



Government  
of South Australia

Report  
of the  
Auditor-General  
Supplementary Report  
for the  
year ended 30 June 2017

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Tabled in the House of Assembly and ordered to be published, 28 November 2017

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Second Session, Fifty-Third Parliament

State finances and related  
matters: November 2017

By authority: Sinead O'Brien, Government Printer, South Australia

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ISSN 0815-9157



27 November 2017

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Dear President and Speaker

**Report of the Auditor-General: Supplementary Report for the year ended 30 June 2017 'State finances and related matters: November 2017'**

As required by the *Public Finance and Audit Act 1987*, I present to each of you the Auditor-General's Supplementary Report for the year ended 30 June 2017 'State finances and related matters: November 2017'.

**Content of the Report**

Part A of the Auditor-General's Annual Report for the year ended 30 June 2017 referred to audit work that would be subject to supplementary reporting to Parliament.

This Supplementary Report provides detailed commentary and audit observations on aspects of the State's finances.

**Acknowledgements**

The audit team for this report was Salv Bianco, Ken Anderson, Grace Lum and Stefanie Chin Papageorgiou.

We also appreciate the cooperation and assistance given by staff of the Department of Treasury and Finance during the review.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'I. McGlen'.

Ian McGlen  
**Acting Auditor-General**



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# 1 Introduction

The 2017-18 State Budget (2017-18 Budget) was tabled in Parliament in June 2017. This Report provides our observations on the State's public finances based on a review of the 2017-18 Budget, in particular:

- an overview of key matters currently relevant to the State's public finances
- a brief analysis of the financial performance of the State. This primarily involves examining 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 analysis of major assets and liabilities.

This chapter summarises our main observations on the 2017-18 Budget. Further details and analysis are provided in the corresponding subsequent chapters.

## 1.1 Key overall observations

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### 1.1.1 Consistent modest net operating surpluses are expected over all four Budget years

The Budget expects to achieve consistent modest net operating surpluses over all four years of the 2017-18 Budget, underpinned by steady GST revenue grants growth and expenditure restraint.

The Budget has also adjusted previous budget estimates for Health and Ageing savings targets and taxation revenue. Some other standout items are:

- MAC will return almost \$2.8 billion to the general government sector between 2014-15 and 2019-20
- the recognition of the \$2.8 billion nRAH asset and finance lease in 2016-17
- the commencement of the State Government's \$550 million Our Energy Plan, including building Australia's largest battery storage and gas production incentives.

The 2017-18 Budget indicates that there is continued emphasis on providing modern health services, supporting jobs and developing future industries, while also investing in services and infrastructure. It also identifies the need for economic reform and modernising South Australia's workforce towards a high technology, globally connected and competitive economy.

Significant economic challenges remain with the cessation of car manufacturing in the State in October 2017.

### **1.1.2 The budget expects a net lending surplus in 2017-18 following a significant net lending deficit in 2016-17**

A net lending deficit of \$2.6 billion is expected in 2016-17 reflecting the commencement of the finance lease for the nRAH. Following a net lending surplus in 2017-18, deficits are projected before a return to surplus in 2020-21. The net lending deficits reflect the SA Government's significant capital expenditure program on transport, health and education infrastructure.

### **1.1.3 GST grants growth and expenditure restraint are important to achieving Budget outcomes**

The 2017-18 Budget faces a number of risks to its fiscal outlook and these are discussed fully in section 6 of Budget Paper 3 'Budget Statement', including sensitivity analysis.

The projected surpluses for 2017-18, 2018-19 and 2019-20 are significantly less than what was projected for these estimate years in the previous Budget. Figure 3.2 provides further details.

GST grants are a significant revenue source for the State and write-downs can significantly impact fiscal targets. The Budget expects strong GST grants growth in the 2017-18 budget year reflecting both growth in the national GST pool and South Australia's share of GST revenue. Thereafter, steady modest growth is estimated in all years through to 2020-21.

The Monetary Policy Decision Statement issued by the Reserve Bank Governor on 3 October 2017 indicated the Australian economy expanded by 0.8% in the June quarter. This outcome and other recent data are consistent with the Reserve Bank's expectation that growth in the Australian economy will gradually pick up over the coming year. Trends in the national economy are a significant driver of GST receipts.

Expenditure restraint has been demonstrated over recent years, with low levels of growth in expenditure for the years 2013-14 to 2015-16. After a higher increase in expenses in 2016-17, continued achievement of expenditure restraint is an important element in realising budget outcomes. This is particularly so for wages restraint and achieving revised Health and Ageing portfolio savings targets.

Over the four years of the Budget employee expenses are expected to decline in real terms, with nominal growth in each year generally below 2%. Realising restrained wages growth will be a key challenge for the Budget.

### **1.1.4 Net operating balances significantly impacted by Motor Accident Commission dividend returns**

MAC has contributed significantly to actual general government sector net operating surpluses in recent years and expected surpluses over the 2017-18 and 2018-19 budget years. The estimated returns to the State from MAC operations are minimal from 2019-20 onwards. The budget flexibility available from MAC, if needed, will need to be sourced elsewhere.

## 1.2 Fiscal strategy

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### 1.2.1 Fiscal targets are expected to be met

Two key fiscal targets in the 2017-18 Budget are:

- a net operating surplus in the general government sector in every year
- a maximum ratio of general government net debt to revenue of 35%.

The 2017-18 Budget expects these fiscal targets to be met for 2016-17 and for all four years of the 2017-18 Budget.

### 1.2.2 Moody's highlights revenue growth as a key risk

In October 2017 Moody's commented that it sees weaker than forecast revenue growth as a key risk to the State's budgetary position, noting that the State's underlying reliance on Commonwealth grants constrains the State's revenue flexibility, leaving it exposed to downside risk.

## 1.3 Operating statement

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### 1.3.1 Consistent modest net operating surpluses are expected over all four Budget years

The Budget expects to achieve consistent modest net operating surpluses over all four years of the 2017-18 Budget, underpinned by steady GST revenue grants growth and expenditure restraint.

### 1.3.2 The estimated net operating surplus for 2016-17 includes large offsetting variations

The 2017-18 Budget estimates a net operating balance surplus of \$239 million for 2016-17 compared to the budgeted surplus of \$254 million, but includes several significant revenue and expense variations.

### 1.3.3 Net operating balances from 2017-18 onwards have all been revised significantly downwards since the 2016-17 Budget

The projected surpluses for 2017-18, 2018-19 and 2019-20 are significantly less than what was projected for these estimate years in the previous Budget.

This is mainly due to the net effect of policy measures, as shown in figure 3.8, including reforming the State's child protection system, the Our Energy Plan, additional resources for health services and the Future Jobs Fund.

## 1.4 Operating revenue

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### 1.4.1 Expected reliance on Commonwealth GST funding increasing

A greater proportion of total revenue is expected from GST revenue grants over the period 2014-15 to 2020-21. While total State revenues are expected to change only modestly, the increased proportional reliance on GST revenues means heightened exposure to national economic activity. Although a diversified risk, the experience of the global financial crisis shows the exposure is potentially significant.

The Productivity Commission has also recently reviewed the HFE<sup>1</sup> process at the request of the Australian Government. The Productivity Commission released a draft report on its recommendations in October 2017. The adoption of the recommendations by the Australian Government may adversely impact South Australia's GST revenues.

### 1.4.2 Total dividend and income tax equivalent income in 2016-17 is expected to be \$302 million higher than the 2016-17 Budget

Total dividend and income tax equivalent income in 2016-17 is expected to be \$302 million higher than the 2016-17 Budget. This is mainly due to the large dividend payment from MAC exceeding budget by \$192 million following the transition to new CTP insurance arrangements and the unbudgeted income tax equivalent payment from ReturnToWorkSA of \$86.3 million.

## 1.5 Operating expenses

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### 1.5.1 Operating expenses grow in 2017-18 but continued restraint over the forward estimates

Operating expenses are expected to grow by 5.8% in 2017-18, reflecting the commencement of full-year operating service payments associated with the nRAH and the implementation of significant initiatives introduced in the 2016-17 MYBR and 2017-18 Budget. This includes the Our Energy Plan initiative and the first year of fully implementing the State's response to the Child Protection Systems Royal Commission.

Expenditure growth is contained over the remaining forward estimates at levels below 2%, reflecting expenditure restraint and the impact of cumulative savings initiatives.

No new savings are included in the 2017-18 Budget, however the existing efficiency dividend policy continues.

### 1.5.2 Wages policy limiting wage growth continues

Employee expenses are expected to decline in real terms over the forward estimates, reflecting reductions in general government workforce numbers and constraint in public sector wages growth.

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<sup>1</sup> HFE is the process through which GST revenues collected by the Commonwealth are distributed to the States and Territories.

The wages policy introduced in the 2016-17 Budget limiting wage growth to 1.5% p.a. over the next three years of each enterprise agreement will continue. Salaries and wages remain the main public sector operating cost and achieving this level of wages restraint is important to achieving planned budget outcomes.

### **1.5.3 New Royal Adelaide Hospital impacts on operating expenditure from 2016-17**

The nRAH achieved commercial acceptance on 13 June 2017, triggering the commencement of the annual service payments and recognition of associated assets and liabilities. This has contributed to the increase in costs in 2016-17 for interest expenses, depreciation and amortisation, and other operating expenses.

The 2016-17 Budget assumed that commercial acceptance would be achieved at an earlier date for budgeting purposes. The delay in achieving commercial acceptance improved the net operating balance for 2016-17 by \$185 million mainly due to the reprofiling of finance lease charges and depreciation and amortisation, offset by additional project office costs.

### **1.5.4 Health and Ageing portfolio savings task continues to be a challenge**

Our previous Reports have emphasised that the Health and Ageing portfolio has not achieved savings targets or has experienced other service demands that have necessitated additional funding.

Health and Ageing's savings targets have been further reduced by \$321 million across the forward estimates in the 2017-18 Budget to support the revised timing of expected efficiencies. Figure 5.7 summarises changes to the Health and Ageing savings task since the 2012-13 Budget.

Achieving the current level of Health and Ageing savings remains a difficult challenge and poses a significant risk to achieving the Budget strategy.

## **1.6 Purchases and sales of non-financial assets**

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### **1.6.1 Purchases of non-financial assets in 2016-17 increase by \$2.76 billion due to recognition of the new Royal Adelaide Hospital**

Purchases of non-financial assets for the general government sector increase significantly in 2016-17 due to the recognition of the nRAH on the balance sheet, representing 62% of total capital investment in 2016-17.

The 2016-17 estimated result in the 2017-18 Budget recognises an asset and finance lease liability of \$2.76 billion. This accounts for the large increase in net debt in 2016-17.

## 1.6.2 Maintaining a significant capital expenditure program

Purchases in 2017-18 are expected to be \$2.2 billion and are projected to be at or above \$1.5 billion for each year of the forward estimates.

Roads and public transport projects are a significant part of the projected capital expenditure program. Substantial amounts are also projected for health, education and energy infrastructure.

Major capital projects carry high inherent risks including cost estimating, complex contract arrangements, cost escalations and timeliness of completion. Sustained higher capital outlays require effective procurement, contract and project management expertise and sound information systems and financial controls. Major projects are often subject to capital funding arrangements with the Commonwealth. Section 4.2.4 discusses this further.

## 1.6.3 Significant proceeds expected in 2017-18 from the sale of government assets and privatisation of land services functions

Total asset sales for the general government sector over the four years to 2020-21 are estimated to be \$1.5 billion, with most sales expected in 2017-18.

Proceeds are expected to be \$1.3 billion in 2017-18, an 83% increase compared to the 2016-17 estimated result. The substantial increase is mainly due to:

- significant proceeds from the separation and outsourcing of the transactional/service delivery activities provided by the Land Services Group
- the revised timing of asset sales including the State Administration Centre precinct
- the sale of Techport Common User Facility land and assets to the Commonwealth Government.

The privatisation of land services functions was finalised in August 2017. Announcements about the sale indicate that the SA Government will receive \$1.605 billion in an upfront payment as well as an ongoing royalty stream. These proceeds exceed those estimated in the 2017-18 Budget by \$855 million.

The proceeds from these asset sales have a significant impact on the net lending position of the State.

## 1.7 Balance sheet

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### 1.7.1 Expected asset increases are significant and include recognition of the new Royal Adelaide Hospital

Total assets for the NFPS are expected to increase over the forward estimates from \$73.7 billion at 30 June 2017 to \$77.6 billion at 30 June 2021. This is mainly due to a rise in the value of land and other fixed assets.



There was a large increase in total assets in 2016-17 owing to the recognition of the nRAH (\$2.8 billion). This increase in assets is offset by a corresponding increase in borrowings of \$2.8 billion under the finance lease arrangements.

### **1.7.2 Borrowings and the unfunded superannuation liability are the dominant liabilities**

Borrowings and the unfunded superannuation liability are the major components of liabilities over the period of the forward estimates. For the NFPS, borrowings are estimated to increase by \$1.3 billion, from \$15 billion at 30 June 2017 to \$16.3 billion at 30 June 2021. The unfunded superannuation liability is estimated to reduce from \$11.2 billion at 30 June 2017 to \$9.7 billion at 30 June 2021.

### **1.7.3 General government sector net debt estimated to increase**

General government sector net debt is forecast to increase by \$1.9 billion in 2017 to a total of \$6.3 billion at 30 June 2017. This is driven by the first time recognition of the \$2.8 billion nRAH on the State's balance sheet, partially offset by private insurer fees, dividends and return of equity from MAC of \$948 million.

Net debt is forecast to decrease by \$225 million in 2017-18 to a total of \$6.1 billion. This is mainly due to dividends and return of equity from MAC, estimated to be \$339 million in 2017-18. General government sector net debt is expected to peak at \$6.8 billion at 30 June 2020 before declining to \$6.7 billion by 30 June 2021.

### **1.7.4 Unfunded superannuation liability valuation is sensitive to interest rate movements**

Unfunded superannuation liabilities are valued at points in time by discounting future superannuation benefit payments by a discount rate that reflects the prevailing risk-free interest rate, consistent with the requirement of AASs. A discount rate of 3.3% was used for the estimate in the 2017-18 Budget, compared with 3.2% for the 2016-17 Budget. A 1% increase in the discount rate is estimated to decrease the superannuation liability by \$2.5 billion.

The SA Government reports that it remains committed to fully funding the superannuation liability by 2034. Table 4.4 of 2017-18 Budget Paper 3 'Budget Statement' itemises expected past service superannuation liability cash payments for 2016-17 and the four years of the Budget.

### **1.7.5 The reform of compulsory third party insurance will result in almost \$2.8 billion being returned to the general government sector by the Motor Accident Commission between 2014-15 and 2019-20**

It is expected that the reform of CTP insurance will result in almost \$2.8 billion being returned to the general government sector (Highways Fund) between 2014-15 and 2019-20,

comprising dividends of \$1.6 billion, a total return of equity of \$854.6 million and private insurer approval fees of \$259.4 million. This represents an increase of \$687 million in total distributions since the 2016-17 Budget.

MAC has \$361 million of remaining equity as at 30 June 2017.

## 1.8 Treasurer's Statements

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The main public accounts are the Consolidated Account, special deposit accounts and deposit accounts established under the PFAA.

A large proportion of public money is 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. The Treasurer's 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).

Special deposit accounts and deposit accounts are used by almost all agencies as their main operating account. The Treasurer's Statements only report the closing balances of these accounts. Details of agency transactions are reported in the individual general purpose financial reports of agencies. Money appropriated from Parliament in one year and transferred to a deposit account need not actually be expended in that year; it may be carried over into the next year unless required by the Treasurer to be paid to the Consolidated Account.

### 1.8.1 Consolidated Account deficit for 2016-17

The actual Consolidated Account result for 2016-17 was a \$618 million deficit, which was less than the budgeted deficit of \$979 million.

Total payments from the Consolidated Account of \$12.9 billion were within the appropriation authority of \$13.7 billion (refer Treasurer's Statement K).

### 1.8.2 Movements in the special deposit account and deposit account balances

The balance of funds on hand in special deposit accounts (\$6039 million) and deposit accounts (\$772 million) collectively increased by \$1.3 billion. The largest contribution to the increase was the MAC payments and CTP private insurer approval fees of \$947.6 million in 2016-17 to the Highways Fund (a special deposit account). This is in addition to a \$1.3 billion contribution to the Highways Fund by MAC in 2014-15 and 2015-16.

## 1.9 Limitation on audit analysis

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Most of our analysis in this Report is based on data provided in the Budget Papers, particularly the 2017-18 Budget, supplemented with information provided by DTF.

There are some limitations associated with the data when analysing results. They 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 a financial report. The Budget data represents unaudited estimates.
- Our review considers the estimated result for 2016-17. 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. The Budget Papers explain structural breaks in time series.

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

## 2 Fiscal strategy and State credit rating

### Key points

- The 2017-18 Budget expects the net operating surplus fiscal target to be met for all four years.
- For all years of the 2017-18 Budget the ratio of net debt to revenue stays below the 35% maximum fiscal target, although only marginally in 2018-19 and 2019-20.
- Standard & Poor's commented that its ratings on the State are supported by the State's asset sales that are supporting the budget during a period of higher expenditure growth, which is lowering operating surpluses in the near term.
- Moody's commented that it sees weaker than forecast revenue growth as a key risk to the State's budgetary position.

### 2.1 Fiscal strategy

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The SA Government sets out its fiscal strategy in each Budget and its broader fiscal targets, together with performance against those targets.

#### 2.1.1 Sustainable operating surpluses were a key fiscal target in early budgets post the global financial crisis

After the global financial crisis in 2008-09 a common fiscal target was to achieve sustainable surpluses. Some of the key elements of past Budgets were as follows:

- 2009-10 Budget – The announced fiscal strategy was to return the State to sustainable surpluses in the medium term.
- 2010-11 Budget – The fiscal strategy was to establish and maintain sustainable surpluses through significant budget improvement measures.
- 2011-12 Budget – A key fiscal strategy was to re-establish and maintain sustainable operating surpluses.

#### 2.1.2 Fiscal targets changed in 2011-12 mid-year budget review

The SA Government set new fiscal targets in the 2011-12 MYBR. Two key targets were:

- a net operating surplus by the end of the forward estimates (then 2014-15)
- a maximum ratio of general government net debt to revenue of 50%.

Changes to fiscal targets since the 2011-12 MYBR include:

- 2014-15 Budget – Maintained the target of a net operating surplus by the end of the forward estimates. Changed the target of a maximum ratio of general government net debt to revenue of 50% to a maximum of 35%. This was in response to a reduction in

general government sector net debt of \$2.7 billion, arising from the SA Government’s decision to change the gearing level (level of debt as a percentage of assets) arrangements of SA Water from 2014-15

- 2016-17 Budget – The net operating surplus fiscal target was revised to a net operating surplus in the general government sector in every year.

### 2.1.3 Net operating balance target expected to be met for all years of the 2017-18 Budget

The 2017-18 Budget expects an operating surplus of \$239 million in 2016-17. This surplus is supported by the dividend of \$298 million from MAC.

The 2017-18 Budget also projects net operating surpluses for all four years. Expected MAC dividends have a significant impact on the surplus in 2017-18 and 2018-19. This is discussed further in section 3.1.3.

### 2.1.4 Debt fiscal target expected to be met for all years of the 2017-18 Budget

Since the 2011-12 MYBR, the SA Government’s debt fiscal target has been based on the ratio of general government net debt to revenue.

Net debt is expected to increase from \$6.297 billion at 30 June 2017 to \$6.687 billion at 30 June 2021. Net debt peaks at 30 June 2020 at \$6.808 billion. Expressed as a percentage of revenue, net debt is forecast to decrease from 34.5% at 30 June 2017 to 33.1% at 30 June 2021.

Figure 2.1 shows the ratio of net debt to revenue for recent years and for the 2016-17 and 2017-18 Budgets.

**Figure 2.1: General government sector ratio of net debt to revenue Budget comparisons**

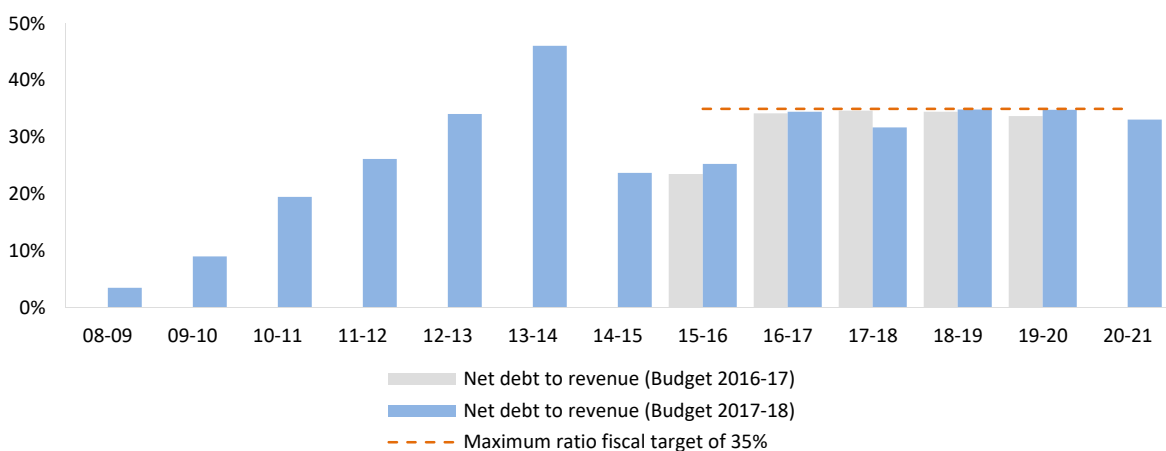


Figure 2.1 shows that for all years of the 2017-18 Budget the ratio of net debt to revenue stays below the 35% maximum set by the SA Government’s fiscal target in 2014-15. The ratio

is only marginally below the maximum in 2018-19 (34.9%) and 2019-20 (34.8%). Net debt increases significantly in 2016-17 as a consequence of recognising the finance lease obligation for the nRAH.

## 2.2 The State credit rating

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### 2.2.1 Background to changes in the credit rating of the State

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

South Australia's credit rating from Standard & Poor's was downgraded from AAA to AA+ after the release of the 2012-13 Budget in May 2012. In early September 2012, Moody's also downgraded South Australia's credit rating.

