's prison at Mobilong and a co-located Forensic Mental Health Centre and a new Youth Detention Centre and a Pre-Release Centre, both at Cavan. The Government announced the cancellation of the PPP Project would reduce net debt by more than $500 million.

In September 2009 the Government announced a new facility for juvenile offenders would be constructed, mainly funded from the sales of land.

Anticipated investing spending on new schools and the hospital in the four years of the 2009-10 Budget is in the order of $360 million.

The Education Works - New Schools PPP project reached financial close in July 2009 with a total reported value of $323 million including the cost of construction and management and maintenance of the schools over a thirty year period. The Government announced that the PPP model proved to be about $9.2 million (3 percent) more expensive than a traditional build. The successful consortium had, however, committed to meeting the Government's timetable for delivery of the schools at a fixed price.

The indicative program for a New Royal Adelaide Hospital was for expressions of interest and request for proposal processes during 2009 and completion in 2016.

8.2.9.1 Financial reporting of PPPs

The use of PPPs can alter the financial reporting of costs associated with the construction and operation of relevant infrastructure. Depending on the terms of contracts, PPPs may, under current accounting standards, be excluded from State balance sheets (may be off-balance sheet) through their contractual arrangements and assignment of risks and benefits.

DTF have advised that PPPs arrangements for schools and the hospital are recognised as finance leases in the balance sheet, and consequently have an impact on net debt and net financial liabilities.

8.2.10 Asset sales

The MYBR resulted in decisions to sell a range of assets as part of the Government's debt reduction measures namely:

- ForestrySA harvests
- building assets
- regional housing assets.

In addition to asset sales, responsibility for the management of the Government's motor vehicle fleet will be transferred to SAFA as part of a review of operational and financial arrangements. The transfer of operations to SAFA results in an improvement in net debt for the general government and non-financial public sectors but not for the whole-of government as this is a inter-sector transfer to the PFC sector. The cost of running the fleet, including interest on borrowings, will be recovered through lease fees to the other sector agencies. The value of Fleet SA borrowings at 30 June 2009 was $235 million.

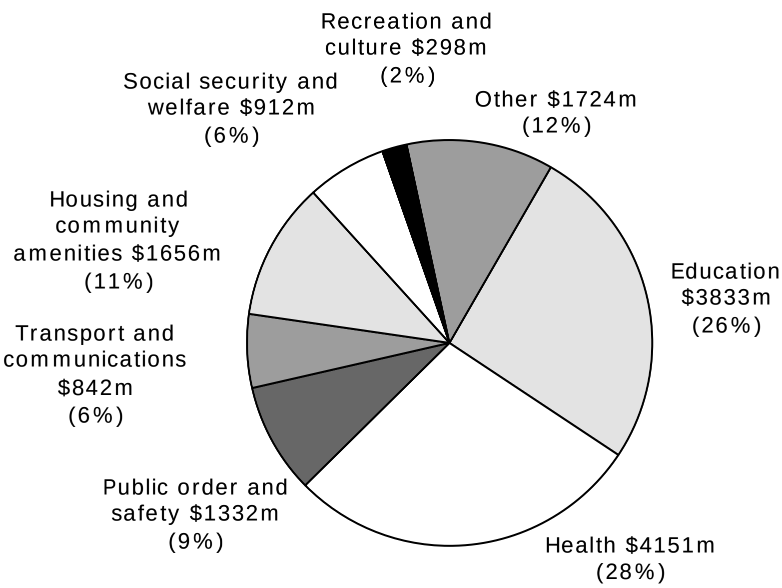
Sales of non-financial assets are expected to return $343 million in 2009-10.

Inquiries with DTF indicate that for the forestry, building and housing assets, relevant expertise was being seconded as required to implement sales processes with DTF. The sales process would include scoping studies, due diligence and marketing to obtain the best possible price. In 2008-09, 31 government employee housing disposals were completed with total proceeds of $4.4 million. Remaining sales are expected to occur over three years to 2011-12.

8.3 EXPENSES BY FUNCTION

The GFS reporting framework also provides information on expenditure (excluding capital payments) by its function for the General Government Sector. The following charts the 2009-10 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[15] ($'million)



[15] Budget Statement 2009-10, Budget Paper 3, Table 2.18.

8.4 RISKS TO EXPENSES

8.4.1 Overview

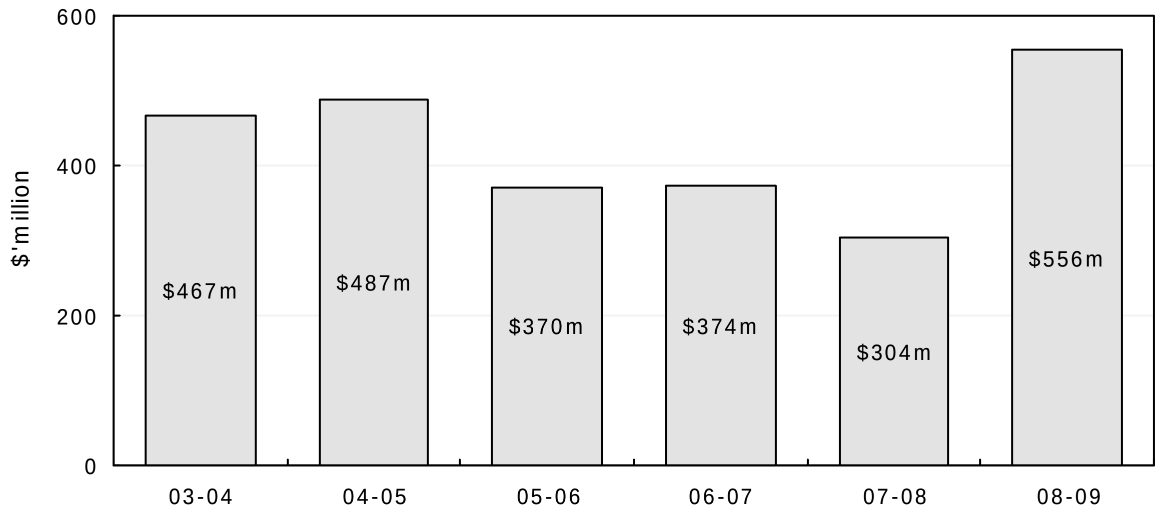
As with revenue, the 2009-10 Budget provides detailed consideration of various risks to the expenditure budget and acknowledges the management task for achieving budgeted outcomes.[16]

Some of the key risks reported are:

- ***Wages and salaries*** — an increase of 1 percent per annum above the amounts factored into the Budget would have an adverse impact of approximately $250 million in 2012-13
- ***Capital investment pressures*** — a number of departments including Transport, Energy and Infrastructure and Health have large capital investment programs over the forward estimates period. Historically there has been considerable cost escalation compared with original projections. As other states embark on significant infrastructure programs over the forward estimates period this risk increases. If cost escalations exceed the amounts included in the capital investment program, annual net lending outcomes will be impacted. A 1 percent increase in costs for the capital program in the general government sector will increase expenditure by approximately $22 million in 2009-10.

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)]



(a) 2008-09 is the difference between budget and the estimated result.

The chart highlights that, notwithstanding classification changes, expenses consistently exceeded original budget expense targets in the five years to 2007-08 due to parameter variations and policy measures. These were funded by rising revenues.

While 2008-09 also exceed budget, for the various reasons explained in this report, mainly to do with the global financial crisis, much of this increase was funded by Commonwealth stimulus grants.

[16] Budget Statement 2009-10, Budget Paper 3, p 7.6

8.4.2 Savings and revenue offsets

Setting large value savings targets is a feature of past Budgets.

The 2008-09 MYBR in December 2008, resulted in announced operating savings of $250 million up to 2011-12 from a package of measures namely; a reduction of 1600 public servants not directly involved in the delivery of frontline services over three years ($131 million up to 2011-12), deferral of grants for the redevelopment of AAMI Stadium ($87.4 million) and revised Shared Services SA office accommodation providing savings of both rental (operating) and fit-out (capital) expenditure.