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

In late September 2012 Standard & Poor's further downgraded South Australia's credit rating from AA+ to AA with a stable outlook.

In September 2016 Standard & Poor's upgraded South Australia's credit rating from AA with a stable outlook to AA with a positive outlook.

### 2.2.2 Standard & Poor's outlook

Standard & Poor's commented in October 2017 that it could raise its long-term rating on the State within the next two years if the State delivers sustainable operating surpluses and a stable debt profile, while maintaining its current liquidity policy. Conversely, it could revise the outlook to stable if the State's budgetary performance were to weaken compared with forecasts in the lead up to the next State election.

Standard & Poor's also commented that its ratings on the State are supported by the State's asset sales that are supporting the budget during a period of higher expenditure growth, which is lowering operating surpluses in the near term.

### 2.2.3 Moody's highlights weaker than forecast revenue growth as a key risk

In October 2017, Moody's commented that it sees weaker than forecast revenue growth as a key risk to the State's budgetary position. The State's underlying reliance on Commonwealth grants constrains the State's revenue flexibility, leaving it exposed to downside risk.

Moody's also reiterated that a credit strength of the State is the success in slowing expenditure growth in recent years, evidencing strong fiscal resolve.

## 3 Operating statement

### Key points

- The estimated net operating surplus for 2016-17 is marginally lower than budget.
- The projected surpluses for 2017-18, 2018-19 and 2019-20 are significantly less than what was projected for these estimate years in the previous Budget.
- Net operating balances for the period 2014-15 to 2018-19 are supported by significant dividend returns from the privatisation of CTP insurance.
- For 2016-17 net acquisition of non-financial assets is estimated to be \$2833 million, compared to the budgeted amount of \$2690 million. This is due mainly to lower than expected sales of non-financial assets, including a delay in the sale of the State Administration Centre precinct.
- A net lending deficit of \$2.6 billion is expected in 2016-17, reflecting the commencement of the finance lease for the nRAH.
- Following a net lending surplus in 2017-18, deficits are projected before a return to surplus in 2020-21.
- The 2017-18 Budget reflects consistent modest net operating surpluses over all four budget years.

### 3.1 Net operating balance – issues and trends

#### 3.1.1 Estimated net operating surplus for 2016-17 is marginally lower than budget

Figure 3.1 shows 2015-16 financial year data and differences between the estimated result and budget for 2016-17.

**Figure 3.1: General government budget comparisons**

	2015-16 Actual \$'million	2016-17 Budget \$'million	2016-17 Estimated result \$'million	2016-17 Difference to budget \$'million	2016-17 Difference to budget %
Revenue:					
Taxation revenue	4 409	4 517	4 421	(96)	(2)
Grants:					
Current	8 675	9 505	9 377	(128)	(1)
Capital	321	740	628	(112)	(15)
Sales of goods and services	2 455	2 487	2 527	40	2
Interest income	24	24	24	-	-
Dividend and income tax equivalent income	792	326	628	302	93
Other	686	664	664	-	-
<b>Total revenue</b>	<b>17 362</b>	<b>18 263</b>	<b>18 269</b>	<b>6</b>	<b>-</b>

	2015-16 Actual \$'million	2016-17 Budget \$'million	2016-17 Estimated result \$'million	2016-17 Difference to budget \$'million	2016-17 Difference to budget %
<i>Less: Expenses:</i>					
Employee expense	7 721	7 899	8 009	110	1
Superannuation expenses:					
Superannuation interest cost	402	392	345	(47)	(12)
Other superannuation expenses	744	859	829	(30)	(3)
Depreciation and amortisation	890	963	888	(75)	(8)
Interest expenses	210	346	191	(155)	(45)
Other operating expenses	4 398	4 613	4 562	(51)	(1)
Grants	2 698	2 937	3 206	269	9
<b>Total expenses</b>	<b>17 062</b>	<b>18 009</b>	<b>18 030</b>	<b>21</b>	<b>-</b>
<b>Net operating balance</b>	<b>300</b>	<b>254</b>	<b>239</b>	<b>(15)</b>	<b>(6)</b>
<i>Less: Net acquisition of non-financial assets:</i>					
Purchases of non-financial assets	1 162	4 630	4 454	(176)	(4)
<i>Less: Sales of non-financial assets</i>	66	976	733	(243)	(25)
<i>Less: Depreciation</i>	890	963	888	(75)	(9)
<i>Add: Change in inventory</i>	(3)	-	-	-	-
<i>Add: Other movements in non-financial assets</i>	-	-	-	-	-
<b>Total net acquisition of non-financial assets</b>	<b>204</b>	<b>2 690</b>	<b>2 833</b>	<b>143</b>	<b>5</b>
<b>Net lending (borrowing)</b>	<b>96</b>	<b>(2 436)</b>	<b>(2 595)</b>	<b>(159)</b>	<b>(7)</b>

Note: Totals may not add due to rounding.

The 2017-18 Budget estimates a net operating balance surplus of \$239 million for 2016-17 compared to the budgeted surplus of \$254 million. Several significant revenue and expense variations largely offset each other, including:

- taxation revenue and grant revenue being lower than budget by a total of \$336 million
- dividend and income tax equivalent income and sales of goods and services income exceeding budget by a total of \$342 million
- employee expenses and grant expenses exceeding budget by a total of \$379 million
- superannuation, depreciation and amortisation, interest and other operating expenses being lower than budget by a total of \$358 million.

These variations are discussed further in chapters 4 and 5.

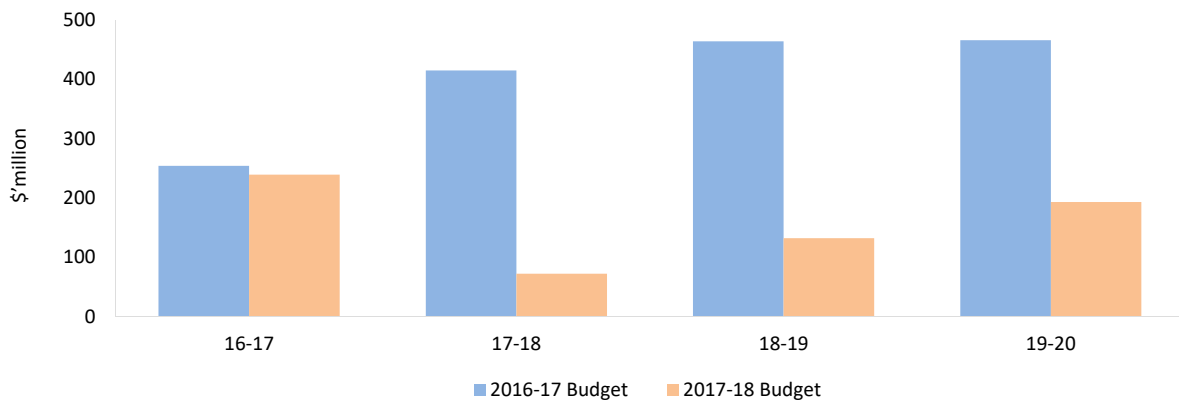
The estimated net lending deficit (\$2595 million) is \$159 million higher than the budgeted net lending deficit (\$2436 million). This variation is mainly due to sales of non-financial assets being lower than budget, partly offset by purchases of non-financial assets and depreciation also being lower than budget. This is discussed further in chapter 6.

### 3.1.2 Changes in net operating balance estimates

Figure 3.2 compares net operating balance estimates for the general government sector in the 2016-17 Budget and 2017-18 Budget.



**Figure 3.2: Comparison of estimated net operating results between 2016-17 and 2017-18 Budgets**



The 2017-18 Budget expects net operating surpluses for all four years.

Figure 3.2 shows that net operating balances from 2017-18 onwards have all been significantly reduced since the 2016-17 Budget.

This is mainly due to the net effect of policy measures, as shown in figure 3.8, including reforming the State’s child protection system, the Our Energy Plan, additional resources for health services and the Future Jobs Fund.

### 3.1.3 Net operating surpluses significantly supported by returns from the Motor Accident Commission

Figure 3.3 shows the net operating balance and dividend returns from the privatisation of CTP insurance for the period 2014-15 to 2019-20.

**Figure 3.3: Net operating balance and MAC dividends**

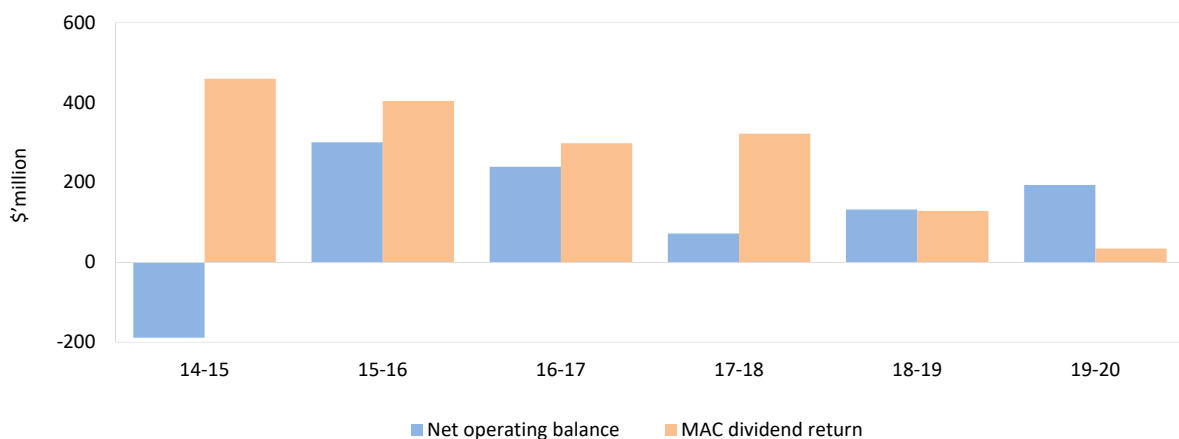


Figure 3.3 shows that net operating balances for the period 2014-15 to 2018-19 are significantly supported by dividend returns from MAC. The effects flow through to the net lending result.

For 2014-15 a net operating deficit resulted even after receiving a large MAC dividend. For the period 2015-16 to 2017-18, the MAC dividend exceeds the net operating balance surplus.

The SA Government makes a number of policy decisions about allocating resources in preparing the Budget. In the absence of returns from privatising CTP Insurance, alternative policy decisions may have been made to still achieve net operating surpluses, such as increases in the taxation revenue base or further savings initiatives.

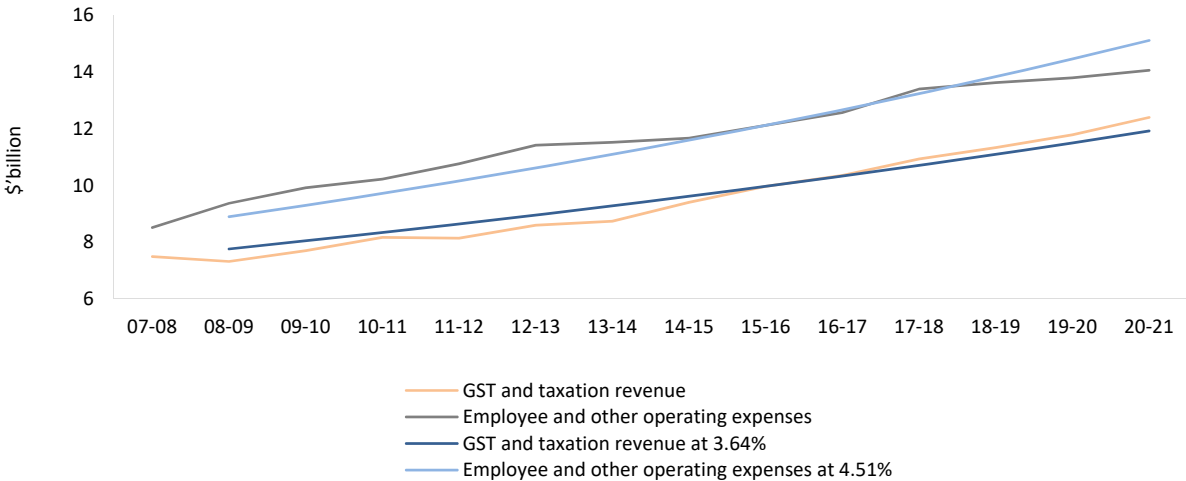
Notwithstanding this, the privatisation of CTP insurance is a significant one-off event that has contributed significantly to actual net operating surpluses in recent years and expected surpluses over the 2017-18 and 2018-19 budget years. Most of this benefit has now been used or is projected to be used by 2018-19.

The estimated returns to the State from MAC operations are minimal from 2019-20 onwards.

### 3.1.4 Trends in key revenue and expense items

The net operating result is at risk from both revenue and expense outcomes. Figure 3.4 compares trends for key revenue and expense items in the 2017-18 Budget, namely GST and taxation revenue and employee and other operating expenses.

**Figure 3.4: Comparison of GST and taxation revenue and employee and other operating expenses**



### GST and taxation revenue projections tracking closely with historical average growth rates

In figure 3.4, the GST and taxation revenue line tracks actual revenues up to 2015-16 and estimated revenues from 2016-17 to 2020-21. Between 2007-08 and 2015-16, these two combined items grew on average annually by about 3.64%. Applying this average growth rate from 2007-08 through to 2020-21 creates the GST and taxation revenue at 3.64% line. The charted past experience and the budget estimates lines correlate closely.

## Employee and operating expenses are forecast to grow at rates lower than historical growth rates

Between 2007-08 and 2015-16 combined employee and other operating expenses grew on average annually by about 4.51%. Applying this average growth rate from 2007-08 to 2020-21 creates the employee and other operating expenses at 4.51% line. Comparing the trend of this line to the estimated expenses for the 2017-18 Budget shows an increasing difference between the two lines. This difference highlights the significance of the expenditure restraint built into the 2017-18 Budget estimates.

The flattening of growth in actual expenses from 2012-13 onwards indicates that expenditure restraint has been achieved through the impact of cumulative savings initiatives.

The 2017-18 Budget estimates over the four years contain significant savings initiatives that were introduced in recent Budgets. New savings (being the value for the four years of each Budget) introduced since the \$1.5 billion Sustainable Budget Commission savings in the 2010-11 Budget include:

- \$430.7 million in the 2012-13 Budget
- \$227.2 million in the 2012-13 MYBR
- \$140 million in the 2013-14 Budget
- \$1.5 billion in the 2014-15 Budget
- \$357 million in the 2016-17 Budget.

While no new savings initiatives are included in the 2017-18 Budget, agency budgets include a continuation of the existing efficiency dividend policy.

This policy requires ongoing savings of 1% of the agency employee expenses budget per annum and a 1% reduction in their net cost of services per annum. The efficiency dividend on net cost of services excludes the judicial areas of courts, police officers (with only 0.5% applied to the remainder of Police) and frontline emergency services staff, prison operations, disabilities and schools.

The policy puts responsibility on agencies to tailor savings to their particular operating structures to ensure more efficient ways of conducting business are pursued. Agencies will be required to continue to find expenditure efficiencies to deliver these savings. Savings initiatives are discussed in further detail in section 5.3.

## 3.2 Net acquisition of non-financial assets in 2016-17

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### 3.2.1 2016-17 estimated net acquisition of non-financial assets exceeded budget

For 2016-17 the net acquisition of non-financial assets (the balance of purchases of non-

financial assets less sales of non-financial assets and depreciation) is estimated to be \$2833 million, compared to the budgeted amount of \$2690 million. The difference is mainly due to lower than expected sales of non-financial assets, including a delay in the sale of the State Administration Centre precinct.

### 3.2.2 Adjustments made to the 2016-17 Budget estimate of purchases of non-financial assets

The 2016-17 estimated result for purchases of non-financial assets of \$4454 million is \$176 million below the 2016-17 Budget.

Figure 3.5 shows that, consistent with the high value of capital spending, significant adjustments were made during 2016-17. The estimated result decrease is driven by a number of factors, including carryovers, reversals of slippage provisions and project re-profiles.

The 2016-17 estimated result also allows for mid-year budget adjustments and slippage provisions beyond the financial year.

**Figure 3.5: Comparison of purchases of non-financial assets budget to 2016-17 estimated result**

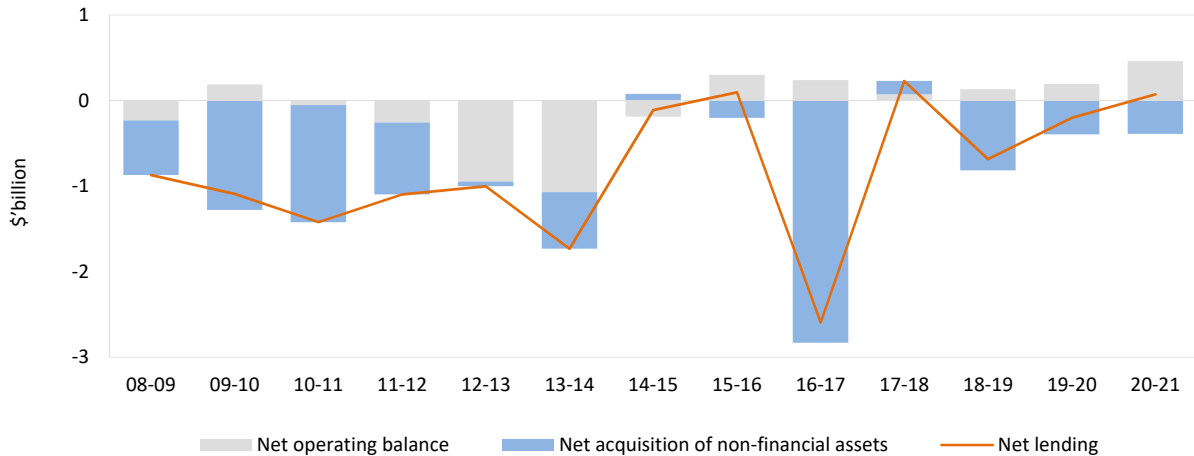
	\$'million	\$'million
2016-17 Budget		4 630
<i>Policy decisions</i>		25
<i>Parameter variations:</i>		
Carryovers from 2015-16	178	
Reversal of slippage provision for carryovers from 2015-16	(120)	
Carryovers into 2017-18 and forward years	(231)	
Reversal of slippage provision for carryover from 2016-17	230	
Significant project re-profiles	(226)	
Other (includes reclassifications to operating and contingency adjustments)	(32)	(201)
2016-17 estimated result		4 454

Figure 3.5 shows that carryovers to 2017-18 are expected. These relate to identified projects across various portfolios. The 2016-17 estimated result also includes a provision for capital slippage, reflecting slippage expected to occur in the remainder of 2016-17.

## 3.3 Changing financial position

Figure 3.6 demonstrates the trend in net lending since 2008-09 and the expected trend over the forward estimates.

**Figure 3.6: General government sector net operating balance, net acquisition of non-financial assets<sup>(a)</sup> and net lending**



<sup>(a)</sup> Net acquisition of non-financial assets included as negative amounts.

Figure 3.6 shows net lending deficits (where revenues are less than operating and net investment expenditure) for the period 2008-09 to 2014-15, with a small net lending surplus in 2015-16.

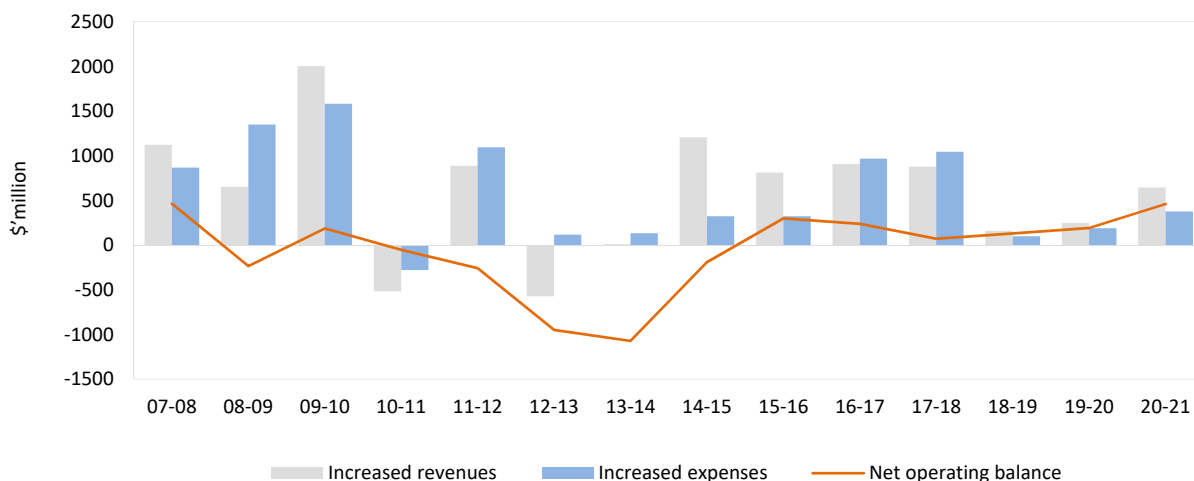
A net lending deficit of \$2.6 billion is expected in 2016-17 reflecting the commencement of the finance lease for the nRAH. Following a net lending surplus in 2017-18, deficits are projected before a return to surplus in 2020-21.

The net lending deficits reflect the SA Government’s significant capital expenditure program. Chapter 6 discusses this further.

### 3.4 Budget forecasts 2017-18 to 2020-21

Figure 3.7 shows annual changes in actual revenues and expenses up to 2015-16 and estimated changes for the period 2016-17 to 2020-21, together with each year’s net operating balance.

**Figure 3.7: Net operating balance and annual change in general government sector revenue and expenses**



The global financial crisis affected the years 2008-09 to 2011-12. Commonwealth funding, including stimulus grants, peaked in 2009-10 and concluded in 2011-12.

### 3.4.1 Consistent modest net operating surpluses expected

The Budget expects to achieve consistent modest net operating surpluses over all four years of the 2017-18 Budget, underpinned by GST revenue grants growth and expenditure restraint. Over the four years of the Budget employee expenses are expected to decline in real terms, with nominal growth in each year generally below 2%.