The 2009-10 Budget includes new operating savings totalling $831 million over the next four years but essentially not commencing until 2010-11. New operating savings include:

- an addition of $75 million in 2012-13 to the 2008-09 Budget savings target, taking the total of this savings target to $225 million in that year. This saving has been removed from agency budgets in tables 2.3-2.15[17]

- a further savings target of $750 million that will require the achievement of savings of $150 million in 2010-11, $250 million in 2011-12 and $350 million in 2012-13. This saving will be held centrally by the DTF pending the Government's consideration of budget improvement measures recommended by the Sustainable Budget Commission through reviewing revenues, operating and capital expenditures and asset sales. Of this total, the Government estimates that up to $290 million will be saved if the public sector is limited to a 2.5 percent wage cap over four years.

These come on top of savings identified in each of the 2006-07, 2007-08 and 2008-09 Budgets based on either achieving efficiencies or reducing particular services. The 2008-09 Budget included a savings target allocated across portfolios of $25 million in 2009-10, $75 million in 2010-11 and $150 million in 2011-12. This savings target remains in the forward estimates. Specific savings measures that will achieve the first tranche of $25 million from 2009-10 are presented in the 2009-10 Budget[18].

A summary of the published total operating savings initiatives for the past four Budgets for the five years to 2012-13 is as follows:

Table 8.2 — Summary of budget operating savings

	2008-09 $'million	2009-10 $'million	2010-11 $'million	2011-12 $'million	2012-13 $'million
Total savings 2006-07 Budget	223	277	*	*	*
Total savings 2007-08 Budget	45	64	82	*	*
Total savings 2008-09 Budget	8	36	86	161	*
Total savings 2009-10 Budget	N/A	1	152	251	427
Total savings	276	378	320	412	427

* Ongoing indexed savings but not published

17 Budget Statement 2009-10, Budget Paper 3

18 Shown under 'Memorandum Items – Initiatives to Meet 2008-09 Budget Savings Target for 2009-10' in tables 2.3-2.15, Budget Statement 2009-10, Budget Paper 3.

Revenue offsets are revenues received from external parties for the specific purpose of, and incidental to, a Budget expenditure measure. The 2009-10 Budget includes revenue offsets of $128 million. These include contributions from the Commonwealth Government totalling $120 million comprising $93.6 million to the Department of Primary Industries and Resources for exceptional circumstances interest rate subsidies for drought affected areas and $26 million to the Department of Water, Land and Biodiversity Conservation for water projects.

8.4.3 Nature of savings initiatives

Savings initiatives include:

- implementing shared services arrangements for administrative support services
- savings from efficiency dividends
- departmental efficiencies
- reducing the number of public servants.

As shown in table 8.2, the 2009-10 Budget virtually does not add to existing saving targets for 2009-10. Audit observations on savings achievements follow in section 8.4.8 ‘Audit Review of 2008-09 Budget Monitoring and Reporting’.

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

Audit review of savings in this and past years shows that some areas of savings are more difficult to achieve than originally estimated. Last year I reported that savings were not being achieved for the shared services initiative in the timeframes estimated. Review in 2008-09 indicates that the Department of Health was not expected to achieve target savings and also has experienced cost pressures for which it received additional resources in 2008-09. Final data on performance against budget was not available at the time of this Report but while variations were small compared to the overall health budget, they made up a sizeable part of targeted savings.

DTF is reporting that a high proportion of the value of targeted savings for 2008-09 is being achieved. Some details are provided in the following sections.

Saving targets are also typically directed at public servants not directly involved in the delivery of frontline services. Over time the ability to draw savings primarily from one section of the workforce will diminish. There may also be unintended consequences from reducing capacity in support services that mean a range of those service activities are impeded or stopped.

8.4.4 Targeted voluntary separation program

The 2008-09 MYBR, released on 19 December 2008, outlined the Government’s decision to seek a reduction of 1600 full-time equivalent (FTE) public sector staff focused on administrative positions (1200 by the end of 2009-10, with a further 200 in each of 2010-11 and 2011-12). The strategy is estimated to provide ongoing savings in excess of $100 million per annum.

To assist agencies achieve 2009-10 MYBR FTE reductions, a targeted voluntary separation program (TVSP) was approved. A central contingency of $124.8 million was established to fund TVSPs that assist agencies achieve their 2008-09 MYBR FTE reduction targets for 2009-10.

Under the 2009 TVSP Scheme, agencies identify excess employees in order to meet either:

- the 2008-09 MYBR FTE reduction targets for 2009-10, or

- other savings measures (including the 2008-09 MYBR FTE reduction targets for 2010-11 and 2011-12).

To the extent that TVSPs assist agencies to achieve their 2008-09 MYBR FTE reduction targets for 2009-10, they are centrally funded. Otherwise agencies can enter into a 'loan' arrangement with DTF or self-fund the TVSP.

At the time of this Report, DTF advised that at the end of August 2009, agencies have reported making a total of 951 offers of a TVSP and having received a total of 400 acceptances. Employees had until the end of September 2009 to accept an offer of a TVSP.

8.4.5 Savings initiatives – shared services

The shared services initiative was projected to be a significant contributor to the total savings targets presented in the 2006-07 Budget reaching $45 million by 2008-09 and $60 million each year by 2009-10. There remain timing and other pressures on these savings targets.

The shared services initiative is discussed in Part A of this Report.

8.4.6 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.

Strategies used by DTF, the Treasurer and the Expenditure Review and Budget Cabinet Committee (ERBCC) to control and monitor agency budgets include:

- monthly reporting by agencies of year to date budget outcomes and revisions to expected end of year outcomes
- quarterly reporting of progress of achieving budget initiatives or whether the initiative is at risk
- end of October, December and February reporting by agencies on the status of their Capital Investment Program
- a carry over policy to identify under expenditure by agencies allowing Cabinet to approve carryovers or redirect funds
- a cash alignment policy to ensure agencies do not build up excessive cash balances to fund unauthorised expenditures (see section 11 in this Part of the Report)
- FTE monitoring against FTE caps
- an end of year process where agencies and DTF review financial performance and meet, if required
- a chief executive accountability framework where CEs are required to report to their Minister and Treasurer in cases where they do not believe they can manage their budget
- submissions are presented to ERBCC for approval before review by the full Cabinet. Submissions not approved require revision before further consideration. For ERBCC, DTF gives written comments on submission recommendations and costings.

Budgets can only be changed with appropriate approval. Changes to budget results are approved by the Treasurer, ERBCC or Cabinet.

8.4.7 The global financial crisis and changes to analysis, monitoring and reporting

A comment is made in the Budget[19] in the context of the capital program and keeping state debt at manageable levels that 'This will require state operating expenditures to be very tightly constrained in the future'. I asked for details of any changes to capital and operating expenditure monitoring processes for 2008-09. I also asked about areas of the Budget considered to be the highest risks and any specific monitoring measures in place.

In response DTF advised that no significant changes were planned to monitoring processes for 2009-10. Consistent with previous years, budget initiatives monitoring will continue to include initiatives (expenditure and savings) from previous budgets that are not complete. DTF did indicate that for 2009-10, agencies will be required to report monthly on their achievement of FTE reductions from the 2008-09 MYBR.

DTF indicated that expenditure risks are outlined in the Budget Papers[20] and no changes were planned to specifically monitor these risks.

I also inquired if any substantial changes were made or are planned in the way the DTF operates to meet its responsibilities for policy analysis and advice and budget financial management in the aftermath of the global financial crisis.

DTF responded that it had not substantially changed its approach to the way it meets it responsibilities for policy analysis and advice and budget financial management. DTF continued its approach of evaluating an updated budget position on a regular basis.

DTF noted that given the unpredictable nature of the economy, revenue projection updates were sought on a regular basis during 2008-09 and changes were factored into forward projection models. Projected variations in expenditure were also regularly included in the forward projection models. This allowed DTF to provide advice on budget financial management that was based on an up-to-date prediction of the state of the South Australian economy. The short to medium impact of the global financial crisis within the forward prediction models showed that the net operating balance position would continue to be challenged once the initial impact of the global financial crisis had passed.

DTF referred to the establishment of the Sustainable Budget Commission as a means to ensure that an ongoing sustainable net-operating balance position was maintained in the short to medium.

8.4.8 Audit review of 2008-09 Budget monitoring and reporting

Audit reviewed aspects of the DTF and ERBCC budget monitoring process for 2008-09. The following summarises processes observed and/or advised. The review focussed on the processes and evidence of completion of the process. It did not address the reliability of reported data.