There is a significant increase in expenditure in 2017-18 which reflects:

- the commencement of service payments on the nRAH, including associated interest expenses and amortisation. The nRAH was recognised on the State's balance sheet for the first time in 2016-17, following commercial acceptance on 13 June 2017
- additional resources to address continual reform of the State's child protection system in response to the Child Protection Systems Royal Commission
- the commencement of the SA Government's Our Energy Plan, including building Australia's largest battery storage and gas production incentives.

The impact of these changes and initiatives on operating expenses is discussed further in chapter 5.

## 3.5 Reconciliation of variations since 2016-17 Budget

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Each year the Budget Papers include a reconciliation of the current budget estimates with the corresponding estimates for the previous year. This explains differences between Budgets arising from the SA Government's two key categories:

- Parameter changes – variations that do not flow from policy choice changes. Revenue parameter changes include changes in taxation driven by economic activity and changes in revenue received from the Commonwealth. Expense parameter changes include carryovers between years to reflect timing differences, reclassifications and corrections.
- Policy changes – decisions made by the SA Government to increase or decrease taxation and spending.

Figure 3.8 summarises all parameter and policy changes made since the 2016-17 Budget that affect the net operating balance.<sup>2</sup>

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<sup>2</sup> 2017-18 Budget Paper 3 'Budget Statement', table 1.5.

**Figure 3.8: Reconciliation of general government sector net operating balance**

	2016-17 Estimated result \$'million	2017-18 Budget \$'million	2018-19 Estimate \$'million	2019-20 Estimate \$'million
2016-17 Budget estimated net operating balance	254	415	464	466
Parameter and other variations:				
Revenue – taxation	(96)	(114)	(109)	(119)
Revenue – other	92	220	147	(23)
Operating expenses	226	14	(199)	(111)
Net effect of parameter and other variations	222	120	(161)	(253)
Policy measures:				
Revenue – taxation	-	87	93	94
Revenue – other	-	-	-	-
Revenue – offsets	10	39	204	214
Operating expenses	(247)	(590)	(467)	(329)
Net effect of policy measures	(237)	(464)	(170)	(21)
2017-18 Budget estimated net operating balance	239	72	132	193

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

### 3.5.1 Revenue variations

Taxation parameter variations reduce revenue over the forward estimates by \$438 million. Figure 3.9 shows the components of revenue parameter changes.<sup>3</sup>

**Figure 3.9: Revenue parameter changes since the 2016-17 Budget**

	2016-17 Estimated result \$'million	2017-18 Budget \$'million	2018-19 Estimate \$'million	2019-20 Estimate \$'million
All State taxation	(96)	(114)	(109)	(119)
Commonwealth specific purpose and national partnership grants:				
Special purpose	33	(44)	(52)	(42)
National partnership	(118)	46	(20)	(163)
GST revenue grants	(167)	(122)	75	213
Sales of goods and services	41	(19)	(12)	(22)
Other contributions and grants	6	2	(2)	(1)
Dividends and income tax equivalents	301	342	130	5
Interest income	-	-	-	2
Royalties	(25)	(9)	(8)	(13)
Other	23	24	39	(1)
Total	(2)	106	41	(141)

Note: Totals may not add due to rounding.

<sup>3</sup> Sourced from 2017-18 Budget Paper 3 'Budget Statement', table 1.7 and 2016-17 MYBR, table 1.7.

Figure 3.9 shows that taxation revenue has been written down over all four years since the 2016-17 Budget. The most significant write-down is for conveyance duties which primarily reflects the flow through impact of lower transaction levels. The Budget notes that underlying real property transactions are expected to grow over the forward estimates period returning to longer term levels.

Payroll tax revenues have been revised to reflect lower collections resulting from compositional factors, including differential growth rates between small and large employers.

Commonwealth Government special purpose grants have been revised up in 2016-17 primarily due to a payment following the finalisation of National Health Reform funding for 2015-16 activity levels. Future years have been revised down primarily due to a decrease in funding expected to be received under the National Health Reform Agreement and the Commonwealth’s Quality Schools reforms.

Commonwealth Government national partnership grants have been revised down in all years except 2017-18. The downward revision in 2016-17 mainly reflects the deferral of funding into later years and is partially offset by an overall increase in local government grant funding through the State.

Dividends and income tax equivalents have been revised upwards mainly due to higher expected dividend payments from MAC following the transition to new CTP insurance arrangements.

### 3.5.2 Operating expense variations

Figure 3.8 shows that parameter effects are estimated to increase operating expenses by \$70 million over the four years to 2019-20. Policy spending decisions since the 2016-17 Budget are expected to add a further \$1.6 billion to operating expenses over the same period, \$247 million of which is estimated for 2016-17.<sup>4</sup> Figure 3.10 shows the value of policy measures taken in each of the past five years after presenting the Budget for the year.

**Figure 3.10: Policy spending decisions**

	2012-13	2013-14	2014-15	2015-16	2016-17
	\$'million	\$'million	\$'million	\$'million	\$'million
Policy measure operating expenses	352	226	164	272	247

Figure 3.10 shows that \$1.3 billion was added to spending for the past five years, an average of \$252 million p.a.

<sup>4</sup> 2017-18 Budget Paper 3 ‘Budget Statement’, table 1.5.



## 4 Operating revenues

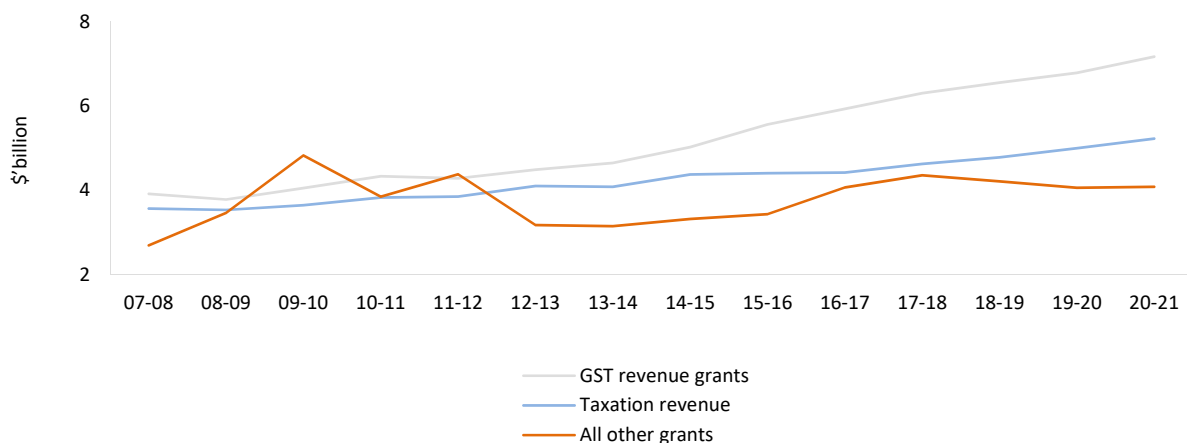
### Key points

- Steady modest growth in GST revenue grants over the four years of the Budget, averaging 4.9% nominal growth per year.
- Taxation revenues are projected to grow in real terms by around 1.9% p.a. on average over the period 2016-17 to 2020-21.
- A greater proportion of total revenue is expected from GST revenue grants over all four years of the Budget and an increasing proportion from taxation revenue from 2018-19 onwards.
- Total dividend and income tax equivalent income in 2016-17 is expected to be \$302 million higher than the 2016-17 Budget, mainly due to the dividend payment from MAC exceeding budget by \$192 million and an unbudgeted \$86 million income tax equivalent payment from ReturnToWorkSA.
- MAC dividends are budgeted for each year up to 2019-20.

### 4.1 Revenue forecasts 2017-18 to 2020-21

Figure 4.1 shows expected trends for the major revenue items in the 2017-18 Budget against the experience of the 10 years to 2016-17.

**Figure 4.1: General government sector Commonwealth grants and taxation revenue**



The Budget notes total general government revenues are projected to grow in real terms by 0.2% p.a. on average over the period 2016-17 to 2020-21. This relatively low growth reflects expected low growth in GST grants in 2018-19 and 2019-20, a decline in Commonwealth Government national partnership grants and the impact of the 2015-16 State Budget tax cuts being phased in over the coming years.

### 4.1.1 Expected strong growth in GST revenue grants and capital grants

Figure 4.1 shows the significant growth in GST revenue grants for the period 2015-16 to 2017-18. Thereafter, there is steady modest growth in all years through to 2020-21.

The Budget notes an increase in South Australia's per capita relativities for the distribution of GST revenue grants in 2017-18. Based on the new relativity and current GST pool estimates for 2017-18, South Australia will receive nearly \$2 billion more than it would if funding was distributed on a simple population share basis, without regard to the fiscal needs and capacities of each State.

The Budget also notes the impacts on relativities of continued strength in eastern States' property markets and volatility in the underlying Australian Bureau of Statistics data supporting the wage cost assessment.

Following growth for the period 2014-15 to 2017-18, all other grants are expected to flatten out and reduce from 2018-19 onwards. All other grants mainly reflect Commonwealth Government capital grants for infrastructure projects.

## 4.2 Operating revenues – trends and issues

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GST revenue grants in 2016-17 are estimated to be \$167 million lower than budgeted, while taxation revenues for 2016-17 have been revised down by \$96 million since the 2016-17 Budget.

GST revenue has been shown to be highly sensitive to household spending patterns. State taxation also varies with economic activity and demand for housing.

Steady modest growth in GST revenue grants is expected over the four years of the Budget, averaging 4.9% nominal growth per year.

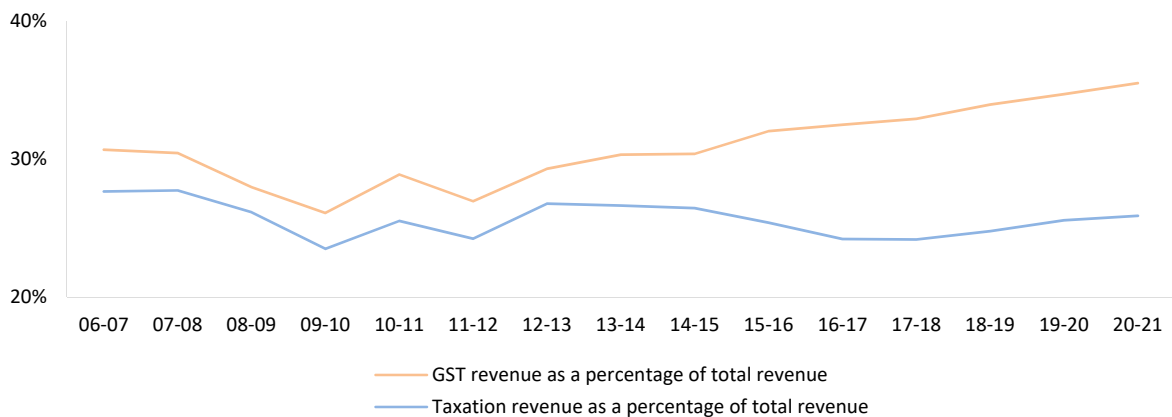
Nominal growth for taxation revenue is expected to average 4.3% over the four years of the Budget. This is significantly larger than the estimated nominal growth for 2016-17 (0.3%).

The increases in taxation revenue over the four years of the Budget are mainly attributable to payroll tax and conveyance duty.

### 4.2.1 Trends in GST and taxation revenue

The significance of GST and taxation revenue is demonstrated in figure 4.2, which shows the annual proportions of actual GST and taxation revenue to total general government sector revenue up to 2015-16 and estimated proportions for the period 2016-17 to 2020-21.

**Figure 4.2: GST grant revenue and taxation revenue as a percentage of total revenue**



### Increased reliance on GST revenue

Figure 4.2 also shows the widening gap between the GST and taxation revenue ratios over the period 2014-15 to 2020-21, as a greater proportion of total revenue is expected from GST revenue grants and a diminishing proportion from taxation revenue. Revenue is primarily dependent on the level of economic activity. While total State revenues are expected to change only modestly, the increased proportional reliance on GST revenues means heightened exposure to national economic activity. Although a more diversified risk, the experience of the global financial crisis shows it is potentially significant.

Over the four years of the 2017-18 Budget there is an upward trend in the GST revenue ratio, which approaches 36%. This reflects expected growth in the GST pool and South Australia’s share of the pool.

### Forecast changes in proportions of taxation revenue

For taxation revenue, the trend over the forward estimates is that the ratio flattens and then increases modestly. Other grant revenue and dividend and income tax equivalent income reduce relatively. The decreases in other grant revenue are primarily due to reductions in Commonwealth Government grants for infrastructure projects. Dividend and income tax equivalent income is estimated to be lower as a result of reduced returns to the SA Government from the privatisation of CTP insurance over the period 2017-18 to 2019-20.

### 4.2.2 Relative volatility of major taxation revenues

The two largest items of State taxation are payroll tax and conveyance duty. Growth in payroll tax is based on the outlook for employment and wages growth and payroll compositional factors. For conveyance duty, the Budget assumes that underlying property market transactions will return to long-term trend levels over the medium term. Property prices are expected to grow broadly in line with long-term trend growth in per capita nominal household income.

The Budget comments on the difficulty in predicting trends in property market values and activity levels, particularly transaction numbers which can change significantly from one year to the next. This makes forecasting property taxes difficult, especially conveyance duty. Since 1999-2000 the annual growth in conveyance duty revenue has ranged from negative 20% to positive 42%.

## Volatility of conveyance duty compared to payroll tax

The difference in volatility of the two main sources of taxation revenue is represented in figure 4.3, which shows actual annual nominal percentage changes from 2005-06 to 2015-16 and estimated changes for the period 2016-17 to 2020-21.

**Figure 4.3: Annual percentage change in payroll tax and conveyance duty**

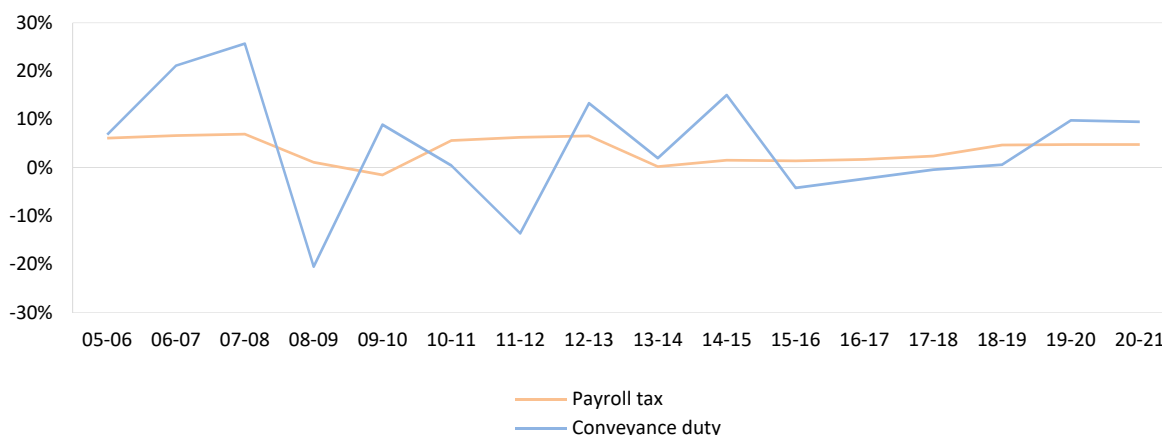


Figure 4.3 shows the relative stability of payroll tax growth over the period in comparison to the significant fluctuations in conveyance duty. It also demonstrates that, over the forward estimates, while payroll tax is expected to only grow modestly, conveyance duty is expected to grow by around 10% in 2019-20 and 2020-21.

### 4.2.3 Risk factors for major revenue items

Conveyance duties are sensitive to both transaction levels and transaction prices. The 2017-18 Budget reports that there is a risk that property prices and/or activity levels will be lower than estimated, particularly if structural changes in the economy cause uncertainty.

The Budget also identifies there is a risk that employment or wages growth will be lower than forecast, which would reduce payroll tax revenue.

The Budget further notes that South Australia's GST revenue grants comprise over 50% of total grant revenue and therefore the budget is particularly exposed to lower than expected growth in the GST pool. Further, changes to the methodology and data underlying the HFE process for GST grant distribution have the potential to significantly impact (both positively and negatively) the State's revenue base and budget position.

Risk analysis in the Budget Papers notes that a 1%:

- change in GST pool growth has a revenue impact for South Australia of about \$63 million p.a. and a 0.01 change in South Australia's relativity would result in a change in GST revenue grants of about \$44 million. This highlights the importance of GST to the Budget projections
- change in taxable payrolls equates to about \$12 million in payroll tax revenue
- variation in 2017-18 property values equates to about \$10 million in conveyance duty revenue

- variation in transactions in 2017-18 equates to about \$8 million in conveyance duty revenue.

## The HFE process is currently under review by the Commonwealth Grants Commission and the Productivity Commission

The Commonwealth Grants Commission and the Productivity Commission have recently reviewed the HFE process at the request of the Australian Government. The Commonwealth Grants Commission released a position paper on the principle of HFE and its implementation in September 2017, while the Productivity Commission released a draft report on its recommendations in October 2017.

The Commonwealth Grants Commission position paper proposed no major changes to the HFE methodology.

The Productivity Commission draft report made the following observations and recommendations:

- Equalising comprehensively and to the fiscally strongest State means that the redistribution task is too great for any jurisdiction to bear and is volatile at times of significant cyclical and structural change.
- The Australian Government should articulate a revised objective for HFE. While equity should remain at the heart of HFE, it should aim to provide States with the fiscal capacity to provide a reasonable level of services.
- Equalisation should no longer be to the highest State, but instead the average or the second highest State. This will provide States with a high level of fiscal capacity not distorted by the extreme swings of one State.
- The Commonwealth Treasurer should ask the Commonwealth Grants Commission to recommend relativities consistent with the revised equalisation objective.
- Any material change to HFE in the current extreme environment will lead to significant redistributions of the GST. Timing and careful transition are paramount, especially to ensure the fiscally weaker States are not significantly disadvantaged.

The final report of the Productivity Commission will be prepared after further submissions have been received and public hearings have been held, and will be submitted to the Australian Government in January 2018.

The adoption of the Productivity Commission's recommendations by the Australian Government may adversely impact South Australia's GST revenues. The Productivity Commission draft report notes that a move to average equalisation would result in a reduction of \$557 million to 2017-18 GST payments for South Australia, while a move to the second strongest State would result in a reduction of \$256 million in 2017-18 GST payments.

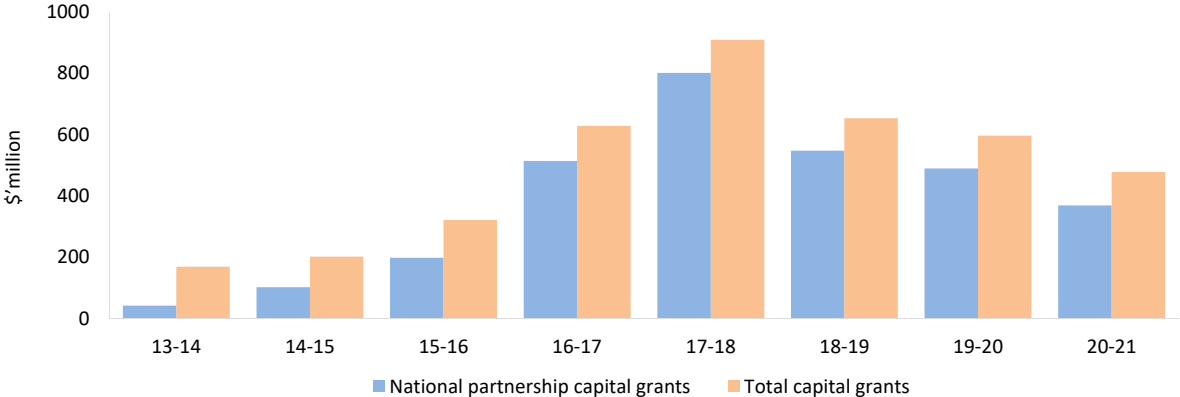
### 4.2.4 Expected strong growth in Commonwealth capital grant revenue supports the operating result

The net operating balance is significantly influenced by capital grant revenue from the Commonwealth. The Budget includes a substantial increase in Commonwealth capital grants in 2017-18, before this funding levels off and trends downwards over the forward estimates.

Most of this funding reflects national partnership grants for road and rail transport infrastructure projects. The Budget notes that the variability in Commonwealth capital grants largely reflects the timing, and changes to the profile, of funding for these projects, including funding for the Darlington upgrade, the Goodwood/Torrens rail junction project and the Tonsley rail extension project.

Figure 4.4 shows the recent trend in Commonwealth capital grant funding and the expected trend over the forward estimates.

**Figure 4.4: Commonwealth capital grant funding**



Most of this capital grant funding does not have a corresponding operating expenditure in the operating statement. Rather, the expenditure from this funding is reflected in the ‘purchases of non-financial assets’ line item, which impacts directly on the net lending balance. The operating result is impacted once the asset is complete and in use through the annual charging of depreciation expense over the useful life of the asset.

#### 4.2.5 Sales of goods and services

Revenue from sales of goods and services (\$2527 million) represented 14% of estimated total revenues in 2016-17. Sales of goods and services by the general government sector include government fees and charges. Most government fees and charges will be increased by 2.2% from 1 July 2017.

Revenue from sales of goods and services in 2016-17 is estimated to be \$40 million higher than the 2016-17 Budget, mainly due to upward revisions to regulatory fees and Commonwealth Government contributions, partially offset by lower revenue from other user charges and health unit fees.

Revenue from sales of goods and services is expected to be \$2742 million in 2020-21. This reflects marginal declines in real terms across all four years of the Budget except 2018-19.