My review indicated that the ERBCC did not meet after April 2009 up to 30 June 2009 however relevant reports were prepared and submitted by the Treasurer. Review of the DTF and ERBCC budget monitoring reports highlighted the following:

- Monthly portfolio budget monitoring reports were prepared up to April 2009 for departments summarising the year to date and end of year estimated positions with commentary on key points on the projected positions and main points influencing the projections.

19 Budget Statement 2009-10, Budget Paper 3, p 1.2.

20 Budget Statement 2009-10, Budget Paper 3, pp 7.6 to 7.9.

A summary report was prepared for the ERBCC consolidating year to date and projected year end for all portfolios. The overall end of year projection for 2008-09 was mainly affected by the Department of Health as discussed later.

- 2008-09 Budget initiatives reports, on savings, operating and capital (investing) budget initiatives, were prepared for September and December 2008 and March 2009. Savings initiatives scheduled to begin in 2008-09 included those from the 2006-07, 2007-08 and 2008-09 budgets. Each initiative was reported within classifications of complete, expected success, at risk/delayed, not proceeding.

  At 31 March 2009, of $166 million budgeted savings initiatives, agencies had or were expected to have achieved, $129 million of savings. The shortfall of $38 million was essentially due to the Department of Health where health service reforms and operations savings would not be achieved. Reporting noted that the Department was slow to identify that savings would not be achieved and there was inadequate time to identify and implement alternatives.

  Of $45 million of centrally held savings, essentially shared services, $27.9 million was allocated to agencies. Savings from printing and publications and advertising were not proceeding or were deferred.

  For the year to March 2009 most of the operating expenditure initiatives were expected to be delivered. Capital expenditure initiatives of $353 million were estimated to be underspent by around $100 million.

- Capital project budget monitoring reports were prepared three times to 28 February 2009. At that time there was an expected underspend in the order of $60 million, about 4 percent of an approved budget of $1.3 billion. To achieve the expected result though, depended on agencies more than doubling expenditure in the last four months of the year compared to the average for the year to date. The need for such a dramatic acceleration was noted as a concern and suggested the likelihood of agencies requesting significant carryovers.

- FTE monitoring reports were prepared for September and December 2008 and March 2009. As at 31 March 2009, in aggregate, portfolios were under the overall cap as most agencies were under their caps due to vacant positions. Health was over its cap by 457 FTEs or 1.5 percent, reporting additional activity and savings measures not being achieved. The Department for Education and Children's Services and the Department for Transport, Energy and Infrastructure were only slightly above their FTE caps.

For the last two years I reported it was evident there was a need for improvement of data quality in some areas. Audit review of the summaries to April 2009 shows there was an improvement in 2008-09. While early in the year data quality was often regarded as low, in April 2009 the majority of agencies were rated by DTF as medium and high on a high to low scale.

The overall end of year projection for 2008-09 was mainly affected by the Department of Health which at May 2009 projected a significant year-end deterioration in the order of $90 million. This position was subject to review under the chief executive accountability framework. The Department also received an appropriation variation for additional resources in 2008-09.

Reporting is provided to ERBCC for the completed year generally in October following the year. The report is prepared from completed agency financial reports for the financial year.

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 to data for both the general government sector and also the non--financial public sector, which consolidates the general government and public non-financial corporations (including the South Australian Water Corporation, Forestry SA and TransAdelaide).[21]

9.2 OVERVIEW OF THE STATE'S FINANCIAL POSITION

The following summarises the financial position information for South Australia for the general government and public non-financial corporation (PNFC) sectors.

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)

	2005-06 Actual $'million	2006-07 Actual $'million	2007-08 Actual $'million	2008-09 Estimated result $'million	2009-10 Estimate $'million	2010-11 Estimate $'million	2011-12 Estimate $'million	2012-13 Estimate $'million
Financial assets	17 979	19 311	20 539	21 680	22 937	23 163	24 509	26 071
Non-financial assets	13 857	14 018	16 161	16 943	18 229	19 709	20 332	20 674
Total assets	31 836	33 329	36 700	38 622	41 166	42 872	44 840	46 744
Total liabilities	12 133	11 201	12 959	17 503	19 425	20 378	21 545	22 389
Net worth	19 703	22 128	23 741	21 120	21 741	22 494	23 295	24 355
Net financial worth	5 846	8 110	7 580	4 177	3 512	2 785	2 963	3 681
Net debt	(119)	(24)	(276)	659	2 142	2 807	3 200	3 114

Note: Totals may not add due to rounding.

Of note is the expectation that:

- financial assets increase across the forward estimates. This is essentially due to cash and deposits up $2.5 billion and investments in other public sector entities up $2.6 billion
- non-financial assets increase over the period 2005-06 to 2012-13. This is mainly from asset revaluations of the State's land and buildings assets. Net acquisitions (gross fixed capital formation less depreciation), account for the majority of other movements from year to year
- net worth (assets less liabilities) increases across the forward estimates. This is due to asset growth
- net debt increased across the forward estimates to $3.1 billion in 2012-13 due mainly to increased borrowing to fund major capital investment programs.

21 Budget Statement 2008-09, Budget Paper 3, Appendix D details agencies within the respective sectors.

9.2.2 Non-financial public sector financial position

The following table provides time series data for the non-financial public sector.

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

	2005-06 Actual $'million	2006-07 Actual $'million	2007-08 Actual $'million	2008-09 Estimated result $'million	2009-10 Estimate $'million	2010-11 Estimate $'million	2011-12 Estimate $'million	2012-13 Estimate $'million
Financial assets	3 902	4 084	4 259	3 894	4 257	4 569	5 557	6 604
Non-financial assets	29 592	30 922	34 227	37 094	40 232	42 365	43 572	44 549
Total assets	33 494	35 006	38 486	40 987	44 489	46 934	49 130	51 153
Total liabilities	13 790	12 878	14 745	19 868	22 748	24 440	25 835	26 798
Net worth	19 703	22 128	23 741	21 120	21 741	22 494	23 295	24 355
Net financial worth	(9 889)	(8 795)	(10 487)	(15 974)	(18 491)	(19 871)	(20 279)	(20 195)
Net debt	1 786	1 989	1 611	3 082	5 230	6 327	6 656	6 571

Note: Totals may not add due to rounding.

This table highlights that:

- non-financial assets dominate the financial position
- the value of non-financial assets are estimated to increase by $2.9 billion in 2008-09 to $37.1 billion, and a further $7.5 billion by 2012-13 to $44.5 billion. The main increases in 2008-09 are revaluations of South Australian Housing Trust rental assets, estimated to increase by $1.1 billion in 2008-09
- net financial worth is negative as financial liabilities exceed financial assets and is estimated to deteriorate over the forward estimates period
- net debt is estimated to increase over the forward estimates period.

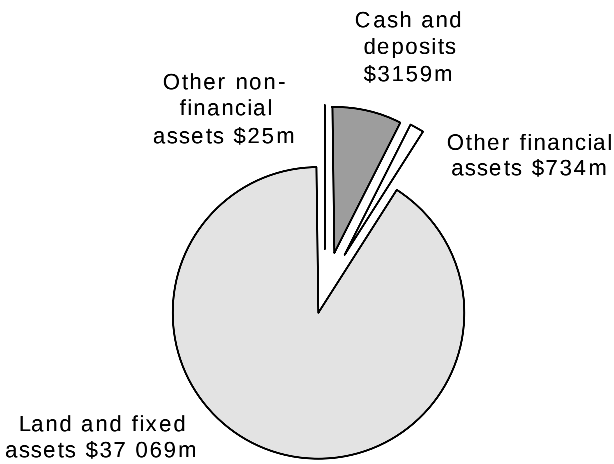
9.3 ASSETS

Table 9.2 shows that the State's asset position is varying significantly from year to year because of major asset acquisitions or revaluations. 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 2009 for the non-financial public sector.

Chart 9.1 — Non-financial public sector assets at 30 June 2009



Other financial assets includes the equity value of negative $154 million. This comprises $693 million in equity holdings offset by negative $847 million equity investment in other public sector agencies.

Non-financial assets clearly represent the vast majority of State assets being 91 percent of the total. The State's non-financial or physical assets comprise mainly plant, equipment and infrastructure (including roads and water infrastructure) and land and improvements. These assets are divided between the general government and public non-financial corporations sectors. Assets in the general government sector tend not to be used for revenue raising purposes.

In accordance with the Treasurer's Accounting Policy Statements, major assets are subject to regular revaluation. Valuation of public sector assets, particularly general government sector assets, is a subjective process. Valuations will reflect the specific circumstances of individual government 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 asset value changes over the four year period 2005-06 to 2008-09 for the major agencies in the general government and public non-financial corporations sectors.

Table 9.3 — Revaluation of non-financial assets

	2005-06 $'million	2006-07 $'million	2007-08 $'million	2008-09 $'million	Total $'million
General government	646	240	961	1 142	2 989
Public non-financial corporations	707	970	863	1 727	4 267
Total	1 353	1 210	1 824	2 869	7 256

Revaluation of the assets of the major agencies added $7.3 billion to the total value of non-financial assets over the four year period to 2008-09.

The rental properties of the South Australian Housing Trust alone increased by $2.2 billion as the value of housing stock, after depreciation, acquisitions and disposals, rose from $5.2 billion as at 30 June 2005, to $7.5 billion as at 30 June 2009.

9.3.2 Public financial corporations financial assets

The majority of the Government's financial assets are held by the Superannuation Funds Management Corporation (Funds SA). This includes funds of the Motor Accident Commission and SAFA. The following table shows Funds SA's holdings of investment assets as at 30 June 2009:

Table 9.4 — Funds SA's investments [a] [b]

	Domestic equities $'million	International equities $'million	Fixed interest $'million	Other investments $'million	Total $'million
2008	3 936	3 781	1 977	4 476	14 171
2009	3 236	2 554	1 421	5 406	12 617

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

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 loss from investing activities in 2008-09 of $2 billion due to the major decline experienced in the financial markets during the year. As the majority of managed funds are superannuation assets, most of this loss is reflected in an increase in the unfunded superannuation liability.

Another impact of the negative market returns was a further deterioration in the Motor Accident Commission's statutory solvency level, calculated in accordance with a formula determined by the Treasurer. As at 30 June 2009 the Commission had net assets of $70 million, despite two years of poor investment markets. However, the assets of the compulsory third party fund as at that date were 91.3 percent of the target level of solvency compared to 101.5 percent the previous year.

WorkCover also incurred a loss on investments that contributed to increase its net liability position to $1.1 billion despite an improved operating result.

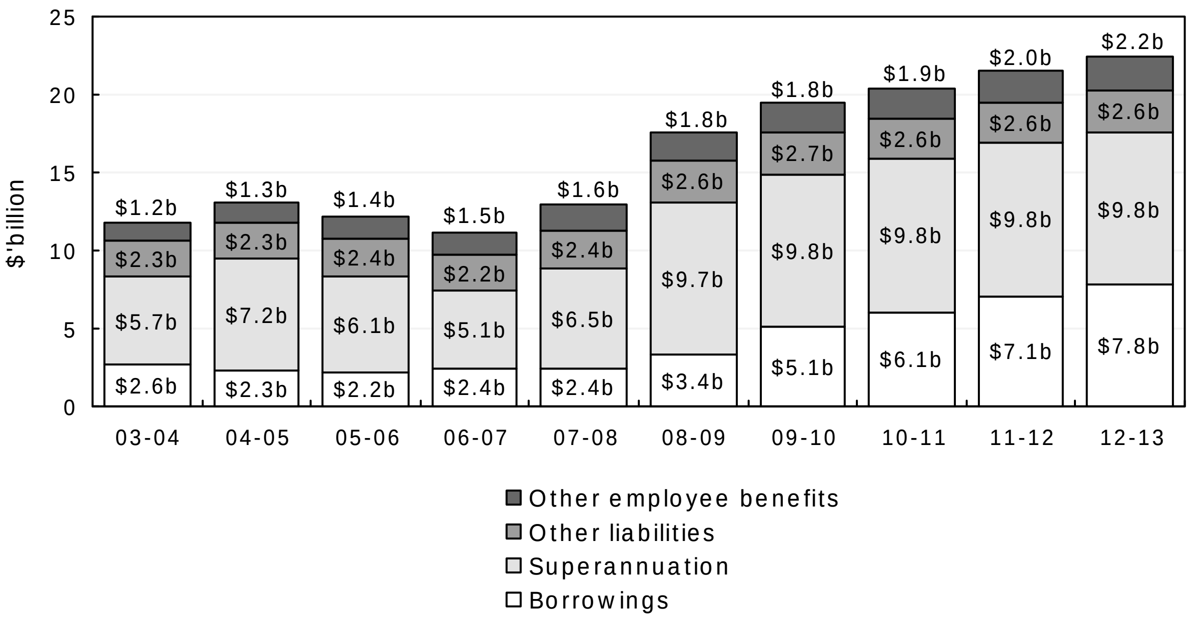
Further commentary is included under 'Motor Accident Commission', South Australian Government Financing Authority', 'Superannuation Funds Management Corporation' (Funds SA) and 'WorkCover Corporation of South Australia' in Part B of this Report.

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 2012-13.

Chart 9.2 — General government sector liabilities (nominal terms)



Total liabilities are estimated to decrease by $4.5 billion or 35 percent to $17.5 billion in 2008-09. This is due mainly to an increase in the unfunded superannuation liability. The variability in the unfunded superannuation liability in the five years to 2008-09 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 $4.9 billion or 28 percent to $22.4 billion over the period of the forward estimates. This is due mainly to increases in borrowings, up $4.4 billion and other employee benefits, up $382 million, over the four years to 2012-13.

9.4.2 Non-financial public sector liabilities

The trends and composition of liabilities for the non-financial public sector are consistent with those of the general government sector.

Total liabilities are expected to increase $6.9 billion or 35 percent to $26.8 billion over the period of the forward estimates. A $5.1 billion or 35 percent increase in total liabilities in 2008-09 is due to an increase in superannuation liabilities, up $3.3 billion or 51 percent, borrowings, up $1.6 billion or 38 percent, other liabilities, up $147 million or 6 percent and other employee benefits, up $132 million or 8 percent.

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 now 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 2009

Unfunded superannuation liabilities are estimated to increase $3.3 billion to $9.7 billion for the year to 30 June 2009. The Budget records that although the value of the liability has increased, there is no material change in the actual expected payments to beneficiaries. While the value can be expected to change from year to year, this increase is extraordinary and it is essential to understand the causes.

$2 billion of the increase is due to the collapse of interest rates in response to the global financial crisis. A discount rate of 5.2 per cent (effective annual rate) was used for the 2009-10 Budget (the May 2021 bond rate was used), compared with 6.3 per cent for the 2008-09 Budget. Should interest rates increase in the future, the value of the liability will reduce as discussed later.

A further $1.3 billion of the increase in unfunded superannuation liabilities is due to the negative returns being experienced in investment markets. The estimate is based on an estimated earnings rate of negative 17 per cent for 2008-09. This earnings rate is well below the long-term assumed earnings rate of 7 per cent.

The following table sets out the major elements that comprise the movement from the estimated unfunded superannuation liabilities at 30 June 2008 to the 30 June 2009 estimated liability.

Table 9.5 — Estimated unfunded superannuation liabilities as at 30 June 2009

		$'million	$'million
Estimated unfunded liability (2008-09 Budget)			6 910
Add:	Lower than expected returns on investments	442	
	Independent review of economic assumptions	(556)	
	Movement in discount rate	(286)	
	Other	(43)	
	Total changes		(443)
Actual 30 June 2008			6 468
Add:	Superannuation interest cost	383	
	Past service superannuation payments	(292)	
	Lower than expected returns on investments	1 251	
	Decrease in discount rate	1 959	
	Variation between actual and expected experience	(21)	
	Total changes		3 280
Estimated closing balance June 2009			9 748

Note: Totals may not add due to rounding.

9.5.2.1 *Superannuation discount rate*

As required by Australian Accounting Standards, 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 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 5.2 percent.

Table 9.6 — Sensitivity analysis of unfunded superannuation liabilities to discount rate movements as at 30 June 2010

Discount rate	Unfunded superannuation liability	Increase (decrease)
Percent	$'million	$'million
6.5	7 800	(1 990)
6.0	8 500	(1 290)
5.5	9 287	(503)
5.2	9 790	-
5.0	10 156	366

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 6 percent, the value of the unfunded liability will reduce by $1.3 billion to $8.5 billion.