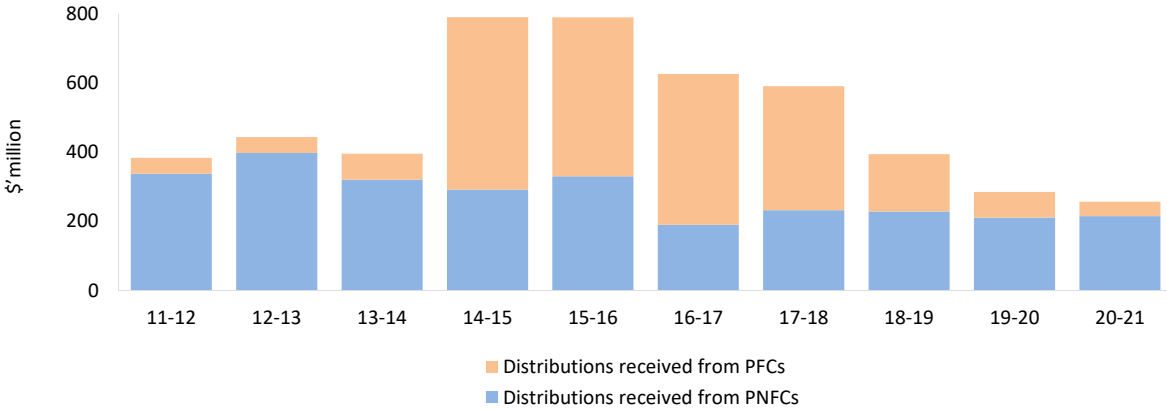
#### 4.2.6 Dividend and income tax equivalent income

Dividend and income tax equivalent income are the distributions received from PNFCs and PFCs. As the distributions come from two other GFS sectors, on a consolidated financial reporting basis these distributions are considered 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 and therefore impact this sector’s net operating balance.

Figure 4.5 shows the trend in distributions received from PFCs and PNFCs for the 10 years to 2020-21.

**Figure 4.5: Distributions received by the general government sector (nominal)**



**2016-17 distributions above budget**

In 2016-17 total distribution income is estimated at \$628 million and predominantly comprises the dividend payment from MAC to the Highways Fund (controlled by the Department of Planning, Transport and Infrastructure) of \$297.8 million, SA Water dividend and income tax equivalent payments totalling \$177.4 million and ReturnToWorkSA income tax equivalent payments of \$86.3 million.

Total dividend and income tax equivalent income in 2016-17 is expected to be \$302 million higher than the 2016-17 Budget. This is mainly due to the large dividend payment from MAC exceeding budget by \$192 million following the transition to new CTP insurance arrangements and the unbudgeted income tax equivalent payment from ReturnToWorkSA of \$86.3 million.

While ReturnToWorkSA does not pay a dividend to the SA Government, it is required to make an income tax equivalent payment on profits under the *Public Corporations Act 1993*. ReturnToWorkSA has not estimated future income tax equivalent payments at this stage.

Distributions from SAFA are estimated to be \$16 million above budget in 2016-17, reflecting higher than budgeted dividends and income tax equivalent payments from its treasury, fleet and insurance operations. Refer to the Annual Report of the Auditor-General for the year ended 30 June 2017: Part B ‘Agency audit reports’ under ‘South Australian Government Financing Authority’ for more detail.

**Longer term trends in distributions**

Figure 4.5 demonstrates that total distributions peaked in 2014-15 and 2015-16 before reducing over the four years to 2020-21. These peaks are mainly due to MAC dividends in 2014-15 (\$459.2 million) and 2015-16 (\$403.5 million).

Distributions received from PFCs in the 2017-18 Budget include a further \$484.3 million in dividends from MAC across the forward estimates.

MAC's ongoing net financial position is now driven by running off existing claims, investment performance and the sale of assets. MAC dividends are estimated to steadily reduce from 2017-18 onwards, with no dividends budgeted in 2020-21. This results in a significant decrease in distributions received from PFCs over the four years of the Budget.

The Budget also includes payments from MAC to the Highways Fund that are categorised as return of equity. A \$649.8 million return of equity from MAC is estimated in 2016-17, including \$259.4 million paid to the State by four private insurers at the time of their entry to the South Australian CTP insurance market. The budgeted return of equity from MAC over the period 2017-18 to 2019-20 is \$25.5 million. There is no budgeted return of equity in 2020-21. Table 5.11 of 2017-18 Budget Paper 3 'Budget Statement' details the equity returns expected for each year. They are not treated as revenue but are recorded in the balance sheet and increase cash balances and reduce general government sector net debt.

The capital of the major PFCs at 30 June for the past four years is summarised in figure 4.6.

**Figure 4.6: Capital of the major PFCs**

	2016-17 \$'million	2015-16 \$'million	2014-15 \$'million	2013-14 \$'million
MAC	361	688	823	1 252
SAFA	368	327	354	340
HomeStart Finance	165	157	173	169
Total	894	1 172	1 350	1 761

Figure 4.6 indicates that SAFA and HomeStart Finance capital has remained relatively stable over the four years, while MAC capital has decreased significantly by \$891 million. MAC has \$361 million of equity as at 30 June 2017.

Distributions received from PNFCs are budgeted to increase by \$42 million to \$232 million in 2017-18. This is mainly due to a \$24 million increase in the SA Water dividend and income tax equivalent to \$201.4 million and an \$18.3 million increase in the Renewal SA dividend to \$20.4 million.

The higher distributions from SA Water reflect higher forecast water sales, while the growth in distributions from Renewal SA is due to the full year recognition of rent revenue from TAFE SA.

There is minimal variation in the estimates of SA Water's dividend and income tax equivalent over the four years of the Budget, ranging from \$197.1 million to \$201.4 million.

#### 4.2.7 Other revenue

Other revenue mainly comprises royalties, fines, penalties and school fundraising revenues. The 2016-17 estimated result for total other revenue of \$664 million is consistent with the 2016-17 Budget. This reflects higher other revenue offset by lower revenue from royalties, fines and penalties.



The upward revision to other revenue in 2016-17 is mainly due to a contribution from SA Water associated with the Darlington and Torrens to Torrens projects, as well as contributed assets revenue related to the Murray-Darling Basin Authority joint venture operations and the Commonwealth Government's Essential Vaccines Program.

Royalty revenue in 2016-17 has been revised down by around \$25 million primarily due to the impact of lower commodity prices and lower minerals production. Relatively stronger growth in royalty revenue in 2017-18 reflects an expected recovery in mineral production volumes following 2016-17 experience. The increase in royalty revenue in 2019-20 is mainly due to the expected commencement of royalties from the Carrapateena mine.

Fines and penalties revenue is also estimated to be lower compared to the 2016-17 Budget estimate largely due to lower detections from fixed cameras and delays associated with these cameras coming online. Modest growth in fines and penalties revenue is expected from 2017-18.

## 5 Operating expenses

### Key points

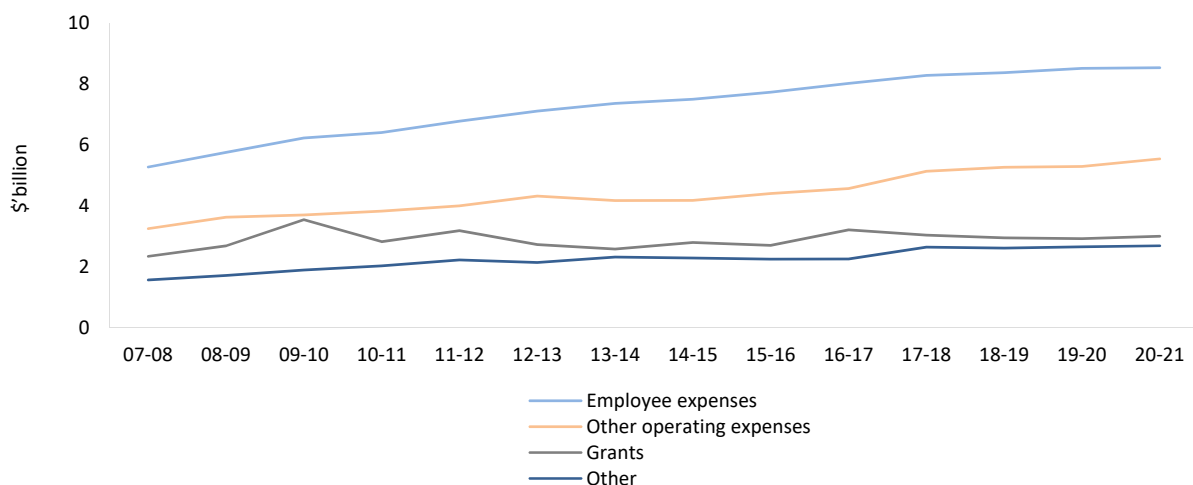
- The wages policy introduced in the 2016-17 Budget, limiting wage growth to a maximum of 1.5% p.a. over the next three years of each enterprise agreement, continues.
- Other operating expenses are expected to increase by 12.4% in 2017-18 due mainly to commencement of full year operating service payments associated with the nRAH, implementation of the Our Energy Plan initiative, and the first year of full implementation of the State’s response to the Child Protection Systems Royal Commission.
- Delay in commercial acceptance of the nRAH resulted in a \$185 million improvement to the net operating balance in 2016-17.
- No new savings are included in the 2017-18 Budget, however the existing efficiency dividend policy continues.
- The Department for Health and Ageing’s savings targets have been reduced by \$321 million across the forward estimates to reflect a longer implementation period in achieving earmarked efficiencies.

## 5.1 Expense forecasts 2017-18 to 2020-21

### 5.1.1 Trends in expenditure items

Figure 5.1 shows trends expected for total expenses in the 2017-18 Budget split into four main categories, against the experience of the previous 10 years.

**Figure 5.1: General government sector expenses**



Consistent with recent past Budgets, the 2017-18 Budget expects significant restraint in spending.

## Restrained growth in employee expenses expected

Employee expenses are expected to increase by 3.3% nominal in 2017-18, and continue to increase over the forward estimates but at significantly lower rates compared to earlier years (between 0.2% and 1.7%). The growth in 2017-18 is mainly due to wage outcomes for existing enterprise agreements that expire over the next two years, and measures approved in the 2016-17 MYBR and 2017-18 Budget including the reform of the child protection system measure and the Health Services additional resources measure.

Employee expenses decline in real terms, primarily reflecting reductions in general government workforce numbers and constraint in public sector wages growth. In the 2016-17 Budget the SA Government revised its wages policy to limit wage growth to a maximum of 1.5% p.a. over the next three years of each enterprise agreement. Previously wages growth was limited to 2.5% p.a.

## Future wage negotiations are critical to expenditure control

Salaries and wages remain the main public sector operating cost. The 2017-18 Budget notes that enterprise bargaining negotiations were completed or are progressing for a number of major workforce groups. Budget commentary states that the outcomes of future wage negotiations will be crucial in determining whether expenditure forward estimates in this Budget can be achieved, and the planned level of government services can be delivered in light of the current challenging economic conditions.

The Budget indicates that if public sector-wide wage outcomes for new enterprise agreements vary by 1% p.a. from allowances in the forward estimates, the budget impact will be around \$220 million in 2020-21 and will flow through directly to the net operating balance. Figure 5.2 summarises the approximate expenditure impact of a 1% p.a. variation by year as advised by DTF.

**Figure 5.2: Expenditure risk – wage outcomes for new enterprise agreements**

	2017-18 \$'million	2018-19 \$'million	2019-20 \$'million	2020-21 \$'million
Expenditure impact if wage outcomes vary by 1% p.a. from allowances in the forward estimates	9.5	52.3	126.1	218.6

The value increases across the forward estimates as active enterprise agreements expire.

Under the SA Government's wages policy, wage growth above the 1.5% p.a. limit will need to be offset by productivity improvements or other cost reduction measures.

The 2017-18 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 DTF to cover future enterprise agreement outcomes.

In 2016-17 enterprise agreement negotiations were finalised for nurses, Rail Commissioner's train operation drivers and maintenance employees, assistants to Members of Parliament, wages parity (weekly paid trade), TAFE SA and SA Ambulance employees, and generally resulted in a 2.5% salary increase. DTF advised that these agreements, which were executed

in 2016-17, were already well progressed at the time of the 2016-17 Budget and were not subject to the 1.5% wages policy.

Enterprise bargaining negotiations will occur for a number of groups in 2017-18, including visiting medical specialists, salaried medical officers and clinical academics, firefighters, Rail Commissioner's tram employees and the wages parity group (salaried and weekly paid).

Enterprise bargaining negotiations for the wages parity group are expected to impact approximately 34 900 FTEs across the general government sector. The wage outcomes for the wages parity group will be critical to expenditure control given this group forms a substantial proportion of total general government sector employees.

### Other operating expenses – significant growth in 2017-18 expected

Other operating expenses include items such as supplies and services, consultancies and contractors, repairs and maintenance, computer and communication charges and operating leases.

Other operating expenses are expected to increase by \$567 million (12.4%) in 2017-18. The significant growth in expenditure in 2017-18 is due to a number of factors including:

- commencement of full year service payments for facilities management and non-clinical services associated with the nRAH
- implementation costs associated with the Our Energy Plan initiative, including operating payments for the grid-connected battery, leasing short-term emergency generation capacity and gas production incentives
- the first year of fully implementing the State's response to the Child Protection Systems Royal Commission.

Further, the 2017-18 Budget indicates that there is real growth across the forward estimates mainly due to growth in expenditure for:

- Child Protection (additional support provided in response to the Child Protection Systems Royal Commission)
- Communities and Social Inclusion (disability services and equal remuneration order for workers in the social and community services sector)
- Education and Child Development (expenditure associated with the National Education Reform Agreement)
- Health and Ageing (nRAH operating costs)
- implementing the Our Energy Plan initiative.

### Grant expenses

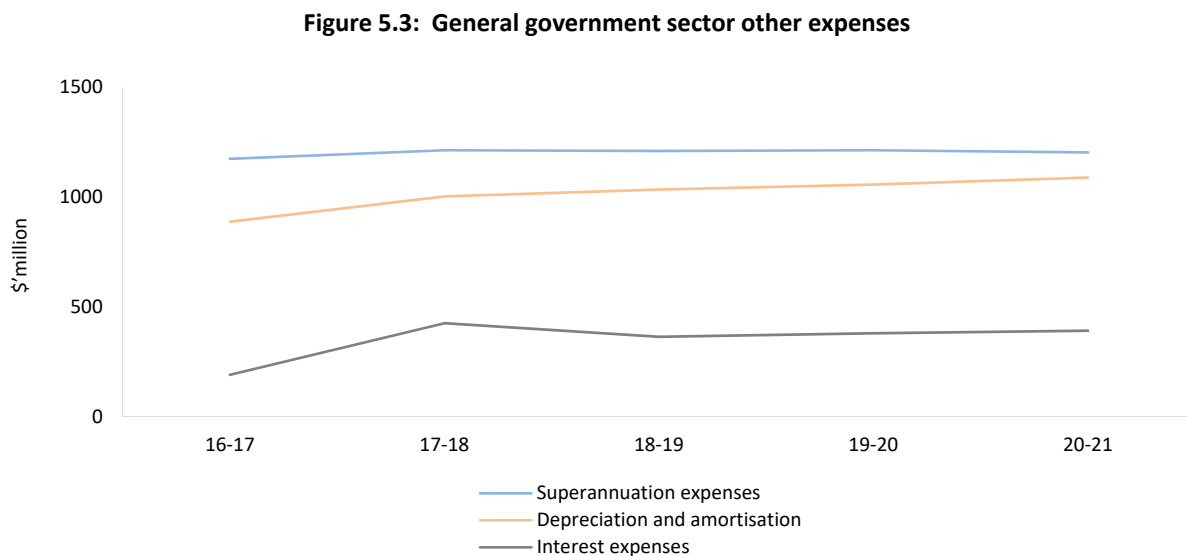
The increase in grant payments in 2016-17 is due to various factors including growth in grant payments provided to non-government schools under the National Education Reform Agreement, measures associated with reform of the child protection system introduced in the 2016-17 MYBR and 2017-18 Budget, and a change in the timing of local government grants.

Grant expenses are expected to decline by \$173 million to \$3 billion in 2017-18 and remain largely consistent across the forward estimates.

## Other expenses

Other expenses include superannuation expenses, depreciation and amortisation, and interest expenses.

Figure 5.3 shows trends expected for other expenses in the 2017-18 Budget split into three main categories.



Interest expenses increase by \$235 million (123%) in 2017-18 mainly due to the recognition of a full year of interest expenses associated with the nRAH finance lease agreement for the first time. These expenses commenced when commercial acceptance was achieved in June 2017. Section 5.2 provides further information on the nRAH's operating costs.

Growth in depreciation is projected across the forward estimates reflecting the first full year of depreciation and amortisation for the nRAH in 2017-18, and the completion of major infrastructure projects including the Adelaide Festival Centre precinct, the Flinders Medical Centre redevelopment, education infrastructure, extending the existing tram network and prison infrastructure.

### 5.1.2 Annual movements in employee expenses and other operating expenses

The expenditure restraint built into the 2017-18 Budget and recent past Budgets is illustrated by the estimated annual movements in the two main expenditure items of the Budget: employee expenses and other operating expenses. Combined they represent 70% of expenses for 2017-18, a proportion comparable with most years.

Figure 5.4 shows the annual movements estimated or projected for employee and other operating expenses for the period 2016-17 to 2020-21 compared to the previous eight years' experience.

**Figure 5.4: Annual change in employee and other operating expenses**

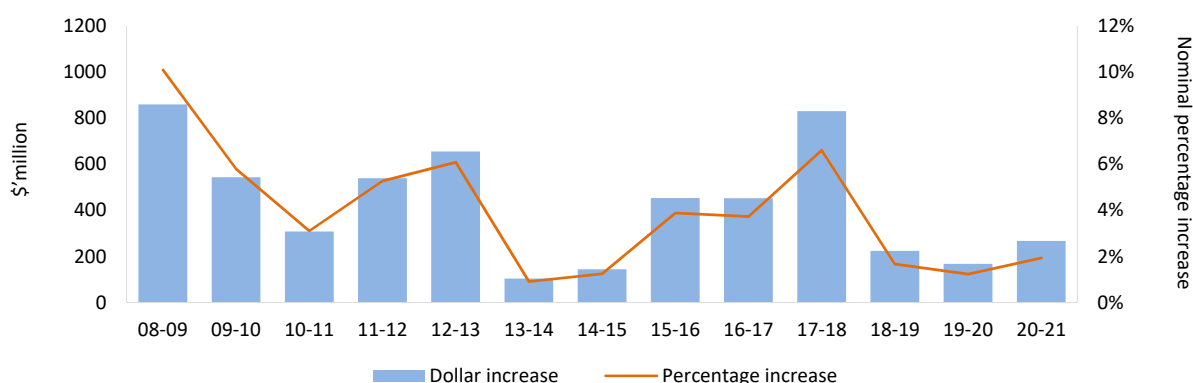


Figure 5.4 shows growth in 2013-14 and 2014-15 below 2% nominal. This reflects the realisation of savings introduced in recent Budgets.

Expenditure growth between 3.7% to 6.6% nominal is observed in 2015-16 to 2017-18 due to the following:

- 2015-16 experienced growth of 3.9% partly due to a shortfall in health savings, costs associated with the Enterprise Patient Administration System, additional expenditure associated with the National Education Reform Agreement and compliance with new educator to child ratio requirements.
- 2016-17 experienced growth of 3.7%, similar to the prior year, reflecting a number of factors including resources to reform the State’s child protection system in response to the Child Protection Systems Royal Commission as announced in the 2016-17 MYBR, and additional expenses in the general government sector as a result of lease payments for TAFE SA assets that were transferred to Renewal SA.
- An increase in expenses of 6.6% is expected in 2017-18 mainly due to:
  - the first full year of service payments for the nRAH
  - the first year of fully implementing the State’s response to the Child Protection Systems Royal Commission
  - implementation of Our Energy Plan commencing.

For the remaining three years of the 2017-18 Budget expenditure growth for these two items combined is predicted to grow at or below 2% p.a. nominal.

## 5.2 New Royal Adelaide Hospital operating costs

### Operating costs included in the 2017-18 Budget

The nRAH achieved commercial acceptance on 13 June 2017, which triggered the commencement of the annual service payments. 2017-18 expenses reflect the first full year of service payments for the nRAH.

The composition of estimated service payment operating expenses for 2017-18 is set out in figure 5.5.

**Figure 5.5: nRAH service payment operating expenses estimated for 2017-18**

Component	Budget line	2017-18 Estimate \$'million
Facilities management and non-clinical services	Other operating expenses	61.4
Finance charge on the finance lease	Interest expenses	262.4
<b>Total service payment operating expenses</b>		<b>323.8</b>

The annual finance charge expense reduces over the forward estimates over the life of the lease.

The 2017-18 Budget also includes costs in 2017-18 to support the transition from the old to the new RAH sites, including \$50.3 million for nRAH transition project office costs and \$11.8 million in dual running costs to run both the old and new RAH sites for a period of time.

The asset under the finance lease is expected to be amortised at \$60.3 million p.a. from 2017-18.

### Financial impact of delay in commercial acceptance of the nRAH

The 2016-17 Budget assumed that commercial acceptance would be achieved at an earlier date for budgeting purposes. Figure 5.6 shows the impact of delays to the opening of the nRAH on the net operating balance and net lending balance in 2016-17 and over the four years of the Budget as advised by DTF.

**Figure 5.6: Financial impact of delay in commercial acceptance of the nRAH**

	2016-17 \$'000	2017-18 \$'000	2018-19 \$'000	2019-20 \$'000	2020-21 \$'000
Additional project office costs (operating)	(10 677)	(44 997)	-	-	-
Depreciation and amortisation	65 994	102	102	102	148
Finance lease charge savings	129 712	-	-	-	-
<b>Total net operating balance impact</b>	<b>185 029</b>	<b>(44 895)</b>	<b>102</b>	<b>102</b>	<b>148</b>
Additional project office costs (investing)	(38 997)	-	-	-	-
Less: Depreciation/Amortisation	(65 994)	(102)	(102)	(102)	(148)
<b>Total net lending impact</b>	<b>80 038</b>	<b>(44 997)</b>	<b>-</b>	<b>-</b>	<b>-</b>

### Old RAH site costs

Announcements made by the SA Government indicate that the estimated combined cost of demolishing and remediating the old RAH site is in excess of \$150 million.

The 2017-18 Budget includes provisions for decommissioning the old RAH site to ensure it is secure and safe following the move to the nRAH, and demolition and remediation costs.

## 5.3 Savings initiatives

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### 5.3.1 Savings initiatives have been significant since the 2010-11 Budget

Our past Reports have detailed the history of savings initiatives since 2010-11.