9.5.2.2 Superannuation funding

In 2009-10, total superannuation funding is budgeted to be $1.1 billion (up $138 million or 14 percent on 2008-09). It is a significant part of cash outlays. Payments comprise amounts paid from agencies as contributions to current employment 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. Equally, additional funding contributions are required, however, to compensate for reduced earnings to remain on target.

The past service superannuation liability cash payment for 2009-10 is estimated to be $406 million.[22] This is $101 million higher than was estimated in the 2008-09 Budget.

9.5.2.3 Earnings

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

As mentioned, an earnings rate of negative 17 percent was estimated for 2008-09. Previous years have benefitted from higher outcomes than the assumed earnings rate.

9.5.3 Long-term funding of superannuation liabilities

The commitment to fully fund unfunded liabilities was reaffirmed by the Government in the 2009-10 Budget, with the position as at 30 June 2009 remaining consistent with the plan to eliminate unfunded superannuation liabilities by 2034.

Due to the poor investment performance in 2008-09 and the fall in the discount rate, increased past service superannuation liability cash payments are forecast until 2034. Assuming no change in the discount rate and a return to long term earnings, unfunded liabilities are expected to increase until peaking around the period 2011-12. It is estimated that benefit payments will peak in 2023-24.

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

9.6 NET DEBT

The achievements over a number of years of restructuring the State's finances 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

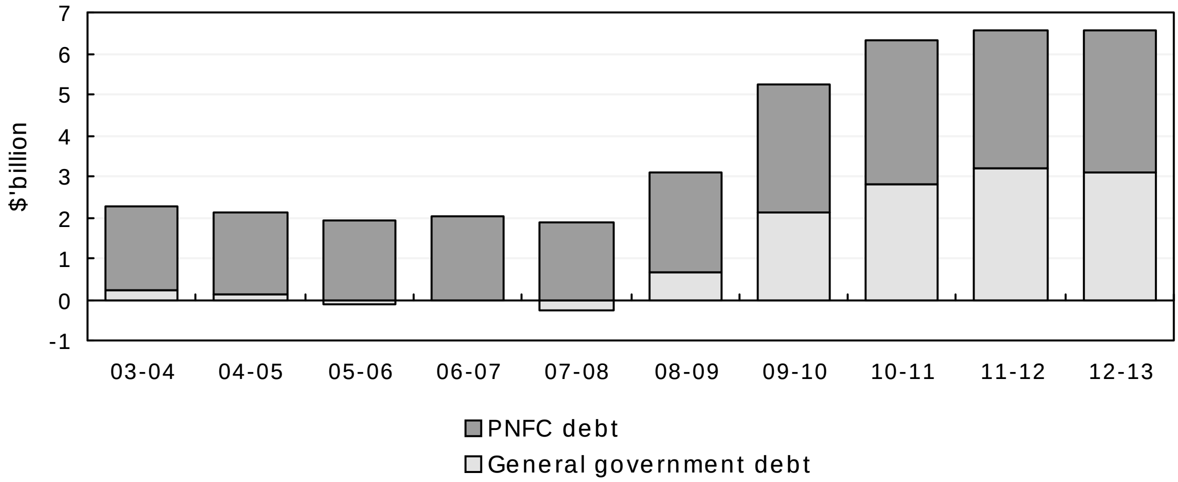
Net debt[23] equals certain financial liabilities (the sum of deposits held, advances received and borrowing) minus financial assets (the sum of cash and deposits, advances paid, and investments, loans and placements) as defined in the GFS framework.

[22] Budget Statement 2009-10, Budget Paper 3, Table 5.7

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. Public sector net debt has reduced by $674 million to $1.6 billion (2.2 percent of South Australia's Gross State Product) in the period 2003-04 to 2007-08. In 2008-09 net debt has increased by $1.5 billion to $3.1 billion (4 percent of South Australia's Gross State Product). Forward estimates show that net debt is projected to rise to $6.6 billion in 2012-13 (7.2 percent of South Australia's Gross State Product).

Chart 9.3 — South Australian public sector net indebtedness 2004 to 2013



General government sector is estimated to have net debt of $659 million at the end of 2008-09. Over the forward estimates net debt increases in this sector by $2.5 billion to $3.1 billion due to projected net borrowing (net lending deficits) due to the Government's significant capital investment program and net operating deficits in 2008-09 and 2009-10.

Net debt of the public non-financial corporations increases by $1 billion over the same period to $3.5 billion.

The chart highlights that most debt resides with the public non-financial corporations sector. In 2011-12 and 2012-13 debt in GGS and PNFC sectors is about the same. The main holders of debt in the PNFC sector are the South Australian Water Corporation, South Australian Housing Trust and TransAdelaide. Of these the South Australian Water Corporation is a commercial business servicing its debt from business revenues.

The 2009-10 Budget Papers state that PPP arrangements for hospitals and schools are recognised as finance leases in the balance sheet and consequently have an impact on net debt and net financial liabilities.

From 30 June 2009, net debt for the general government and non-financial public sectors is reduced by the Government's motor vehicle fleet being transferred to the SAFA which is part of the PFC. This is an inter-sector transfer, not an improvement in the whole-of-government position. The cost of running the fleet, including interest on borrowings, will be recovered through lease fees to the other sector agencies. The value of Fleet SA borrowings at 30 June 2009 was $235 million.

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[23] 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.

Table 9.7 explains the expected movements in net debt for the General Government sector at the time of the 2009-10 Budget.

Table 9.7 — Reconciliation of movements in general government net debt as at the 2009-10 Budget

	2008-09 Estimated result $'million	2009-10 Budget $'million	2010-11 Budget $'million	2011-12 Budget $'million	2012-13 Budget $'million
Opening net debt	**(276)**	**659**	**2 142**	**2 807**	**3 200**
General government net lending	(932)	(1 541)	(1 324)	(483)	17
Add back:					
Superannuation interest cost	383	444	441	437	433
Accrued expenses	(54)	32	61	90	112
Less:					
Accrued revenue	8	69	(14)	23	12
Past service superannuation payment	292	406	422	439	456
GFS cash surplus/deficit	**(903)**	**(1 540)**	**(1 230)**	**(418)**	**93**
Add back:					
Sales of shares and other equity assets	-	69	574	34	1
Other adjustments	(33)	(11)	(8)	(8)	(8)
Improvement/deterioration in GG net debt	**935**	**1 483**	**665**	**393**	**(86)**
Closing net debt	**659**	**2 142**	**2 807**	**3 200**	**3 114**

Note: Totals may not add due to rounding.

9.6.3 Debt affordability and servicing

Chart 9.3 clearly highlights the increase in net debt over the period 2008-09 to 2011-12. At the end of 2008-09 total public sector net debt is estimated to represent 4 percent of Gross State Product compared to 7 percent in 2012-13.

I note that the increase in net debt forecast is not comparable to the increase experienced in years immediately following 1991, principally from the collapse of the State Bank, as that increase reflected the write–off of assets associated with the collapse. I also note that net debt, as then measured, peaked at 26.9 percent of gross state product in 1992 and 1993.

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 Agreement debt) is managed on a passive basis. Any losses or gains made on the settlement of these transactions is to the Treasurer's account, resulting in either an increase or decrease in the amount owed by the Treasurer. SAFA's debt management performance is measured against benchmarks approved by the Treasurer.

The Treasurer's approved policy for benchmark duration applied during the 2008-09 financial year is between 1 to 1.5 years. Lower duration benchmarks offer lower average interest costs over the long-term but with possible higher short-term budget volatility.

The Budget states that SAFA's ability to raise funding was only modestly impacted by the recent volatility in global financial markets during 2008-09.

For further details on SAFA refer to the section 'South Australian Government Financing Authority' in Part B of this Report.

9.7 OTHER NON-FINANCIAL PUBLIC SECTOR LIABILITIES

Other NFPS liabilities in 2008-09 comprise other employee benefits ($1.9 billion), payables ($775 million), advances ($656 million), deposits ($195 million) and other liabilities ($994 million).

Other employee benefits include long service leave provisions ($1286 million estimate result for 2008-09), workers compensation liabilities ($376 million estimate result for 2008-09) and outstanding insurance claims ($340 million actual in 2008-09).

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

- estimated long service leave provisions amounting to $1.28 billion for 2008-09 and $1.36 billion in 2009-10. Long service leave is calculated by an estimation process in most cases subject to guidelines issued by DTF
- estimated workers compensation totalling $376 million for 2008-09 and $390 million in 2009-10
- outstanding claims payable to entities external to SAFA amount to $278 million for 2007-08 and $340 million in 2008-09. Details of SAFA's insurance operations are included in Part B of this Report.

9.8 CONTINGENT LIABILITIES

As reported in the Budget Papers[24] 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.

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[24] Budget Statement 2009-10, Budget Paper 3, pp 7.10 – 7.18 provides a detailed summary of contingent liabilities.

Guarantees and contingent liabilities of the Government of South Australia as at 30 June 2008 were valued at $675 million ($723 million as at 30 June 2007). Guarantees are valued at nominal values without adjustment for the probability of actual liabilities occurring.

The $48 million decrease is due mainly to a $37 million downward variation in the estimated value of guarantees.

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 recent 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.

10 COMPARISON WITH OTHER STATES

10.1 SOME OBSERVATIONS

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

Across jurisdictions, net worth is influenced by varying valuation approaches between states, differences in the type and level of infrastructure, and can be associated with higher debt levels. Infrastructure can also be provided through the private sector and therefore not be included in government data.

Importantly before drawing conclusions, any assessment needs a sound understanding of the specific circumstances prevailing in different states. I have not sought to provide all of the relevant information in this Report. Rather I take the opportunity to show what each State is forecasting through to 2013.

The following table shows 2009-10 budgeted total revenue for each State.

Table 10.1 — 2009-10 Budgeted general government total revenue by State

State	NSW $'million	VIC $'million	QLD $'million	WA $'million	SA $'million	TAS $'million
Total Revenue	52 958	42 388	37 192	20 700	14 444	4 216

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 2009-10 budget data.

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

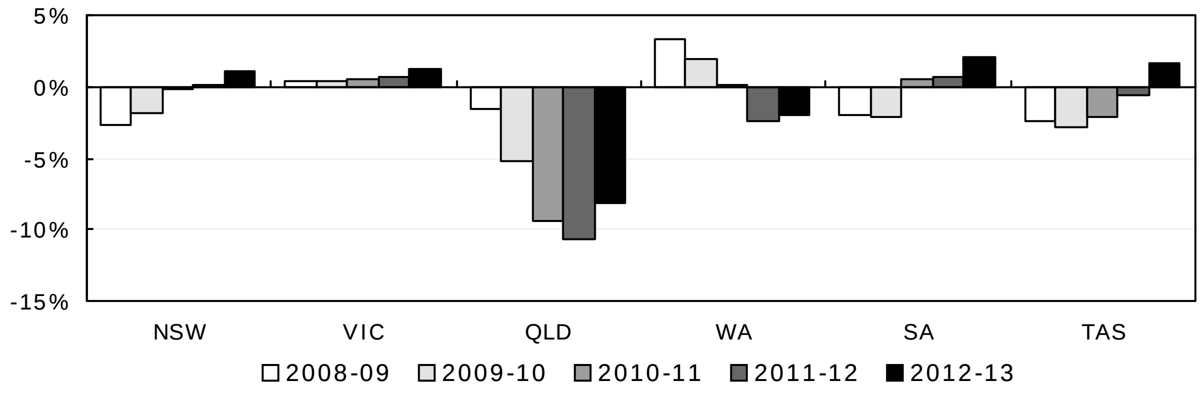
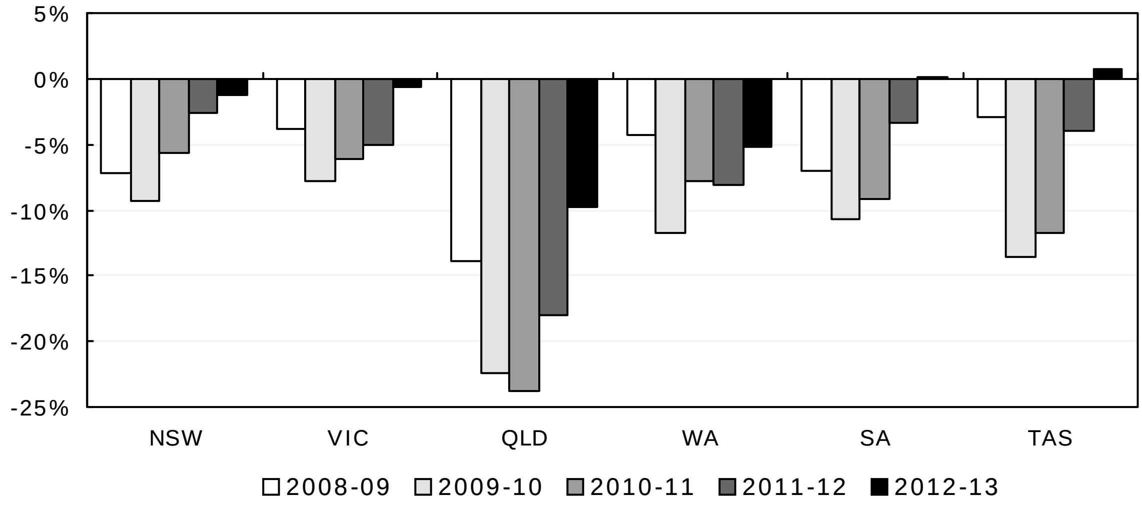


Chart 10.1 shows that South Australia's net operating balance as a ratio to total revenue compares favourably with most other states.

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



As detailed in chart 10.2, most states are estimating net borrowing (deficit) outcomes for all or most of the four years to 2012-13.

Chart 10.2 shows that South Australia's net borrowing as a proportion of total revenues is consistent with other states.

10.3 BALANCE SHEET

10.3.1 Ratio of net financial liabilities to revenue

The fiscal targets include a measure, the ratio of net financial liabilities to revenue. This measure is broader than net debt as it includes significant liabilities other than borrowings, such as unfunded superannuation and long service leave entitlements.

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

Chart 10.3 — Ratio of net financial liabilities to revenue

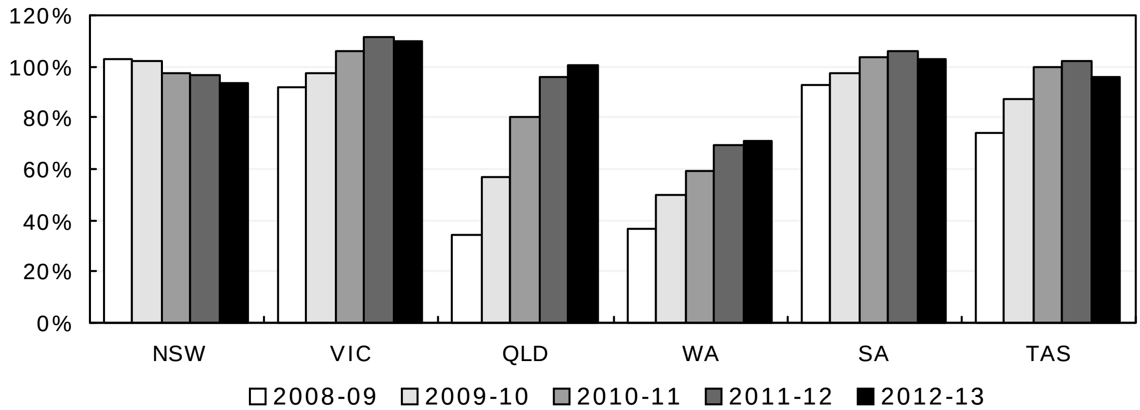


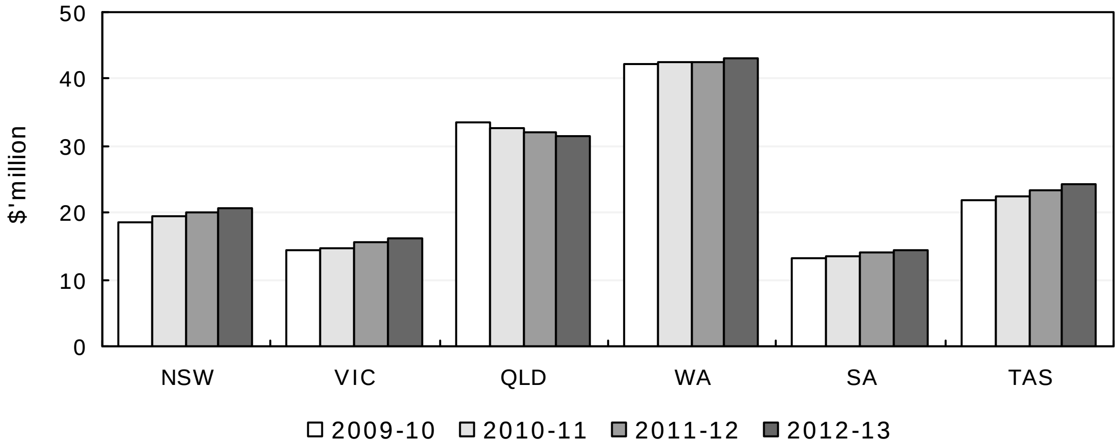
Chart 10.3 shows the 2009-10 Budget settings result in the ratio for South Australia rising until 2011-12, and then falling in 2012-13. It is evident that a similar situation exists for most states.