The 2014-15 Budget saw a return to major savings measures (other than in the form of efficiency dividends) amounting to \$1.5 billion over the four years of the Budget. This comprised operating savings of \$1.2 billion and investing savings of \$290 million.

The 2016-17 Budget introduced new savings of \$357 million over four years by revising its wages policy to limit wages growth to 1.5% p.a. over the next three years of each enterprise agreement.

The expenditure outcome from 2012-13 to 2015-16 shows that there was expenditure restraint compared to prior years. Expenditure growth from 2012-13 to 2015-16 was 2% or less per annum.

No new savings initiatives are included in the 2017-18 Budget, however agency budgets include a continuation of the existing efficiency dividend policy of 1% of the agency employee expenses budget per annum and a 1% reduction in their net cost of services per annum. Agencies will be required to continue to find expenditure efficiencies to deliver these savings.

### 5.3.2 Health and Ageing has had difficulties achieving savings targets

The Health and Ageing savings task is discussed in section 5.4. Given past outcomes, achieving the current level of budgeted Health and Ageing savings continues to be a difficult challenge and poses a significant risk to achieving the Budget strategy.

## 5.4 Health and Ageing portfolio savings task

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### 5.4.1 Background

In the past, Health and Ageing has not been able to achieve savings targets or has experienced other service demands that have necessitated additional funding. Given that savings measures required of agencies were continuing, together with requirements to further reduce expenditure, Health and Ageing implemented the following strategies:

- Following Cabinet approval in November 2011, the Office for Business Review and Implementation was established within the Department for Health and Ageing to support the delivery of improved financial management and savings measures.
- In 2012 Health and Ageing commissioned the hospital budget performance and remediation reviews of the three main local health networks.

In July 2012 and October 2012 the SA Government approved the implementation of specific efficiency strategies identified in the hospital budget performance and remediation reviews



and additional measures required to meet forward budget estimates. On both occasions the savings measures proposed were still insufficient for Health and Ageing to meet its budget targets by 2015-16.

#### 5.4.2 Health and Ageing savings targets reduced in 2017-18

At the time of the 2012-13 Budget, the Department for Health and Ageing was projected to overspend its 2011-12 Budget by \$122 million. A provision was made in the Budget for this projected overspend. In addition, the 2012-13 Budget included new operating initiatives totalling \$167 million in 2012-13 and 2013-14 to re-profile the Department for Health and Ageing's budget savings task. The aim was to provide Health and Ageing with additional resources for a more even annual build-up of savings to enable it to achieve its aggregate savings target by 2014-15. Since the 2012-13 Budget there have been numerous revisions of the Health and Ageing savings task:

- A reduction of \$523.2 million to the Health and Ageing's budget savings target over the forward estimates in the 2012-13 MYBR.
- The 2014-15 Budget introduced additional savings of \$532.7 million for the Health and Ageing portfolio. This included identifying hospital bed reductions or efficiencies in other health services to save \$332 million over the forward estimates.
- The 2016-17 Budget included an expenditure initiative of \$526.8 million over four years (in addition to \$144.4 million in 2015-16) for the Department for Health and Ageing to revise the timing and level of the Health and Ageing portfolio's previously budgeted savings targets.
- The 2017-18 Budget includes a reduction of \$321 million across the forward estimates to the Department for Health and Ageing's savings targets. DTF advised that the Department for Health and Ageing's savings have been re-profiled to support a longer implementation period in achieving earmarked efficiencies, based on an assessment of what was reasonable and informed by recent experience in achieving savings.

#### 5.4.3 Transforming Health savings

In March 2015, the SA Government approved the implementation of the Transforming Health program to transform the State's health system to provide consistent, quality care in the future. Transforming Health was considered necessary to deliver a sustainable health system that meets contemporary safety and quality standards, as well as being economically viable for the future. Financial sustainability was expected to be improved by delivering significant productivity savings from 2015-16 to 2019-20.

Savings targets associated with the program were included in the 2015-16 and 2016-17 Budgets. We reported that SA Health has not achieved these savings targets in our 2016-17 Annual Report.<sup>5</sup>

The 2017-18 Budget indicates that the Transforming Health program is nearing completion and clinical innovation service reforms to improve the consistency and quality of care, and to support the financial sustainability of the health system, will transition to business as usual.

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<sup>5</sup> Annual Report of the Auditor-General for the year ended 30 June 2017: Part A 'Executive summary', section 4.2.4.

## 5.4.4 Health and Ageing savings task since the 2012-13 Budget

Figure 5.7 provides the revised savings measures since the 2012-13 Budget and a breakdown of the Health and Ageing's savings initiatives.

**Figure 5.7: Summary of revised savings measures and initiatives<sup>(1)</sup>**

	2012-13 \$'million	2013-14 \$'million	2014-15 \$'million	2015-16 \$'million	2016-17 \$'million	2017-18 \$'million	2018-19 \$'million	2019-20 \$'million	2020-21 \$'million
2016-17 Budget revised savings measures				(270.7)	(421.6)	(588.8)	(707.0)	(737.6)	(824.8)
2017-18 Budget reduction in savings measures					65.0	128.0	128.0	65.0	-
<b>2017-18 Budget revised savings measures</b>					(356.6)	(460.8)	(579.0)	(672.6)	(824.8)
Annual growth in savings task		(117.1)	(120.4)	12.9	(86.0)	(104.2)	(118.2)	(93.6)	(152.2)
Annual savings achieved	(126.5)	(108.7)	(92.4)	(14.4)	(72.9)				
						2017-18 \$'million	2018-19 \$'million	2019-20 \$'million	2020-21 \$'million
<b>Department for Health and Ageing savings initiatives<sup>(2)</sup></b>									
Identified savings						104.2	199.0	291.7	356.9
Other savings requiring further planning						-	23.4	24.2	111.3
						104.2	222.4	315.9	468.2

Note: Totals may not add due to rounding.

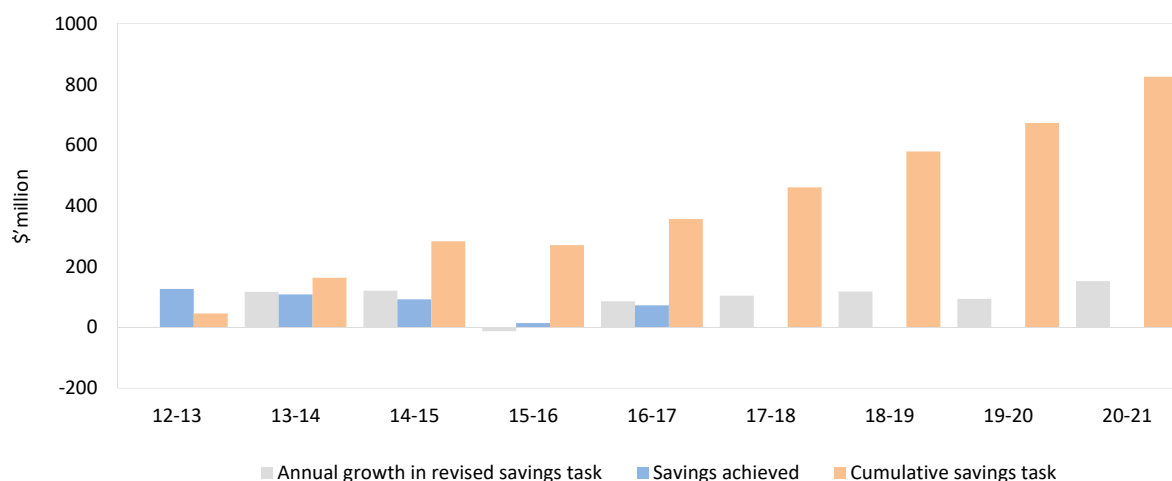
<sup>(1)</sup> Revised savings target figures provided by DTF in September 2017.

<sup>(2)</sup> Savings initiatives figures provided by DTF in September 2017 for savings starting in 2017-18 and subsequent years. For example, 2017-18 is \$460.8 million less \$356.6 million and 2018-19 is \$104.2 million plus \$118.2 million.

The reduction in savings targets between 2017-18 and 2016-17 is discussed in section 5.4.2.

Figure 5.8 shows how the annual growth in savings task and cumulative savings for the Health and Ageing portfolio have changed over recent budgets.

**Figure 5.8: Comparison of Health and Ageing savings task between budgets**

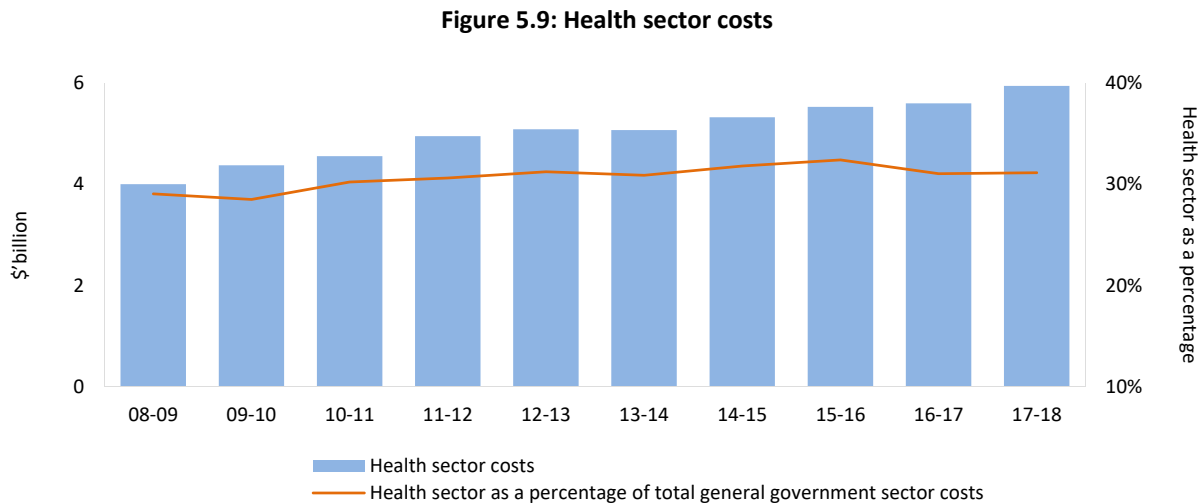


## 5.4.5 Health sector costs are a significant component of general government sector costs

Health sector costs are a significant component of the general government sector budget

and hospital expenditure growth remains a highlighted risk in the 2017-18 State Budget, as it has for many years.

Figure 5.9 shows the actual health sector costs over the past eight years<sup>6</sup> compared to the 2016-17 estimated cost and the 2017-18 budgeted cost.



Estimated health sector expenses for 2016-17 are \$5.6 billion, \$21 million less than the 2016-17 Budget. This favourable outcome is largely due to the impact of delays to the opening of the nRAH as discussed in section 5.2, which improved the estimated result by \$185 million, offset by an increase in other costs including:

- increases in drug costs associated with administering a new Hepatitis medication under the Pharmaceutical Benefits Scheme (\$55 million)
- additional expenditure associated with activity funded from the Commonwealth (\$40 million)
- enterprise agreement outcomes (\$30 million).

The Budget notes that a 1% increase in hospital expenditure above the level incorporated in the 2017-18 Budget would increase expenditure by approximately \$53 million p.a.

The Budget indicates that the SA Government is implementing a number of strategies to manage the expenditure growth in hospitals, including providing services and infrastructure in the most efficient manner to deliver quality health outcomes and productivity improvements. DTF advised that SA Health aims to achieve improvements in the efficiency of the public hospital system by reconfiguring services and improving models of care, targeting reduced average length of stay and improved patient outcomes, and allowing for financial efficiencies to be achieved that will slow the rate of growth in health expenditure.

We reported on health budget and performance management in our 2016-17 Annual Report.<sup>7</sup>

<sup>6</sup> Data sourced from table A.20 'General government sector expenses by function' from the Final Budget Outcome for each year.

<sup>7</sup> Annual Report of the Auditor-General for the year ended 30 June 2017: Part A: 'Executive summary' section 4.1.

## 5.5 Reduction of full-time equivalents

### 5.5.1 Seeking full-time equivalent reductions has been a key part of prior Budget savings strategies

A key part of the savings strategy in Budgets since 2010-11 has involved reducing public sector FTEs. For example, the:

- 2010-11 Budget included a reduction of 3743 FTEs, excluding increases from other initiatives
- 2012-13 Budget introduced a savings initiative to reduce a further 1000 FTEs
- 2013-14 Budget brought forward the 2015-16 FTE reductions into 2014-15
- 2014-15 Budget included savings initiatives for reductions of a further 308 FTEs from specific measures, including 200 FTEs identified as a result of the reductions announced in the 2014-15 Commonwealth Budget.

### 5.5.2 2017-18 Budget projects full-time equivalent reductions

The 2017-18 Budget notes that FTEs in the general government sector are estimated to decrease by 405 to 81 875 between 30 June 2017 and 30 June 2021, reflecting the cumulative impact of savings measures, partially offset by new expenditure measures.

FTE reductions have been achieved through various means such as TVSPs, natural attrition, not renewing employment contracts and not filling vacancies.

Figure 5.10 summarises DTF's advice on all general government budgeted FTE reductions associated with specific savings measures since the 2008-09 Budget.

**Figure 5.10: FTE employee reductions as at 30 June**

	2010 FTEs	2011 FTEs	2012 FTEs	2013 FTEs	2014 FTEs	2015 FTEs	2016 FTEs	2017 FTEs	Total FTEs
2008-09 MYBR	1 200	200	200						1 600
2010-11 Budget	-	608	954	742	369				2 673
2011-12 Budget		-	26	200	202	2			430
2011-12 MYBR		-	18	16	3	-			37
2012-13 Budget			-	7	309	350	350		1 016
2012-13 MYBR			-	-	202	65	393		660
2013-14 Budget <sup>(a)</sup>				-	-	-	-	-	-
2013-14 MYBR <sup>(a)</sup>				-	-	-	-	-	-
2014-15 Budget					-	70	68	170	308
2014-15 MYBR <sup>(a)</sup>					-	-	-	-	-
2015-16 Budget <sup>(b)</sup>						-	13	-	13
<b>Originally budgeted FTE reduction</b>	<b>1 200</b>	<b>808</b>	<b>1 198</b>	<b>965</b>	<b>1 084</b>	<b>487</b>	<b>824</b>	<b>170</b>	<b>6 737</b>

Note: Totals may not add due to rounding.

<sup>(a)</sup> No new specific FTE savings measures are included in these Budgets.

<sup>(b)</sup> There are no specific FTE reduction savings measures in Budgets after the 2015-16 Budget.

### 5.5.3 Status of achieving full-time equivalent caps as at 30 June 2017

Figure 5.11 reflects information provided by agencies to DTF and compares the approved FTE cap to the actual level of FTEs (as at the last pay period in June) for key general government sector agencies.

**Figure 5.11: Actual and cap FTEs by portfolio as at 30 June 2017**

Agency	Actual FTEs	Approved cap FTEs	Variance	
			FTEs	%
Attorney-General's	1 434	1 465	(31)	(2.1%)
Communities and Social Inclusion	3 522	3 695	(173)	(4.7%)
Correctional Services	2 085	2 006	79	3.9%
Courts Administration Authority	638	662	(24)	(3.6%)
Defence SA	37	40	(3)	(7.5%)
Education and Child Development	23 210	22 197	1 013	4.6%
Child Protection	1 804	1 854	(50)	(2.7%)
Emergency Services	1 237	1 211	26	2.1%
Environment Protection Authority	214	212	2	0.9%
Environment, Water and Natural Resources	1 562	1 548	14	0.9%
Health and Ageing	30 978	30 801	177	0.6%
Planning, Transport and Infrastructure	2 998	3 020	(22)	(0.7%)
Premier and Cabinet	1 744	1 952	(208)	(10.7%)
Primary Industries and Regions	927	911	16	1.8%
South Australia Police	5 884	6 001	(117)	(1.9%)
State Development	2 836	2 912	(76)	(2.6%)
Tourism	128	126	2	1.6%
Treasury and Finance	436	468	(32)	(6.8%)
<b>Total</b>	<b>81 674</b>	<b>81 081</b>	<b>593</b>	<b>0.7%</b>

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

DTF advised that, based on data received from major agencies, agencies would be overall an estimated 593 FTEs above their budgeted FTE levels as at 30 June 2017. The 2017-18 estimate of FTEs for the general government sector as at 30 June 2017 was 82 190.<sup>8</sup>

The overall position comprised various agencies being over or under their cap. For example:

- the Department for Education and Child Development reported that actual FTEs were 1013 above cap due to compositional changes and the timing of FTE resourcing over the year compared with assumptions made when budgeting for National Education Reform Agreement expenditure

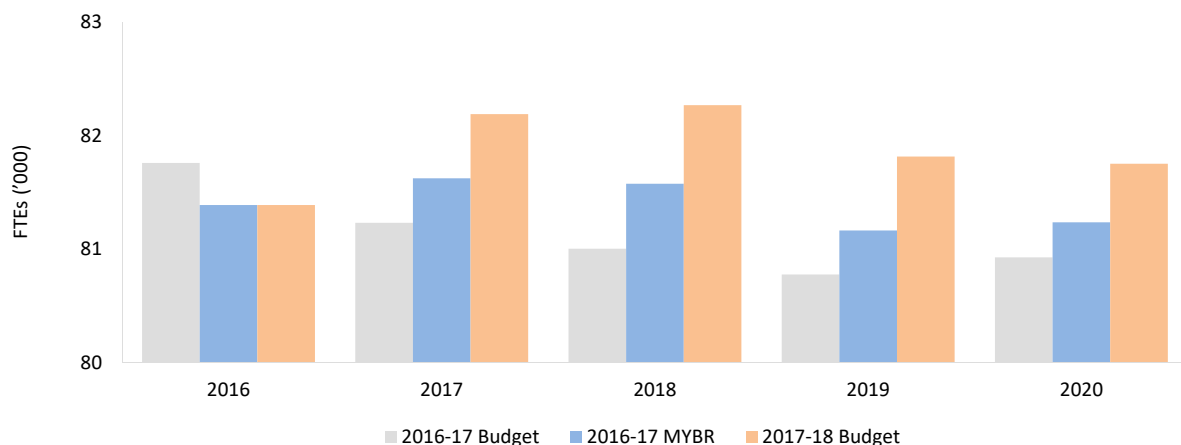
<sup>8</sup> 2017-18 Budget Paper 3 'Budget Statement', table 2.8.

- the Department for Health and Ageing reported that actual FTEs were 177 above cap mainly due to additional FTEs required to support the readiness of and transition to the nRAH
- the Department for Correctional Services reported that actual FTEs were 79 above cap primarily due to additional FTEs related to surge demand management and reducing its reliance on overtime and call backs, as well as other unplanned activities such as hospital watches and prisoner escorts
- the Department of the Premier and Cabinet reported actual FTEs of 208 below cap mainly due to short and longer term vacancies being managed through temporary staff
- the Department for Communities and Social Inclusion reported actual FTEs of 173 below cap mainly due to vacancies in domiciliary care, disability services and other vacancies across the department
- South Australia Police reported actual FTEs of 117 below cap primarily due to unsworn vacancies and lower cadet intake (45 FTEs), partially offset by the use of contractors and agency staff.

#### 5.5.4 Revision upwards of projected full-time equivalents in recent Budgets

Expected FTE levels in 2016-17 and across the forward estimates have been revised upwards in the 2016-17 MYBR and 2017-18 Budget as illustrated in figure 5.12.

**Figure 5.12: General government sector FTEs as at 30 June**



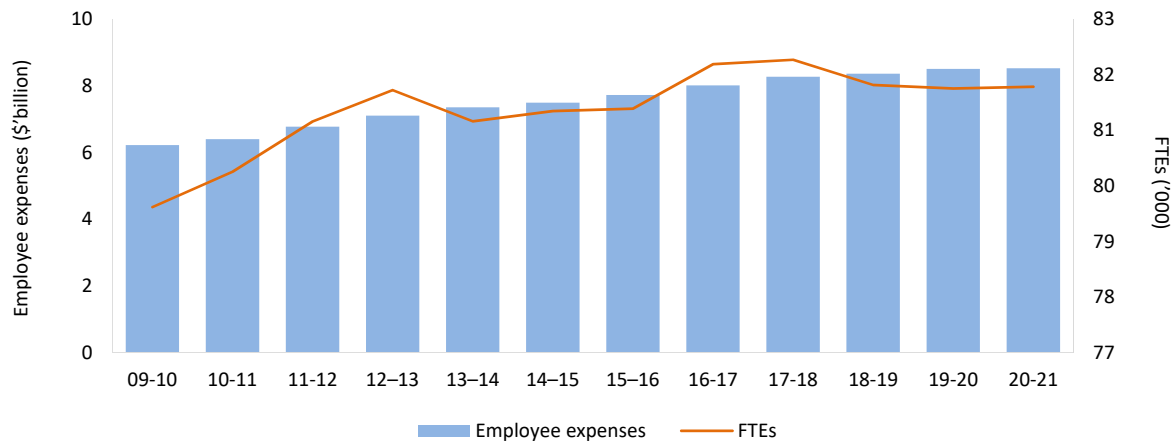
The 2016-17 Budget expected FTEs to be 80 926 as at 30 June 2020. The 2017-18 Budget revised this estimate up to 81 752 FTEs mainly due to:

- resources to support reform of the child protection system in response to recommendations from the Child Protection Systems Royal Commission as detailed in the 2016-17 MYBR and 2017-18 Budget

- the Health Services additional resources initiative introduced in the 2017-18 Budget to provide additional hospital services.

Figure 5.13 shows FTE and employee expense trends expected in the 2017-18 Budget against the experience of recent years. FTE levels are expected to peak at 82 269 FTEs by 30 June 2018 before declining to 81 785 FTEs by 30 June 2021.

**Figure 5.13: General government sector employee expenses and FTEs**



DTF advised that although there is a reduction in FTEs (and associated employee expenses) in 2018-19, this is more than offset by the growth from recent enterprise bargaining outcomes. These outcomes exceed the SA Government’s stated 1.5% wage growth policy as they were executed before the policy was implemented.

### 5.5.5 Targeted voluntary separation program

The SA Government introduced a TVSP scheme from November 2010 to help agencies to achieve savings targets. The scheme remains in operation and TVSP payouts up to a maximum of 52 weeks’ pay are available for workforce reductions associated with specific measures or structural adjustment.

DTF advised that between 1 November 2010 and 30 June 2017, 3985.2 FTE reductions were achieved through TVSP payments (excluding executive reductions), as reported to DTF.

Until 30 June 2015 agencies were centrally reimbursed for TVSP payments made to achieve savings measures. From 1 July 2015, agencies are responsible for meeting the costs of TVSPs, unless otherwise approved by the SA Government.

Figure 5.14 summarises the FTE reductions achieved through TVSP payments (excluding executive reductions), as reported by agencies to DTF, from 1 November 2010 to 30 June 2017.

**Figure 5.14: FTE reductions from TVSPs reported by agencies  
1 November 2010 to 30 June 2017**

	FTE reductions from TVSPs
General government sector:	
Attorney-General's	140.5
Communities and Social Inclusion <sup>(1)</sup>	219.7
Correctional Services	26.2
Courts Administration Authority	7.0
Defence SA	2.0
Education and Child Development <sup>(2)</sup>	378.5
Environment, Water and Natural Resources <sup>(3)</sup>	322.4
Environment Protection Authority	8.2
Green Industries SA <sup>(4)</sup>	8.0
Health and Ageing	776.3
Planning, Transport and Infrastructure <sup>(5)</sup>	652.5
Premier and Cabinet	214.3
Primary Industries and Regions <sup>(6)</sup>	142.2
SACE Board of SA	1.0
SA Fire and Emergency Services Commission	15.0
SA Lotteries	37.3
SA Police	6.0
SA Ambulance Service	10.0
SA Metropolitan Fire Service	3.0
SA State Emergency Service	1.0
State Development <sup>(7)</sup>	358.4
TAFE SA	471.4
Tourism	32.7
Treasury and Finance	83.4
Public non-financial corporations sector:	
Forestry SA	68.3
<b>Total</b>	<b>3 985.2</b>

Note: Totals may not add due to rounding.

<sup>(1)</sup> Formerly Families and Communities.

<sup>(2)</sup> Formerly Education and Children's Services.

<sup>(3)</sup> Formerly Environment and Natural Resources and incorporating Water.

<sup>(4)</sup> Formerly Zero Waste SA.

<sup>(5)</sup> Formerly Transport, Energy and Infrastructure incorporating Planning and Local Government.

<sup>(6)</sup> Formerly Primary Industries and Resources.

<sup>(7)</sup> Formerly Further Education, Employment, Science and Technology and Manufacturing Innovation, Trade, Resources and Energy (formerly Trade and Economic Development) and incorporating Arts SA.

The main FTE reductions from TVSPs in 2016-17 related to TAFE SA (46.9 FTEs) and the Department of Planning, Transport and Infrastructure (88.5 FTEs).

DTF advised that from 1 November 2010 to 30 June 2017 TVSP payments to staff totalled \$448.66 million, most of which were centrally funded. These figures exclude fees paid to Shared Services SA for administering the scheme, payroll tax, employee assistance and executive termination payments.



## 5.6 Contingency provisions

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Contingency amounts are incorporated into the Budget to provide flexibility if additional expenditure needs to be made by the SA Government. Figure 5.15 shows the composition of contingency provisions for 2016-17 and 2017-18.

**Figure 5.15: Contingency provisions**

	2016-17 Budget \$'million	2016-17 Estimated result \$'million	2017-18 Budget \$'million
Employee entitlements	50	17	69
Investing contingencies	36	7	114
Supplies and services	180	112	398
	266	136	581

While allocating sums to each of the categories for presentation purposes, contingency funds may also be transferred from other lines where available. The 2017-18 Budget includes contingency amounts totalling \$581 million, \$445 million more than the estimated outcome for 2016-17. The increase in contingency provisions in 2017-18 is impacted by the inclusion of Our Energy Plan implementation costs in 2017-18.

## 5.7 Interest expense

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Interest expenses comprise interest paid by the Treasurer on net government borrowings and interest expenses of agencies related to finance leases.

Estimated interest expense in 2016-17 is \$191 million, \$155 million (45%) lower than forecasted in the 2016-17 Budget mainly due to the revised timing of interest payments on the finance lease for the nRAH. These payments commenced on 13 June 2017 when commercial acceptance was achieved and are the main driver of the projected increase in interest expense from 2016-17 to 2017-18.

The Budget notes that a 1% increase in the average interest rate applying to general government sector debt would increase net interest expense by approximately \$61 million in 2017-18, rising to an increase of \$67 million in 2020-21.

Debt movements are discussed further in section 7.4.

## 5.8 Grants

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Grants expense from the general government sector represents payments to other sectors of government and the private sector, including:

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

Grants are estimated to be \$3.2 billion in 2016-17, \$269 million (9%) higher than forecasted in the 2016-17 Budget. DTF advised that this increase is mainly due to:

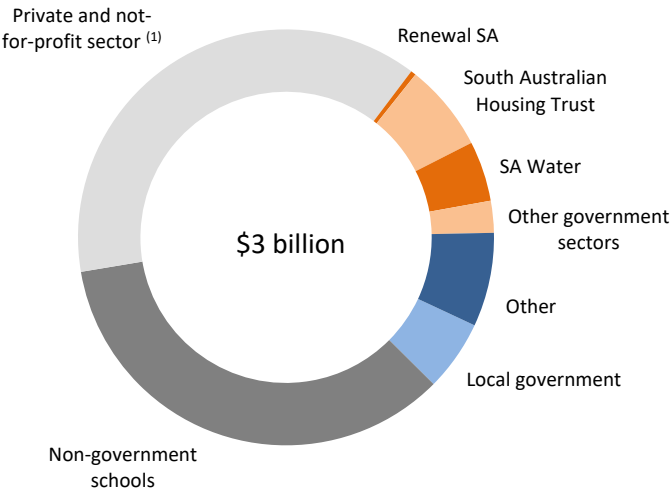
- Child Protection – \$125 million primarily comprising:
  - \$66.2 million provided in the 2017-18 Budget for the Child Protection additional resources measure to meet increased costs of children in care, particularly in commercial care, and to help non-government organisations establish additional residential care facilities
  - \$33.4 million provided as part of the 2016-17 MYBR for the reform of the child protection system measure
- Planning, Transport and Infrastructure – \$125 million primarily comprising:
  - \$77.2 million due to changes in the timing of local government grants brought forward to 2016-17 from future years as advised in the 2017-18 Commonwealth Budget
  - \$30.2 million for grants to SA Water for third party works for the Darlington and Torrens to Torrens projects.

Grants are budgeted to decline by \$173 million to \$3 billion in 2017-18 largely due to:

- the Commonwealth paying 50% (\$78 million) of the 2017-18 Local Government Financial Assistance Grant entitlement in 2016-17
- a \$24 million one-off payment for gas production incentives in 2016-17
- a \$24.2 million reduction in 2017-18 South Australian River Murray Sustainability program grant payments.

Figure 5.16 shows grant expenditure budgeted in 2017-18 by key recipients. Most grants are provided to non-government schools and other parts of the private and not-for-profit sector.

**Figure 5.16: Key grant recipients for 2017-18**



<sup>(1)</sup> Excluding grants to non-government schools which are shown separately.

Grants are budgeted to remain largely consistent over the forward estimates.

### 5.8.1 Growth in grants and initiatives to support job creation

The 2017-18 Budget includes the establishment of the Future Jobs Fund. The fund includes \$100 million in various measures and grants, and \$100 million in low interest loans to support job creation.

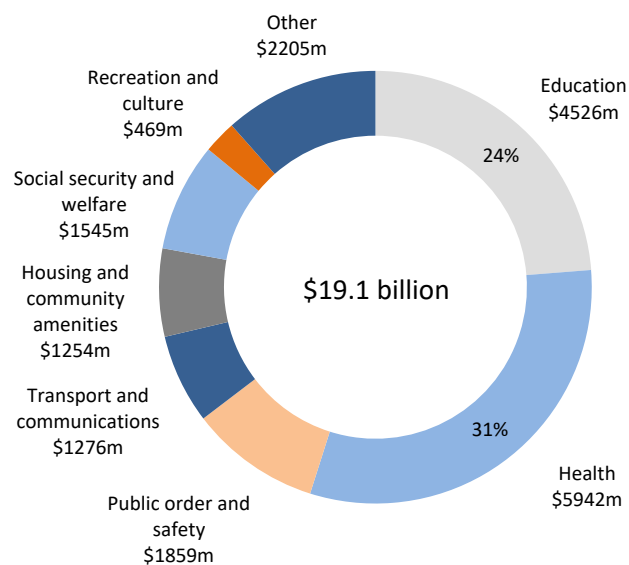
These grants and initiatives are in addition to the Job Accelerator Grant program introduced in the 2016-17 Budget to support business growth and create new employment opportunities. \$117.3 million has been included in the 2017-18 Budget for the Job Accelerator Grant program, which is administered by DTF.

## 5.9 Expenses by function

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The GFS reporting framework provides information on expenditure (excluding capital payments) by function for the general government sector. Figure 5.17 shows the split of 2017-18 Budget expenses by sector and demonstrates the extent to which the health and education sectors dominate the overall expenditure by the State.

**Figure 5.17: General government sector expenses by function<sup>9</sup>**



<sup>9</sup> 2017-18 Budget Paper 3 'Budget Statement', table A.16.

## 6 Purchases and sales of non-financial assets

### Key points

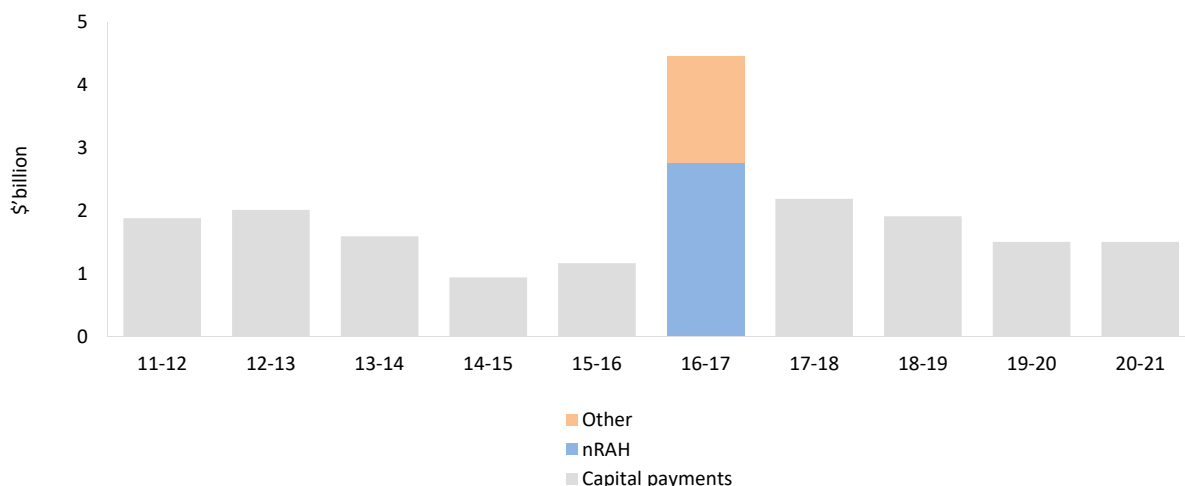
- Purchases of non-financial assets increased significantly in 2016-17 due to the recognition of \$2.76 billion for the nRAH.
- Purchases of non-financial assets are projected to exceed \$1.5 billion for each of the four years of the 2017-18 Budget, with major investment in transport, health and education infrastructure.
- The sale of non-financial assets including government buildings, land services activities and Techport assets is estimated to deliver proceeds of \$1.3 billion in 2017-18.
- In August 2017, the SA Government appointed a private operator to provide land services functions for 40 years. The SA Government will receive an upfront payment of \$1.605 billion as well as an ongoing royalty stream, exceeding 2017-18 Budget estimates by \$855 million.

### 6.1 Capital payments

#### 6.1.1 Trends in capital expenditure

Figure 6.1 shows the purchase of non-financial assets over the 10 years to 2020-21.

**Figure 6.1: General government sector purchase of non-financial assets (nominal)**



Actual and estimated capital expenditure in the general government sector consistently exceeds \$1.5 billion annually over the period except in 2014-15 (\$900 million) and 2015-16 (\$1.2 billion). Significant capital outlays (and the nature of the activity) introduce a heightened risk to the proper management and control of capital projects.

## nRAH finance lease recognised in 2016-17

Purchases of non-financial assets have increased significantly in 2016-17 mainly due to the recognition of the nRAH asset and finance lease liability. The nRAH finance lease asset represents \$2.76 billion (62%) of total capital investment in 2016-17.

## 2017-18 estimated capital expenditure is \$2.2 billion

Estimated capital expenditure in 2017-18 is \$2.2 billion. The Budget includes a capital slippage allowance for 2017-18 of \$460 million, compared to \$430 million in the previous year.

As in past years, carryover adjustments were made for delays in capital projects where expenditure will now be incurred in later years. As part of the budget carryover process, investing carryovers from 2016-17 to 2017-18 and future years are \$231 million.

## Significant capital program across the forward estimates

Purchases of non-financial assets are projected to total \$7.1 billion over the four years of the 2017-18 Budget. The capital program over the four years to 2020-21 comprises large projects with inherent complexities and risk including:

- \$1.9 billion on road projects
- \$875 million on major public transport projects
- \$425.4 million on the redevelopment of major metropolitan and regional hospitals
- \$409.3 million on education projects
- \$300 million on electricity infrastructure associated with the Our Energy Plan initiative
- \$165.1 million on the redevelopment of the Adelaide Festival Centre precinct and carpark.

### 6.1.2 Effective management of major capital projects

Although there will be components of future expenditure that have effectively been committed, the forward years contain funds contingent on approvals.

Major projects carry high inherent risks including cost estimating, complex contract arrangements, cost escalations and timeliness of completion. Sustained higher capital outlays require effective procurement, contract and project management expertise and sound information systems and financial controls.

## 6.2 New Royal Adelaide Hospital – public private partnership project

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In June 2011 the SA Government announced financial close on a contract with the SA Health Partnership Nominees Pty Ltd consortium (now known as Celsus) to build, operate and maintain the nRAH under a public private partnership arrangement.

Commercial acceptance was achieved on 13 June 2017, signalling the transfer of control of the nRAH to the State. The 2016-17 estimated result in the 2017-18 Budget recognises an asset and finance lease liability of \$2.76 billion. This accounts for the large increase in net debt in 2016-17. The amount represents the net present value of design and construction costs, lifecycle payments, interest and other project costs.

Annual service payments commenced when commercial acceptance was achieved and are budgeted to be over \$300 million for each year of the forward estimates. Only part of this annual payment amount will be expensed each year as it includes cash payments that are applied to the reduction in the lease liability in the balance sheet. The rest of the payment is reflected as an expense in the operating statement, including finance charges on the lease and operating expenditure.

There is more detail about the accounting treatment for the nRAH in the section of our 2016-17 Annual Report titled 'Central Adelaide Local Health Network Incorporated'.<sup>10</sup>

### 6.2.1 Financial reporting of public private partnership projects

Depending on the terms of contracts, public private partnerships may, through their contractual arrangements and assignment of risks and benefits under current accounting standards, be classified as either:

- a finance lease that transfers substantially all the risks and rewards incidental to ownership of an asset
- an operating lease that does not transfer substantially all the risks and rewards incidental to ownership and is excluded from the State balance sheet (may be off-balance sheet).

The capital component of the public private partnership arrangement for the nRAH is to be recognised as a finance lease in the balance sheet, and consequently has an impact on net debt and net financial liabilities. As the State is the lessee, at the commencement of the lease term, lessees recognise finance leases as assets and liabilities in the Statement of Financial Position at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. Any initial direct costs of the lessee are added to the amount recognised as an asset. Subsequently, minimum lease payments are apportioned between a finance charge and reducing the outstanding liability.

In 2019-20, new AASs for leases (AASB 16 'Leases') and service concession arrangements to account for public private partnerships (AASB 1059 'Service concession arrangements: grantor') come into effect and will impact the financial reporting arrangements for the nRAH. Our 2016-17 Annual Report provides further commentary on these upcoming changes to accounting standards.<sup>11</sup>

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<sup>10</sup> Annual Report of the Auditor-General for the year ended 30 June 2017: Part B 'Agency audit reports', page 174.

<sup>11</sup> Annual Report of the Auditor-General for the year ended 30 June 2017: Part A 'Executive summary', page 111.

## 6.3 Asset sales

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Total asset sales for the general government sector over the four years to 2010-21 are estimated to be \$1.5 billion.

Most sales of non-financial assets are expected in 2017-18 (\$1.3 billion) before reducing significantly to below \$60 million for the remaining three years of the forward estimates.

### 6.3.1 2016-17 estimated proceeds are less than budgeted mainly due to delays in the sale of government buildings

For 2016-17 proceeds from the sale of non-financial assets are estimated to be \$733 million, \$243 million less than the budgeted amount of \$976 million, mainly due to:

- the delay in the sale of the government owned State Administration Centre precinct
- the reduction in the value of assets transferred from TAFE SA to Renewal SA following an independent valuation of TAFE SA assets.

### 6.3.2 Significant proceeds expected in 2017-18 from the sale of government buildings, land services activities and Techport assets

The sale of non-financial assets is estimated to deliver significant proceeds totalling \$1.3 billion in 2017-18.

The 83% increase in 2017-18 compared to the 2016-17 estimated result is primarily due to:

- the revised timing of asset sales including the State Administration Centre precinct.
- proceeds from the separation and outsourcing of the transactional/service delivery activities provided by the Land Services Group
- proceeds of \$230 million in 2017-18 from the sale of Techport Common User Facility land and assets to the Commonwealth Government, which was approved in the period following the 2016-17 MYBR.

The proceeds from these sales flow through to the net lending position of the State and can significantly impact this item.

### 6.3.3 \$1.605 billion proceeds from the sale of land services activities in 2017-18

In the 2016-17 Budget, the SA Government announced its intention to separate and outsource certain activities provided by the Land Services Group.

In August 2017, the SA Government appointed a private operator, Land Services SA, to provide a range of land services functions on behalf of the SA Government for 40 years.

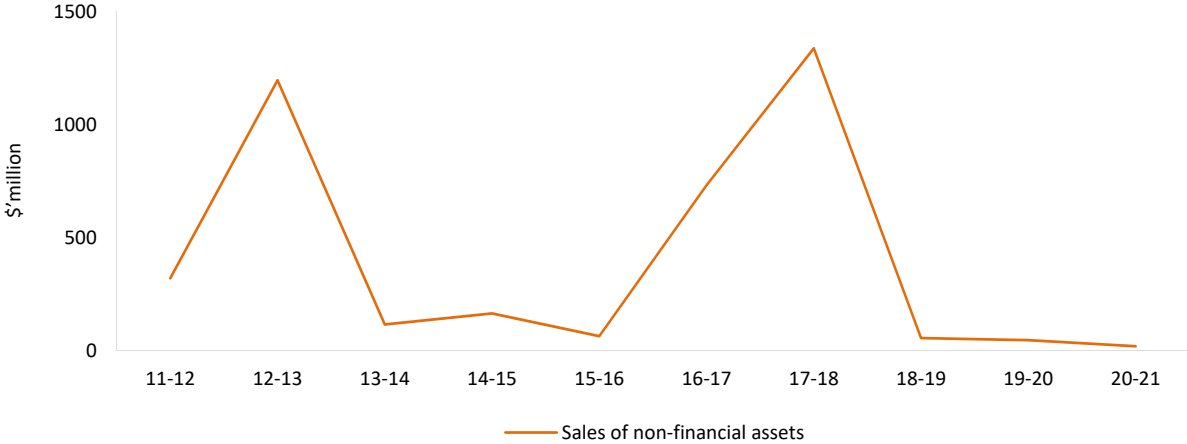
Land Services SA is a consortium comprising Macquarie Infrastructure and Real Assets, and the Canadian Public Sector Pension Investment Board.

Announcements made on the sale indicate that the SA Government will receive \$1.605 billion in an upfront payment as well as an ongoing royalty stream. The commercial details of the contract are confidential. These proceeds exceed those estimated in the 2017-18 Budget by \$855 million and will flow through to net lending and net debt.

### 6.3.4 Significant sale proceeds since the global financial crisis

Figure 6.2 shows trends expected for sales of non-financial assets against the experience of recent years.

**Figure 6.2: General government sector sales of non-financial assets (nominal)**



Proceeds in 2017-18 from the sale of non-financial assets are expected to exceed the high levels experienced in 2012-13, primarily due to the sale of land services activities in 2017-18 as discussed in section 6.3.3.

Sales of non-financial assets were previously highest in 2012-13 at \$1.2 billion as a result of finalising two significant sale processes: proceeds from the forward sale of the State’s Green Triangle forest plantations (\$635.1 million) and proceeds from the appointment of Tatts Lotteries SA Pty Ltd as exclusive Master Agent to operate the Lotteries Commission of South Australia’s brands and products for 40 years (\$402.8 million). These amounts exclude stamp duty.



# 7 Balance sheet

## Key points

- The State's NFPS net worth is expected to grow by \$3.3 billion over the four years of the 2017-18 Budget. This is mainly due to a rise in the value of land and other fixed assets and a decrease in superannuation liabilities, offset partly by increases in borrowings and other employee benefits.
- The recognition of the nRAH in 2016-17 increases non-financial assets by \$2.8 billion but the finance lease arrangements also increase borrowings by \$2.8 billion.
- It is estimated that privatising CTP insurance will result in almost \$2.8 billion being returned to the SA Government between 2014-15 and 2019-20.
- Borrowings and the unfunded superannuation liability are the major components of liabilities over the forward estimates. Borrowings are estimated to increase by \$1.3 billion from \$15 billion in 2016-17 to \$16.3 billion in 2020-21. The unfunded superannuation liability is estimated to reduce from \$11.2 billion in 2016-17 to \$9.7 billion in 2020-21.
- Total NFPS net debt is expected to peak in 2019-20 (\$15 billion) and decrease slightly in 2020-21 reflecting a small net lending surplus in that year.
- The past service superannuation liability cash payment for 2017-18 is estimated to be \$426 million, compared to \$458 million in 2016-17.