10.3.2 Net worth per capita

General government sector net worth is calculated as total assets (physical and financial) less total liabilities (debt, superannuation, other) and therefore highlights the net change in these items. Changes in net worth arise from transactions, the operating result and from revaluations of assets and liabilities. As mentioned, comparison between states is affected by varying valuation and recognition policies.

The following chart plots the Budget data for all states.

Chart 10.4 — General government sector net worth per capita



The chart shows the increase in net worth in this State through to 2012-13 based on current budget settings. This is consistent with the projections for other states except Queensland.

The data suggests that states with higher net worth have additional assets for service provision or disposal despite differences that might arise from measurement issues.

11 TREASURER'S STATEMENTS

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

The Treasurer's Financial Statements are prepared pursuant to the *Public Finance and Audit Act 1987* 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 *Public Finance and Audit Act 1987*.

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 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 Volume V of Part B of this Report.

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.

11.2.1 Audit findings and comments

The results of audit work undertaken indicated a number of areas where improvements could be made.

Review findings are provided under the Audit Findings and Comments heading for the Department of Treasury and Finance in Part B of this Report.

11.3 THE CONSOLIDATED ACCOUNT OUTCOME

The following table sets out total appropriation authority and actual payments for the Consolidated Account in 2008-09.

Table 11.1 — 2008-09 appropriation authority and payments

	Appropriation authority $'million	Actual payments $'million
Appropriation Act 2008	9 313	9 140
Public Finance and Audit Act 1987, section 15	128	128
The Governor's Appropriation Fund	251	135
Specific appropriations authorised in various Acts	146	146
Total	9 838	9 549

The result on the Consolidated Account and variations from budget for 2008-09 was as follows.

Table 11.2 — 2008-09 Consolidated Account result

	2008-09 Budget $'million	2008-09 Actual $'million	Variation $'million
Total receipts	8 828	8 390	(438)
Total payments	9 440	9 549	109
Consolidated Account financing requirement	(612)	(1 159)	(547)

The deficit of $1.159 billion ($117 million surplus in 2007-08) 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 budget were return of surplus cash to Consolidated Account $69 million; Commonwealth First Home Owners Boost grants $67 million; return of deposit account balances $62 million; Commonwealth transitional assistance grants $37 million; Council of Australian Governments funding arrangements grants $37 million; payroll tax $28 million. These were offset by lower than expected GST revenue grants $358 million; stamp duty receipts $180 million and interest on investments $74 million

- ***Payments*** — higher payments for administered items for DTF $129 million; the Department of the Premier and Cabinet $51 million and the Department of Primary Industries and Resources $44 million.

In 2008-09 significant amounts were appropriated to agencies as equity. The main items were Defence SA ($100 million), Department of Health ($156 million) and the Department for Transport, Energy and Infrastructure ($58 million). Equity funding is credited directly to an agency's financial position, not through the Statement of Comprehensive Income.

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 2008-09.

Table 11.3 — Appropriation flexibility

	Authority / budget $'million	Actual payments $'million
Governor's Appropriation Fund	251	135
Contingency provisions in administered items for DTF	334	279
Public Finance and Audit Act 1987, section 15	128	128
Total Flexibility	713	542

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 *Public Finance and Audit Act 1987* 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 Primary Industry and Resources	Construction of Langhorne Creek and Currency Creek irrigation pipeline ($47 million) and additional appropriation for cash flow purposes ($7 million)	54
Department of the Premier and Cabinet	Call on Premier's guarantee by SAFA for Alice Springs to Darwin railway project ($43 million) and grants ($9 million)	52
Department of Water, Land and Biodiversity Conservation	Bringing forward an existing Storm Water Management Fund expenditure authority into 2008-09 ($11 million) and purchase of water for the Living Murray Initiative ($2 million)	13

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 Transfers from Contingency Provisions of the Treasurer's Financial Statements. 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 Health	159
Department of Water, Land and Biodiversity Conservation	60
South Australian Motor Sport Board	12
Department of Primary Industry and Resources	9
Department of Further Education, Employment, Science and Technology	8
Department of Education and Children's Services	7
Department for Families and Communities	7

11.4.3 Appropriation by the Treasurer for additional salaries

Section 15 of the *Public Finance and Audit Act 1987* 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 2008-09 $128 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. This measure was last used in 2007-08 when $57 million was appropriated by the Treasurer.

11.4.4 Appropriation transfers

In addition to the preceding provisions, appropriation can be transferred between agencies. Section 13 of the *Public Finance and Audit Act 1987* provides authority where excess funds exist for one agency and are necessary for another. Section 5 of the *Appropriation Act* provides authority where restructuring of an agency occurs so that appropriation related to transferring functions may in turn be transferred. No section 13 transfers occurred in 2008-09. 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 *Public Finance and Audit Act 1987*. Under related provisions, monies credited to those accounts can be spent without further appropriation from Parliament. This is of significance in that monies appropriated in one year and transferred to a deposit account need not actually be expended in that year, that is, they may be carried over into the next year unless required by the Treasurer to be paid to the Consolidated Account.[25]

[25] *Public Finance and Audit Act 1987* subsection 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.

Table 11.6 shows that over $2.5 billion is in special deposit accounts and deposit accounts as at 30 June 2009, up $433 million from the previous year.

Table 11.6 — Special Deposit Accounts and Deposit Accounts

	2007-08 $'million	2008-09 $'million	Increase $'million
Special Deposit Accounts	1 599	2 016	417
Deposit Accounts	531	547	16
Total	2 130	2 553	433

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

The largest balances at 30 June 2009 were:

- ***Special Deposit Accounts*** — Accrual Appropriation Excess Funds ($443 million), Highways Fund ($231 million), Treasury and Finance administered Items – Intergovernmental Agreement on Federal Finance Relations ($225 million), Treasury and Finance Administered Items Account ($96 million) and Education and Children's Services Operating Account ($88 million)
- ***Deposit Accounts*** — South Australian Housing Trust ($63 million), South Australian Government Financing Authority ($45 million) and Rail Transport Facilitation Fund ($32 million).

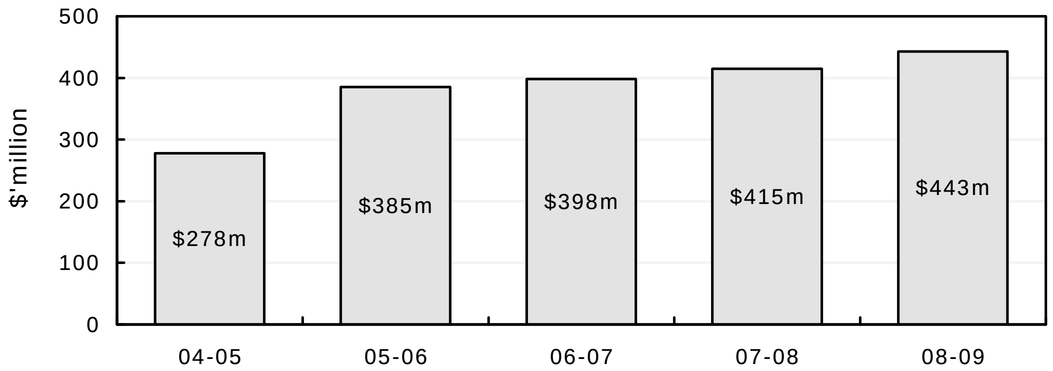
Account balances are subject to the Treasurer's Cash Alignment Policy that aims to minimise balances as discussed below.

11.5.1 Accrual Appropriation Excess Funds Account

The approved purpose of the Accrual Appropriation Excess Funds Account (the 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 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 Report. The balance in the Account at 30 June 2009 was $224.6 million. Of this balance, $224.5 million was committed with various SA Government agencies to fulfil requirements under the Intergovernmental Agreement on Federal Financial Relations agreements (refer Note 57(c) to the DTF financial statements included in Part B of this Report).

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 $80 million ($74 million in 2007-08) of surplus cash was returned to the Consolidated Account during 2008-09. The main amounts were as follows.

Table 11.7 — Cash alignment policy repayments

Agency	Actual payments $'million
Department of Treasury and Finance Administered Items – Industry Financial Assistance Account	33
Department of Further Education, Employment, Science and Technology	13
Department of the Premier and Cabinet	9
Department of Education and Children's Services	9
Department for Environment and Heritage	6
Attorney-General's Department Administered Items	6
South Australia Police	4

12 WHOLE-OF-GOVERNMENT FINANCIAL REPORT (AAS 31)

The whole-of-government financial report presents a different view of the State's financial position when compared against the already discussed GFS presentation. The main difference is that data for the public financial corporation sector is included, which, in the case of South Australia, means that superannuation assets and both funded and unfunded superannuation liabilities are reported on the Statement of Financial Position.

Due to the timing of the preparation of the whole-of-government financial report, the last completed report relates to the year ended 30 June 2008, and the following commentary has therefore been kept purposely brief.

12.1 AAS 31 WHOLE-OF-GOVERNMENT FINANCIAL REPORT

Whole-of-government financial reports for South Australia are prepared by the DTF pursuant to AAS 31.

The basis for consolidation is Australian Accounting Standard AASB 127 'Consolidated and Separate Financial Statements', which details the principles for determining what makes up the economic entity. As a result of using the control concept from the standard, the accounts exclude local government bodies, universities, most marketing and professional regulatory authorities, the Legislature, and associations and financial institutions incorporated under State statute but not controlled by the Government.

12.2 SCOPE OF AUDIT AAS 31 WHOLE-OF-GOVERNMENT FINANCIAL REPORT

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

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

The key features of the audit of the financial report include a review of:

- the principles adopted in the definition of the economic entity for whole-of-government purposes
- controls and procedures within DTF for evaluating the reliability and validity of data forwarded by agencies
- the adequacy and reliability of the database used for the preparation of the whole-of-government financial report
- the preparation of the whole-of-government general purpose financial report
- compliance with appropriate legislation and accounting frameworks, in particular Australian Accounting Standards, Urgent Issue Group Consensus Views, Treasurer's Instructions, and other professional reporting requirements in Australia.

Limitations still exist with the current reporting process. Notwithstanding these limitations, the usefulness and importance of 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.

12.2.1 Audit findings and comments

Following the Audit review of the financial report for 2007-08, a management letter was forwarded to DTF in January 2009 that contained reporting and operational considerations that would need to be addressed in order to provide an unqualified audit opinion for whole-of-government financial report. This would, of course, require legislation changes requiring such an opinion to be issued. The Audit management letter was reproduced in full in the whole-of-government financial report published by DTF.[26]

The matters raised included:

- the inclusion of a number of material account balances from government entities that received qualifications
- the use of unaudited data in the preparation of the whole-of-government financial report
- matters relating to the cash flow statement.

Departmental response

DTF responded positively to each of the issues raised.

In particular, DTF:

- noted the responsibility of agencies to deal with accounting issues as they arise
- advised it considers the impact of any differences in values between audited and unaudited health services data would be immaterial to the whole-of-government financial report but that a project within the Department of Health to improve data reporting was well advanced
- indicated DTF would work with Audit to address any cash flow reporting issues.

12.3 AAS 31 FINANCIAL PERFORMANCE

The following briefly discusses the financial result of the AAS 31 reports as at 30 June 2008. As previously discussed, data for the current year (due to the time needed for preparation) is not available at the time of this Report. It is included for reference only. Full details and analysis are published by DTF.[27] This data provides the opportunity to observe the financial result of the Government using a full accrual accounting basis, and the consolidation of all sectors. The consolidation process means that all inter-sector transactions are eliminated.

The following table summarises the financial result for the year ending 30 June 2008, with comparative amounts for the preceding four years.

[26] Government of South Australia, Consolidated Financial Report for the year ended 30 June 2008.

[27] Government of South Australia, Consolidated Financial Report for the year ended 30 June 2008.

Table 12.1 — AAS 31 financial performance (2002-03 to 2007-08)

	2004 $'million	2005 $'million	2006 $'million	2007 $'million	2008 $'million
Revenues					
Taxation	2 651	2 760	2 779	3 028	3 353
Grants	5 289	5 589	5 952	6 162	6 814
Sale of goods and services, fees and levies	3 282	3 305	3 517	3 610	4 005
Investment revenues	1 757	1 737	2 396	2 997	1 757
Net revenues from asset disposals	41	-	33	34	54
Other	738	821	450	620	2 052
Total revenues	13 758	14 212	15 127	16 451	18 035
Expenses					
Employee expenses	6 057	6 710	4 567	4 800	7 678
Supplies and services	2 305	2 307	3 359	3 393	3 637
Grants and subsidies	1 466	1 661	1 627	1 691	1 906
Borrowing cost expenses	737	688	645	674	721
Other	3 856	4 324	3 762	4 702	5 322
Total expenses	14 421	15 690	13 960	15 260	19 264
Net surplus (deficit)	(663)	(1 478)	1 167	1 191	(1 229)

The table highlights significant growth in revenues over the five years to 2008. Up to 2005, this has been exceeded by growth in expenses and deficits have been incurred. This was again the case in 2007-08.

The main variations in revenues in 2007-08 were as follows:

- ***Taxation*** — increased by $325 million due mainly to a increase in stamp duty on property ($202 million) and payroll tax ($50 million)
- ***Grants*** — increased by $652 million due mainly to an increase in Commonwealth special purpose grants ($282 million) and Commonwealth general purpose grants ($317 million).
- **Sale of goods and services** — increased by $395 million due mainly to an increase in regulatory fees ($125 million) and Land Management Corporation land sales ($154 million).
- ***Other revenue*** — increased by $1432 million due mainly to an increase in imputed recovery from superannuation funds.
- ***Investment revenues*** — decreased by $1240 million due mainly to decrease in gains on revaluation of investments ($900 million) and gains on sale of investments ($459 million).

The main variations in expenses in 2007-08 were as follows:

- ***Employee expenses*** — increased by $2878 million due mainly to an increase in superannuation expense ($2492 million) and salaries and wages ($291 million).
- ***Other expenses*** — increased by $620 million due mainly to an increase in revaluations ($2491 million) offset by a decrease in imputed expense of increased liability in respect of superannuation fund deposits ($1990 million).

12.4 AAS 31 FINANCIAL POSITION

The following summarises the financial position for the five financial years 2003-04 to 2007-08.

Table 12.2 — AAS 31 (whole-of-government financial report) financial position data (nominal terms)

	2004 $'million	2005 $'million	2006 $'million	2007 $'million	2008 $'million
Assets					
Cash and investments	6 643	6 154	6 099	8 220	7 966
Superannuation assets	6 635	7 934	10 326	13 146	14 200
Physical assets	25 261	28 062	30 326	31 972	34 312
Other	1 869	1 900	2 078	1 456	1 576
Total assets	40 408	44 050	48 829	54 794	58 054
Liabilities					
Unfunded superannuation	5 668	7 227	6 146	5 075	6 468
Borrowings	6 781	6 607	5 896	6 376	5 603
Employee entitlements	1 595	1 387	1 486	1 562	1 722
Superannuation liabilities	6 599	7 901	10 290	12 809	14 161
Other	4 710	5 295	5 868	6 721	7 014
Total liabilities	25 353	28 417	29 686	32 543	34 968
Net assets	15 055	15 633	19 143	22 251	23 086

The $835 million increase in net assets for 2007-08 was due mainly to an increase in Superannuation Assets ($1.1 billion) and Physical Assets ($2.3 billion) and decrease in Borrowings ($0.8 billion) offset by an increase in Unfunded Superannuation ($1.4 billion) and Superannuation Liabilities ($1.4 billion).