## 7.1 Introduction

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The balance sheet sets out the assets, liabilities and net worth (difference between assets and liabilities) of the State. This chapter provides commentary on trends and influences noted for the State public sector financial position.

The information below principally relates to data for the NFPS, which consolidates the general government and PNFC sectors, due to the high value of non-financial assets in PNFCs.<sup>12</sup>

## 7.2 Net worth

---

The State's net worth is expected to grow by \$3.3 billion over the four years of the 2017-18 Budget. This is mainly due to a rise in the value of land and other fixed assets and a decrease in superannuation liabilities, offset partly by increases in borrowings and other employee benefits.

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<sup>12</sup> Balance sheet data is for the NFPS as detailed in 2017-18 Budget Paper 3 'Budget Statement', table A.6, unless otherwise stated.

NFPS net financial worth deteriorates over the forward estimates by \$632 million due primarily to the growth in borrowings of \$1.3 billion and other employee benefits of \$564 million, offset by a reduction in the superannuation liability of \$1.5 billion.

## 7.3 Assets

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The vast majority of estimated total assets as at 30 June 2017 is comprised of land and other fixed assets (95%).

Total assets are expected to increase over the forward estimates from \$73.7 billion at 30 June 2017 to \$77.6 billion at 30 June 2021. This is mainly attributable to increases in land and other fixed assets, which are projected to rise from \$69.9 billion to \$73.9 billion over the four years of the Budget. This primarily reflects investment and revaluations in health, transport and water-related infrastructure.

Total financial assets are expected to be \$3.8 billion in 2016-17, decreasing slightly to \$3.7 billion in 2020-21. Total financial assets include investments in other public sector entities. This represents the value of the SA Government's interest in PFCs including ReturnToWorkSA and MAC.

The large increase in estimated total assets in 2016-17 compared to last year (\$3.9 billion) is mainly due to the recognition of the nRAH (\$2.8 billion).

### 7.3.1 Return to Work Corporation of South Australia

#### Changes to legislation reduced future compensation entitlements

On 1 July 2015 the *Workers Rehabilitation and Compensation Act 1986* was replaced with the *Return to Work Act 2014*, significantly reducing future compensation entitlements. As a result of these legislative changes and ReturnToWorkSA's initiatives to get claimants back to work sooner, the Return to Work Scheme became fully funded for the first time in many years in 2014-15.

#### Total comprehensive result improved by \$219 million in 2016-17

The total comprehensive result for ReturnToWorkSA in 2016-17 was a profit of \$175 million. This compares to a total comprehensive result loss of \$44 million in 2015-16. The increase of \$219 million in the total comprehensive result was mainly due to premium revenue and net investment profit increasing, claims paid decreasing and a smaller movement in the net outstanding claims liability.

#### Funding ratio remains above 100%

The funding ratio (assets divided by liabilities) for the Return to Work Scheme was 119.5% in 2016-17 compared to 112.9% in 2015-16. The total liability for outstanding claims has remained consistent at \$2.5 billion in 2016-17.

Given the improved financial results, ReturnToWorkSA reduced the average premium rate levied on employers from 1.95% in 2016-17 to 1.8% in 2017-18.

While ReturnToWorkSA does not pay a dividend to the SA Government, the 2016-17 estimated result includes an estimated income tax equivalent payment from ReturnToWorkSA of \$86.2 million.

There is further commentary in the section of our 2016-17 Annual Report titled 'Return to Work Corporation of South Australia'.<sup>13</sup>

### 7.3.2 Motor Accident Commission

#### Comprehensive profit result of \$361 million achieved in 2016-17

MAC reported a comprehensive profit result for 2016-17 of \$361 million. As at 30 June 2017 MAC had net assets of \$361 million (\$688 million). The reduction in net assets reflects \$297.8 million in dividends and a \$390.4 million return of equity paid in 2016-17.

#### Privatisation of compulsory third party insurance from 1 July 2016

The SA Government opened the provision of CTP insurance to the private sector in South Australia from 1 July 2016. As a consequence, MAC ended its role as the sole provider of CTP insurance in South Australia. MAC has ceased writing new CTP insurance policies and will run off its claims against policies issued up to and including 30 June 2016.

As a result of the reforms, from 2014 to June 2016 MAC paid \$1.3 billion from its surplus assets into the Highways Fund.

MAC paid a further \$688.2 million to the Highways Fund in June 2017 following the transition to the new CTP arrangements. This included \$297.8 million in dividends and a \$390.4 million return of equity. Four private insurers also paid \$259.4 million to the State in 2016-17 at the time of their entry to the South Australian CTP insurance market.

Beyond 2016-17, further contributions totalling \$509.8 million are expected to be paid across the forward estimates.

It is anticipated that privatising CTP insurance will result in almost \$2.8 billion being returned to the SA Government (Highways Fund) between 2014-15 and 2019-20, comprising dividends of \$1.6 billion, a total return of equity of \$854.6 million and private insurer approval fees of \$259.4 million, as shown in table 5.11 of 2017-18 Budget Paper 3 'Budget Statement'.<sup>14</sup>

This represents an increase of \$687 million in total returns since the 2016-17 Budget.

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<sup>13</sup> Annual Report of the Auditor-General for the year ended 30 June 2017: Part B 'Agency audit reports', page 346.

<sup>14</sup> To the extent that they are deposited into the Highways Fund the distributions will be applied for the purpose of the Highways Fund.

MAC’s future distributions depend on the amount of net equity retained and meeting its required solvency ratio

MAC’s Statement of Financial Position comprises assets and liabilities that are sensitive to interest rates, claims experience and other assumptions, and assets that are subject to market movements.

MAC is required to maintain a sufficient level of solvency for the MAC Fund using a formula determined by the Treasurer. The Treasurer issued a revised formula in December 2016.

As at 30 June 2017 the target level of assets, determined by applying the revised formula, was \$1228.2 million. The MAC Fund’s assets at that date were \$1587.7 million, including property holdings of \$565 million. This is \$359.4 million above the target level and equates to 129.3% (119.1%) of the targeted solvency level.

The level of solvency has increased importance given MAC has ceased writing new CTP policies and is now running off existing claims. Any shortfalls or deterioration in claims experience cannot be met by future premiums.

The sale of MAC’s property holdings was completed and finalised on 31 July 2017 for \$565 million.

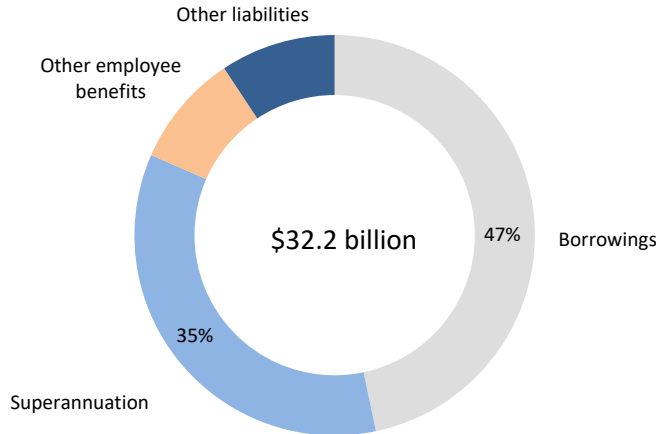
Further commentary is included in the section of our 2016-17 Annual Report titled ‘Motor Accident Commission’.<sup>15</sup>

## 7.4 Liabilities

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Figure 7.1 shows the composition of total liabilities estimated as at 30 June 2017.

**Figure 7.1: Composition of total liabilities estimated at 30 June 2017**



<sup>15</sup> Annual Report of the Auditor-General for the year ended 30 June 2017: Part B ‘Agency audit reports’, page 285.

The major components of total liabilities are borrowings (47%) and superannuation (35%).

Borrowings are estimated to increase by \$1.3 billion from \$15 billion at 30 June 2017 to \$16.3 billion at 30 June 2021. The unfunded superannuation liability is estimated to reduce from \$11.2 billion at 30 June 2017 to \$9.7 billion at 30 June 2021.

#### 7.4.1 Borrowings and net debt – general government

Net debt<sup>16</sup> comprises the stock of selected gross financial liabilities less financial assets. It is reported in the balance sheet and is the sum of deposits held, advances received and borrowings, less the sum of cash and deposits, advances paid, investments, loans and placements.

General government sector net debt is forecast to increase by \$1.9 billion in 2017 to \$6.3 billion as at 30 June 2017. This is driven by the first time recognition of the \$2.8 billion nRAH on the balance sheet, partially offset by private insurer fees, dividends and return of equity from MAC of \$948 million.

Net debt is forecast to decrease by \$225 million in 2017-18 to \$6.1 billion. This is mainly due to dividends and return of equity from MAC, estimated to be \$339 million in 2017-18. General government sector net debt is expected to peak at \$6.8 billion at 30 June 2020 before declining to \$6.7 billion by 30 June 2021.

Figure 7.2 explains the expected movements in net debt for the general government sector at the time of the 2017-18 Budget.

**Figure 7.2: Reconciliation of movements in general government net debt as at the 2017-18 Budget**

	2016-17 Estimated result \$'million	2017-18 Budget \$'million	2018-19 Budget \$'million	2019-20 Budget \$'million	2020-21 Budget \$'million
<b>Opening general government net debt</b>	4 393	6 297	6 072	6 733	6 808
General government cash surplus (deficit)	283	203	(744)	(193)	(20)
Add: Net cash flows from equity transactions	583	20	84	148	144
Less: Assets acquisition under finance leases and similar arrangements	(2 758)	-	-	-	-
Other movements	(11)	2	(1)	(30)	(3)
<b>Improvements (Deterioration) in general government net debt</b>	(1 903)	225	(661)	(74)	121
<b>Closing general government net debt</b>	6 297	6 072	6 733	6 808	6 687

Note: Totals may not add due to rounding.

In figure 7.2:

- the general government cash surplus/deficit represents the sum of net cash flows from operating activities and net cash flows from investments in non-financial assets

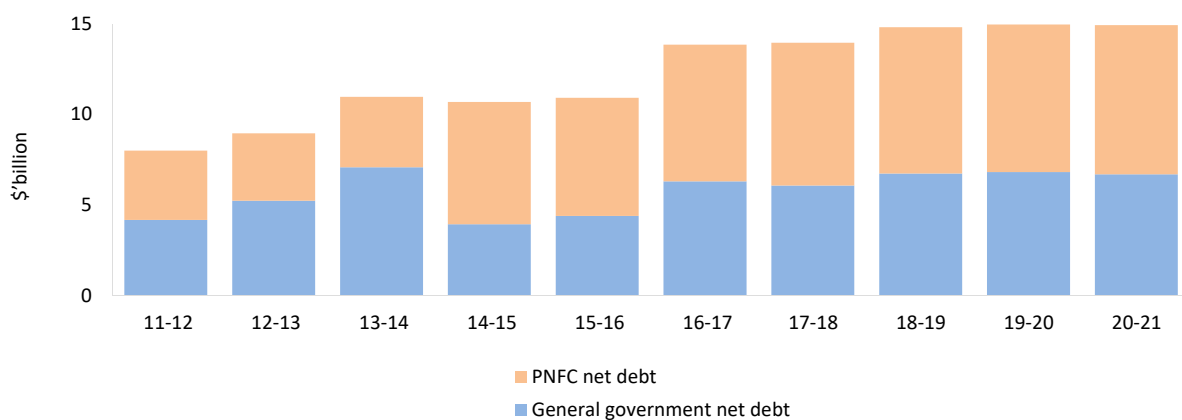
<sup>16</sup> The indebtedness of the Treasurer, published in the Treasurer's Statements, represents the amount the Treasurer has borrowed from SAFA. This amount may be linked with the GFS accrual numbers, but a change in the GFS net lending position is not necessarily reflected by a change in the indebtedness of the Treasurer.

- net cash flows from equity transactions impact on net debt but do not pass through the operating statement. This includes distributions from MAC treated as a return of equity.

## 7.4.2 Longer term trends in the level of debt – non-financial public sector

In 2016-17 total NFPS net debt is expected to increase by \$2.9 billion to \$13.837 billion (13.2% of South Australia’s gross state product). Forward estimates show that net debt is projected to rise to \$14.9 billion by 30 June 2021 (12.1% of South Australia’s gross state product).

**Figure 7:3: South Australian NFPS net indebtedness  
2011-12 to 2020-21**



The 2014-15 reduction in general government debt, as well as the converse rise in PNFC debt, was as a consequence of the SA Government’s decision to vary SA Water’s debt to asset gearing ratio. SA Water is a commercial business servicing its debt from business revenues and is the main holder of debt in the PNFC sector.

The \$1.9 billion increase in general government net debt in 2016-17 to \$6.3 billion mainly reflects the recognition of the financial obligations for the nRAH (\$2.8 billion). This increase is partly offset by an expected contribution of \$948 million from MAC in 2016-17.

The \$1 billion increase in PNFC net debt in 2016-17 is mainly due to the transfer of TAFE SA properties to Renewal SA. On 1 March 2017, Renewal SA purchased a portfolio of TAFE SA properties from the Department of State Development for \$619 million, including stamp duty of \$24 million. The purchase was funded through new borrowings of \$400 million and equity contributions of \$219 million provided by the SA Government.

The PNFC net debt is forecast to increase from \$7.5 billion at 30 June 2017 to \$8.2 billion at 30 June 2021. The expected increase in net debt mainly reflects SA Water increasing its borrowings by \$829.8 million from 2016-17 to 2020-21 to deliver continued capital investment, including the Northern Adelaide Irrigation Scheme project, and maintaining its debt to asset ratio at a target of 45%.

Total NFPS net debt is expected to peak in 2019-20 (\$15 billion) and decrease slightly in 2020-21 reflecting a small net lending surplus in that year.

### 7.4.3 The South Australian Government Financing Authority manages most of the State's debt

SAFA is the State's central borrowing authority and is also responsible for managing most of the State's debt. It lends funds raised from financial markets to a number of South Australian public sector clients, including the Treasurer (who borrows on behalf of public sector agencies to support their operational requirements). SAFA aims to undertake its treasury functions with a low risk appetite and to protect the interests of the SA Government and clients.

At 30 June 2017, SAFA's liabilities were \$27.1 billion. It had loans to the Treasurer totalling \$11.1 billion. The Treasurer also had funds on deposit with SAFA totalling \$6.5 billion as at 30 June 2017.

SAFA manages its treasury function through a portfolio structure. This structure and associated procedures contribute to enhanced treasury risk identification and management. This includes the daily management of liquidity, interest rate, currency and credit risk. Further details on SAFA's functions are included in the section of our 2016-17 Annual Report titled 'South Australian Government Financing Authority'.<sup>17</sup>

## 7.5 Unfunded superannuation

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### 7.5.1 Background to the unfunded superannuation liability

The unfunded superannuation liability is a long-term liability to current and past members of closed defined benefit superannuation schemes. The 2017-18 Budget notes there is significant short-term variability in the unfunded superannuation liability resulting from changes in some key valuation assumptions and financial market movements. While this volatility has resulted in multi-billion dollar revisions to the value of the liability recorded on the balance sheet in the recent past, there has been no material change in the actual expected payments to beneficiaries underlying the liability.

Unfunded superannuation liabilities are valued at points in time by discounting future superannuation benefit payments by a discount rate that reflects the prevailing risk-free interest rate, consistent with the requirement of AASs.

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

The unfunded superannuation liability is calculated in line with AASs as the net difference between the estimated value of accrued defined benefit superannuation obligations and the value of assets set aside to meet these obligations. Superannuation liabilities are determined on long-term estimates of total liabilities. This is a liability to current and past

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<sup>17</sup> Annual Report of the Auditor-General for the year ended 30 June 2017: Part B 'Agency audit reports', page 390.

members of closed defined benefit superannuation schemes. They are not liabilities that will be called on in total in the immediate future, meaning the ability to fund them over many years exists. The State has a long-term funding strategy in place.

In estimating the unfunded superannuation liability a range of variable factors and assumptions are taken into account, including scheduled past service contributions by the SA 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.

## 7.5.2 Estimated unfunded superannuation liability at 30 June 2017

The unfunded superannuation liability is estimated to decrease by \$1.3 billion from the estimated 30 June 2016 figure recorded in the 2016-17 Budget. Figure 7.4 sets out the major elements comprising the movement in the estimated unfunded superannuation liability from 30 June 2016 to 30 June 2017.

**Figure 7.4: Estimated unfunded superannuation liability  
as at 30 June 2017**

	\$'million	\$'million
Estimated unfunded liability as at 30 June 2016 (2016-17 Budget)		12 483
<i>Add:</i> Movement in discount rate	1 854	
Higher than expected returns on investments	(113)	
Adjustments to align with AASB 119	(195)	
Total changes		1 546
Actual as at 30 June 2016		14 029
<i>Add:</i> Movement in discount rate	(2 084)	
Higher than expected returns on investments	(590)	
Other movements	(137)	
Total changes		(2 811)
Estimated closing balance 30 June 2017 (2017-18 Budget)		11 217

Note: Totals may not add due to rounding.

## 7.5.3 Superannuation discount rate

As required by AASs, the unfunded superannuation liability is estimated at a point in time by discounting future superannuation benefit payments by a discount rate that reflects the risk-free interest rate. The reference rate used is the rate that reflects the average maturity on the liability. Due to the high value of the expected payments to beneficiaries and the long-term nature of the liabilities, valuation of the superannuation liability is sensitive to movements in the discount rate.

A discount rate of 3.3% (effective annual rate) has been used for the 2017-18 Budget, compared with 3.2% used in the 2016-17 Budget and 2.8% used in the 2016-17 MYBR. Figure 7.5 shows the impact of varying the discount rate upwards from the current rate of 3.3%.



**Figure 7.5: Sensitivity analysis of unfunded superannuation liabilities to discount rate movements as at 30 June 2017**

Discount rate	Unfunded superannuation liability \$'million	Increase (Decrease) \$'million
3.3%	11 217	-
6.0%	6 448	(4 769)
7.5%	4 664	(6 553)

Figure 7.5 shows how significantly the value of the liability can change with movements in interest rates alone. For example, should the composite of long dated Commonwealth Government nominal bond rates increase to 7.5%, the value of the unfunded liability will reduce by \$6553 million. The Budget notes that while financial market volatility in the recent past has resulted in multi-billion dollar revisions to the value of the liability recorded on the balance sheet, there has been no material change in the actual expected payments to beneficiaries underlying the liability.

#### 7.5.4 Superannuation funding

DTF advised that total superannuation funding (including the fully funded Southern State Superannuation Scheme) is expected to be \$1571 million in 2017-18, rising to \$1739 million in 2020-21. Payments comprise amounts paid from agencies as contributions to current employees for new service and contributions.

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

The past service superannuation liability cash payment for 2017-18 is estimated to be \$426 million, compared to \$458 million in 2016-17.<sup>18</sup>

#### 7.5.5 Earnings

Funds SA is responsible for managing the investment of superannuation assets. Investment earnings on superannuation assets are highly susceptible to economic conditions, financial markets and Funds SA's investment strategy. Further detail on Funds SA's investment performance is provided in the section of our 2016-17 Annual Report titled 'Superannuation Funds Management Corporation of South Australia'.<sup>19</sup>

<sup>18</sup> 2017-18 Budget Paper 3 'Budget Statement', table 4.4.

<sup>19</sup> Annual Report of the Auditor-General for the year ended 30 June 2017: Part B 'Agency audit reports', page 485.

An earnings rate of 12.5% was estimated for 2016-17 at the time of the 2017-18 Budget. This is greater than the long-term assumed earnings rate of 7% and greater than the assumed earnings for 2016-17 at the time of the 2016-17 MYBR of 6.2%. The higher expected returns are due to the gains experienced in financial markets during 2016-17.

Volatility in asset markets poses a risk to the budget. A 1 percentage point lower than expected return on superannuation assets invested by Funds SA would increase estimated unfunded superannuation liabilities by around \$64 million. An increase in unfunded superannuation liabilities of this magnitude would increase nominal superannuation interest expenses, decreasing the net operating balance by around \$2 million p.a.

### 7.5.6 Long-term funding of superannuation liabilities

The commitment to fully fund unfunded liabilities was again reaffirmed by the SA Government in the 2017-18 Budget, with the position as at 30 June 2017 remaining consistent with the plan to eliminate unfunded superannuation liabilities by 2034.

Past service superannuation liability cash payments are estimated to increase over that period in line with the SA Government's expectations of salary inflation. Assuming no change in the discount rate and a return to long-term earnings, unfunded liabilities are estimated to have already peaked (2011-12). It is estimated that benefit payments will peak in 2026-27 (\$902.2 million).

The SA Government's target to fully fund superannuation liabilities by 2034 is plausible based on these estimates. Based on current data and estimates, in 2034 the liability will be fully funded by equivalent assets of \$10.7 billion.

As required by the *Superannuation Act 1988*, a triennial review of the South Australian Superannuation Scheme as at 30 June 2016 by an independent actuary is being performed and is expected to be tabled in Parliament in 2017-18.

## 7.6 Contingent liabilities

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Contingent liabilities are those that have not been recognised in the balance sheet, but rather are disclosed in notes to the accounts.<sup>20</sup>

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

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<sup>20</sup> 2017-18 Budget Paper 3 'Budget Statement', page 97.

Contingent liabilities of the SA Government can arise from:

- legislative provisions requiring the it to guarantee the liabilities of public sector organisations (eg financial institutions)
- its ordinary activities, which might give rise to disputes and litigation that remain unresolved at any given balance date.

The SA Government's guarantees and contingent liabilities as at 30 June 2016 were valued at \$1320 million (\$1296 million as at 30 June 2015). Guarantees are valued at nominal values without adjustment for the probability of actual liabilities occurring.

## 8 Treasurer's Statements

### Key points

- The Consolidated Account outcome for 2016-17 was a \$618 million deficit, representing a \$361 million improvement on the original 2016-17 Budget.
- Consolidated Account payments were within appropriation authority for 2016-17.
- \$120.9 million was transferred from the Governor's Appropriation Fund to the Department for Child Protection to assist with increased costs associated with children in care.
- Special deposit account and deposit account balances grew by \$1.3 billion to \$6.8 billion as at 30 June 2017, largely due to an increase in the Highways Fund special deposit account balance following a substantial dividend and equity return from MAC in 2016-17.

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

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

The main public accounts are the Consolidated Account, special deposit accounts and deposit accounts established under the PFAA.

A large proportion of public money is received and expended through the Consolidated Account. The main receipts to the Consolidated Account are State taxation and Commonwealth general purpose grants to the State.

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

The Treasurer's 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 Statements are reported, in full, in the Annual Report of the Auditor-General for the year ended 30 June 2017: Appendix (Volume 1).

## 8.2 Audit scope for the Treasurer's Statements

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We reviewed the controls exercised by the Public Finance Branch over the appropriation and disbursement of money through the public accounts. This included the:

- processes to ensure compliance with the PFAA, annual Appropriation Act and Treasurer's Instructions
- approval and disbursement of appropriations
- approvals for establishing new accounts and changes to existing accounts
- interest calculations on interest bearing deposits and Treasurer's loans
- approval and monitoring of Treasurer's loans and guarantees.

Our audit work identified some areas where improvements could be made. Review findings are provided under the heading 'Audit findings and comments' in the section of our 2016-17 Annual Report titled 'Department of Treasury and Finance'.<sup>21</sup>

## 8.3 The Consolidated Account outcome

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Money must not be issued from the Consolidated Account except under authority of an Act of Parliament. Figure 8.1 sets out total appropriation authority and actual payments for the Consolidated Account in 2016-17.

**Figure 8.1: 2016-17 appropriation authority and payments**

	Appropriation authority \$'million	Actual payments \$'million
<i>Appropriation Act 2016</i>	13 163.6	12 550.6
PFAA, section 15	36.7	36.7
Governor's Appropriation Fund	361.1	251.6
Specific appropriations authorised in various Acts	106.3	107.3
<b>Total</b>	<b>13 667.7</b>	<b>12 946.2</b>

The result on the Consolidated Account and variations from the Budget for 2016-17 are shown in figure 8.2.

**Figure 8.2: 2016-17 Consolidated Account result**

	2016-17 Budget \$'million	2016-17 Actual \$'million	Variation \$'million
Total receipts	12 290.9	12 328.7	37.7
Total payments	13 269.9	12 946.2	(323.7)
<b>Consolidated Account surplus (deficit)</b>	<b>(979.0)</b>	<b>(617.5)</b>	<b>(361.5)</b>

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<sup>21</sup> Annual Report of the Auditor-General for the year ended 30 June 2017: Part B 'Agency audit reports', page 508.

The deficit of \$618 million (\$1154 million deficit in 2015-16) is reflected as 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 as follows:

- **Receipts** – main items that varied from budgetary expectations:
  - higher taxation revenue (\$116 million) mainly from higher land tax (\$178 million) due to timing issues as a higher proportion of 2015-16 liabilities were paid in 2016-17, particularly for government entities, offset by various other factors
  - higher recoveries (\$162 million) mainly due to the return of cash to the Consolidated Account under the cash alignment policy (\$243 million) which is not budgeted for, offset by lower than expected receipts from the sale of TAFE SA properties to Renewal SA (\$55 million) due to a reduction in the value of assets transferred resulting from an independent valuation, and the return of superannuation deposit account balances relating to certain defined benefit schemes (\$30 million) which was not required in 2016-17

offset by:

- lower Commonwealth general purpose grants (\$180 million) due to lower than expected growth in the total GST pools available for distribution
- lower Commonwealth national partnership payments (\$47 million) mainly due to the re-profiling of payments to the Consolidated Account under the Asset Recycling initiative.
- **Payments** – main items that varied from budgetary expectations:
  - lower than budgeted payments to:
    - Department for Education and Child Development (\$255 million) mainly due to appropriation being transferred to the Department for Child Protection under section 5 of the *Appropriation Act 2016* (refer section 8.4.4)
    - Department for Health and Ageing (\$319 million) reflecting reduced expenditure requirements in 2016-17 due to the delay in commercial acceptance of the nRAH and commencement of service payments. The financial impact of this delay on the 2017-18 Budget is discussed in section 5.2
    - administered items for DTF (\$129 million) due to lower contingency payments and lower than expected community service obligation (CSO) payments to Renewal SA. In the 2016-17 Budget, Renewal SA was budgeted to receive CSO payments in relation to its purchase of TAFE SA properties. The finalised structure provides for the Department of State Development to pay commercial lease rates on the TAFE SA properties and ongoing CSO payments are therefore not required

offset by:

- higher than budgeted payments to the Department for Child Protection (\$327 million). The *Appropriation Act 2016* did not specify the amount budgeted to be appropriated to the Department for Child Protection. Appropriation was provided in 2016-17 in line with section 5 of the *Appropriation Act 2016* (refer section 8.4.4) and also from the Governor's Appropriation Fund (refer section 8.4.1).

Consistent with the previous year, significant amounts were appropriated to agencies as equity in 2016-17. The main equity contributions were to the Department of Planning, Transport and Infrastructure (\$169.4 million), Renewal SA (\$113.9 million), the Department for Health and Ageing (\$57 million) and the Department for Correctional Services (\$47.7 million). Equity funding is credited directly to an agency's Statement of Financial Position, not through the Statement of Comprehensive Income (refer section 8.6). Details of the budget and actual data are presented in Treasurer's Statement A.

## 8.4 Appropriation flexibility

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Appropriation authority flexibility arises from the provision 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 through a combination of legislative provisions and budget practices.

Figure 8.3 sets out relevant items for 2016-17.

**Figure 8.3: Appropriation flexibility in 2016-17**

	Authority/ Budget \$'million	Actual payments \$'million
Governor's Appropriation Fund	361.1	251.6
Contingency provisions in administered items for DTF	266.1	108.8
PFAA, section 15	36.7	36.7
Total appropriation flexibility	663.9	397.1

Use of these provisions requires the Treasurer's approval. Using contingency provisions does not affect the Budget result as they are already included as a budgeted expense item in the administered items for DTF.

### 8.4.1 Governor's Appropriation Fund

Section 12 of the PFAA provides for the Governor's Appropriation Fund, which is generally used to fund new government initiatives or to meet unexpected expenditure needs.

Details of the purpose of appropriations from the Governor’s Appropriation Fund are provided in Treasurer’s Statement K. The main items for 2016-17 are shown in figure 8.4.

**Figure 8.4: Main Governor’s Appropriation Fund payments in 2016-17**

Agency	Purposes	Actual payments \$’million
Department for Child Protection	Primarily to meet increased costs associated with children in care.	120.9
Department of State Development	Largely to incentivise gas production from South Australian gas fields.	37.5
Department for Communities and Social Inclusion	To enable the department to meet expenditure commitments.	35.4
Department for Correctional Services	Primarily for accommodation and facility upgrades at Port Augusta Prison, Mobilong Prison, Mount Gambier Prison and Adelaide Remand Centre.	21.5

## 8.4.2 Contingency provisions

Contingency provisions for employee entitlements, supplies and services and investing contingencies are included in the appropriation total of the ‘Administered Items for the 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 to agencies are provided in Treasurer’s Statement L. These payments represent additional funding to agencies.

The main contingency provision payments for 2016-17 are shown in figure 8.5.

**Figure 8.5: Main contingency provision payments for 2016-17**

Agency	Total payments \$’million
Department for Health and Ageing	47.1
Department of Planning, Transport and Infrastructure	16.5
Department of Treasury and Finance	12.9
South Australian Tourism Commission	8.8



### 8.4.3 Appropriation by the Treasurer under section 15 of the *Public Finance and Audit Act 1987*

Section 15 of the PFAA provides that the Treasurer may appropriate from the Consolidated Account an amount sufficient to cover increases in public sector salaries, wages, allowances, payroll tax or superannuation contributions arising from 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 from the Consolidated Account annually and may affect the Budget result where there are unbudgeted expenses.

In 2016-17 \$36.7 million was appropriated by the Treasurer to administered items for DTF under section 15 of the PFAA and used to meet additional costs for salaries and wage determinations. In 2015-16 the amount appropriated by the Treasurer was \$21 million.

### 8.4.4 Appropriation transfers

In addition to the preceding provisions, appropriation can be transferred between agencies. Section 13 of the PFAA gives this 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 can also be transferred.

No section 13 transfers occurred in 2016-17.

In 2016-17, \$284.9 million in appropriation was transferred between agencies under section 5 of the *Appropriation Act 2016*. The main transfers made under section 5 are shown in figure 8.6.

**Figure 8.6: Main section 5 appropriation transfers between agencies in 2016-17**

From	To	Purpose	Amount transferred \$' million
Department for Education and Child Development	Department for Child Protection	On 24 October 2016, Cabinet approved the establishment of the Department for Child Protection, effective from 1 November 2016. This forms part of the SA Government’s state-wide reform of the child protection system and its response to the Child Protection Systems Royal Commission report.  As a result of creating the new department, a number of functions transferred from the Department for Education and Child Development (Families SA) to the Department for Child Protection.	205.6

From	To	Purpose	Amount transferred \$'million
Department of State Development	Department of the Premier and Cabinet	<p>On 2 March 2017, Cabinet approved the transfer of Resources and Energy Group (REG) and the Office of the Economic Development Board (OEDB) from the Department of State Development to the Department of the Premier and Cabinet as part of a machinery of government change effective from 1 April 2017.</p> <p>As part of the approval, the budget associated with REG and OEDB has been transferred from the Department of State Development to the Department of the Premier and Cabinet.</p>	72.2

## 8.5 Special deposit accounts and deposit accounts

Most appropriation from the Consolidated Account is transferred to special deposit accounts and deposit accounts established under the PFAA. Under related provisions, money credited to those accounts can be spent without further appropriation from Parliament. This is of significance in that money appropriated in one year and transferred to a deposit account need not actually be spent in that year; that is, it can be carried over into the next year unless required by the Treasurer to be paid to the Consolidated Account.<sup>22</sup>

Figure 8.7 shows that \$6 811.3 million is held in special deposit accounts and deposit accounts as at 30 June 2017.

**Figure 8.7: Special deposit accounts and deposit accounts**

	2016-17 \$'million	2015-16 \$'million	Increase (Decrease) \$'million
Special deposit accounts	6 039.4	4 552.0	1 487.4
Deposit accounts	771.9	968.6	(196.7)
Total	6 811.3	5 520.6	1 290.7

Such unspent balances do come under the scrutiny of Parliament as they are reported in the financial positions of agencies and in the Budget Papers. The balances are also reported in Treasurer's Statements F and G.

Significant balances at 30 June 2017 were:

- **Special deposit accounts** – Highways Fund (\$2.909 billion), Accrual Appropriation Excess Funds (\$877 million), Planning, Transport and Infrastructure Operating Account (\$211 million), Treasury and Finance Administered Items Account (\$203 million) and Victims of Crime Fund (\$274 million).

<sup>22</sup> Under section 8(5) of the PFAA, any surplus of income over expenditure standing to the credit of a special deposit account must, at the Treasurer's direction, be credited to the Consolidated Account.

- **Deposit accounts** – SA Health Special Purpose Funds (\$136 million) and Green Industry Fund (\$108 million).

The Highways Fund special deposit account balance increased by \$1.186 billion to \$2.909 billion as at 30 June 2017 mainly due to a \$297.8 million dividend and \$390.4 million equity return from MAC and \$259.4 million CTP private insurer approval fee in 2016-17. These payments represent the return of excess capital from MAC to the Highways Fund to improve road safety and are in addition to the \$448.5 million contribution made to the Highways Fund in 2015-16.

The Green Industry Fund (formerly the Waste to Resources Fund) deposit account continues to grow gradually and increased by a further \$21.5 million to \$108.3 million as at 30 June 2017. Section 17 of the *Green Industries SA Act 2004* requires the Environment Protection Authority to transfer 50% of solid waste levies collected from waste depots to the Green Industry Fund, and these funds may only be used by Green Industries SA for specific purposes prescribed by the *Green Industries SA Act 2004*.

Special deposit account balances are subject to the Treasurer’s cash alignment policy that aims to minimise balances as discussed in section 8.5.3.

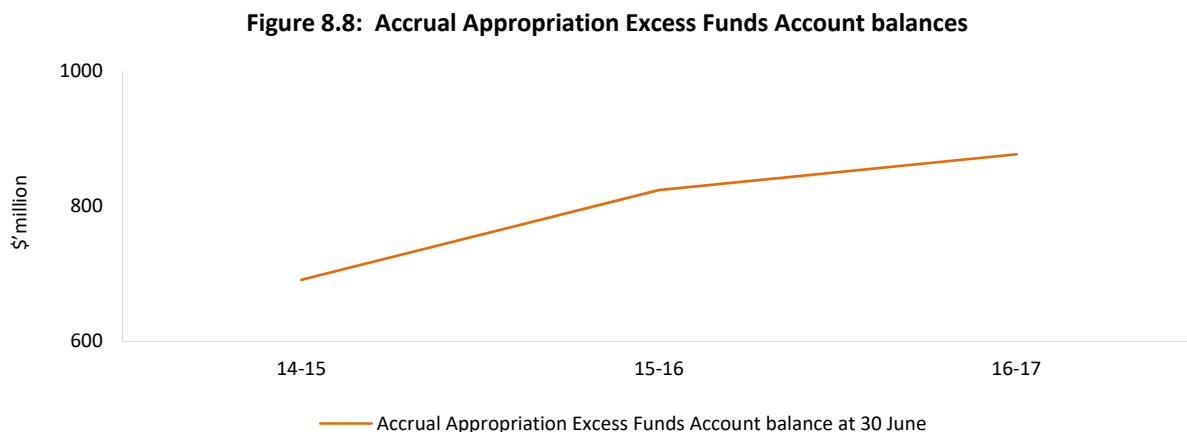
### 8.5.1 Accrual Appropriation Excess Funds Account

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

Accrual appropriations are provided to agencies primarily 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.

DTF policy provides guidance on the use of funds in the Accrual Appropriation Excess Funds Account and the operation of the account.

Figure 8.8 shows the growth in the Accrual Appropriation Excess Funds Account balance for recent years.



Deposits have exceeded withdrawals in recent years leading to growth in the account balance. Deposits occur when appropriation provided exceeds the agency’s cash requirements for the year. These funds are held in the Accrual Appropriation Excess Funds Account until required.

**8.5.2 Treasury and Finance Administered Items – Intergovernmental Agreement on Federal Financial Relations (IAFFR) Account**

The approved purpose of the IAFFR Account is to receive and disburse money paid to the State under the IAFFR for the specific purposes listed in Schedule F of that agreement and for the national partnership payments for the purposes listed in Schedule G.

The operations of the IAFFR Account are included in DTF’s administered financial statements. The balance in the IAFFR Account at 30 June 2017 was \$11.1 million. This entire balance is committed to various SA Government agencies to fulfil requirements under the IAFFR agreements.

**8.5.3 Cash alignment policy**

The SA Government’s cash alignment policy seeks to align agency cash balances with appropriation and expenditure authority. Under 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 is surplus cash. 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 \$243.2 million (\$291.8 million) of surplus cash was returned to the Consolidated Account in 2016-17. The main amounts are shown in figure 8.9.

**Figure 8.9: Cash alignment policy repayments in 2016-17**

Agency	Total payments \$'million
Department of Treasury and Finance	169.4
Department of Planning, Transport and Infrastructure	55.6
Department of Environment, Water and Natural Resources	7.6
Environment Protection Authority	5.8
Department of the Premier and Cabinet	4.8

**8.6 Equity contributions**

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

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

Treasurer's Instruction 3 'Appropriation' provides that where Schedule 1 to the *Appropriation Act* requires that money be appropriated to a public authority as a contribution of equity, as a loan or for program funding, the Treasurer acquires a financial interest in the net assets of the public authority concerned. Money issued or applied from the Consolidated Account under this instruction are not to be reported by the public authority as revenues in the period in which they are received, but are to be shown separately in the public authority's Statement of Financial Position, as a contribution of equity by the SA Government.

Total cumulative equity contributions as at 30 June 2017 were \$6.2 billion. Details of equity contributions provided to agencies are set out in Treasurer's Statement I.

# Appendix 1 – Reporting framework

## Introduction

Three reporting frameworks are used for reporting on the State’s finances:

- Uniform Presentation Framework
- AASs
- Treasurer’s Statements issued under the PFAA.

The following sections provide a brief overview of each framework.

## Uniform Presentation Framework

### Background

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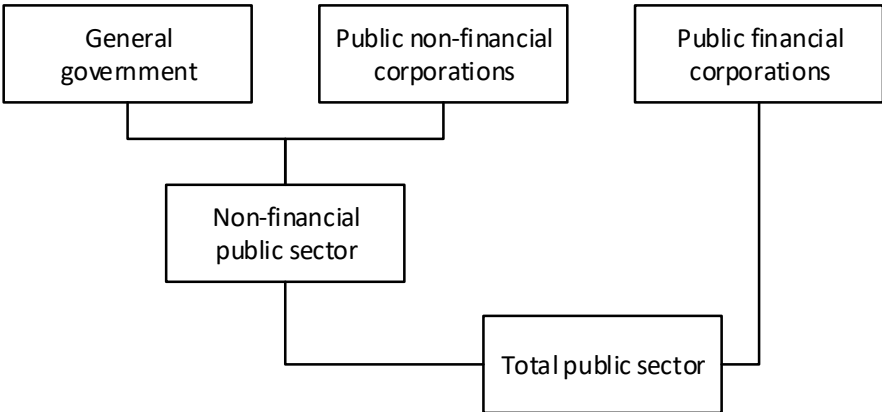
By agreement between the Commonwealth, States and Territories, each jurisdiction presents their Budget Papers and mid-year budget update on a Uniform Presentation Framework basis.

The Uniform Presentation Framework is a reporting standard based on the Australian Bureau of Statistics’ accrual based GFS framework. The primary objective of the Uniform Presentation Framework is to ensure that Commonwealth, State and Territory Governments provide a common core of financial information in Budget Papers to enable direct comparisons across jurisdictions.

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

Three sectors (which are then consolidated into two additional sectors) of government activity are used in the GFS framework, recognising that SA Government responsibilities cover a wide range of activities. They are shown in figure A1.

**Figure A1: Sectors of government activity**



A description 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 primarily financed through taxes and other charges, and for this reason this sector tends to be the focus of fiscal targets.
- **PNFCs** – trading enterprises mainly engaged in producing goods and services for sale in the marketplace at prices that aim to recover most or all of the costs involved. In South Australia this sector includes the South Australian Housing Trust and SA Water. The consolidation of the general government and PNFC sectors represents the NFPS.
- **PFCs** – bodies primarily engaged in providing financial services. This includes financial institutions such as SAFA, HomeStart Finance and Funds SA.

The Budget Papers include the following GFS financial statements:

- general government sector operating statement and balance sheet
- PNFC sector operating statement and balance sheet
- NFPS operating statement and balance sheet
- cash flow statements for these sectors.

PFC sector data is not published in the Budget Papers.

## Key Government Financial Statistics headline amounts

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

- **GFS net operating balance** – also referred to as operating result, is the excess of revenue over expenses from transactions. The net operating balance excludes expenditure on the acquisition of capital assets, but includes non-cash costs such as accruing superannuation entitlements and the consumption of capital (depreciation).
- **GFS net lending/borrowing** – represents the net operating balance less the 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** – is calculated as total assets (both financial and non-financial) less total liabilities, shares and other contributed capital. Net worth incorporates a government's non-financial assets, such as land and other fixed assets, which may be sold and used to repay debt, as well as certain financial assets and liabilities not captured by the net debt measure, most notably accrued employee superannuation liabilities, debtors and creditors.
- **Net financial liabilities** – comprise total liabilities less financial assets (net financial worth), but exclude equity investments (net worth) in the other sectors of the jurisdiction. Net financial liabilities include substantial non-debt liabilities such as accrued superannuation and long service leave entitlements.
- **Net debt** – is the sum of deposits held, advances received and borrowings, less the sum of cash and deposits, advances paid, investments, loans and placements.

## Scope of audit review of Government Financial Statistics financial statements

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This Report primarily comments on GFS based information. Although we seek to have a sound understanding of the Budget preparation process, the data and assumptions are not subject to audit. Work performed on the 2017-18 Budget year's GFS data has included some analytical procedures to ensure that the amounts presented are reasonably supported and that where trends in data materially differ they can be adequately explained.

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

## Australian Accounting Standards

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

## Agency financial reports

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

## AASB 1049 'Whole of Government and General Government Sector Financial Reporting'

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The whole-of-government/general government consolidated financial report is prepared under accounting standard AASB 1049. AASB 1049 sets out the requirements for whole-of-government and general government sector financial reporting. The standard requires compliance with other applicable AASs (except as specified in the standard) and disclosure of additional information such as reconciliations to key fiscal aggregates determined in line with the Australian Bureau of Statistics' 'Australian System of Government Financial Statistics: Concepts, Sources and Methods'.

The consolidated financial report provides the opportunity to observe the financial result of the SA Government using a full accrual accounting basis, and the consolidation of all sectors. The consolidation process means that all inter-sector transactions are eliminated, including significant transactions relating to SA Water and MAC dividends and the transfer of TAFE SA properties to Renewal SA described in this Report.

## Budgetary reporting in general purpose financial statements

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Over many years the AASB worked towards an objective of harmonising generally accepted accounting principles and the GFS. This project, developed in phases, aimed to develop



requirements for a single set of financial reports that are auditable, comparable between jurisdictions, and in which the outcome statements are directly comparable with the relevant budget statements. That is, the AASB saw merit in requiring not-for-profit entities within the general government sector to report original budgeted information and explanations of major variations from budget. Consequently, the AASB issued AASB 1055 'Budgetary Reporting' in 2013. It was first applicable in 2014-15 and requires not-for-profit entities within the general government sector, whose budgeted financial statements are presented to Parliament, to disclose:

- original budgeted amounts, presented and classified on a basis that is consistent with the financial statements prepared in accordance with AASs
- explanations of major variances between the original budget and actual amounts (which may include reference to revised budgets presented to Parliament).

These disclosure requirements have applied to both the controlled and administered items of an entity where such budget information is presented to Parliament.

AASB 1055 requirements also apply to the general government sector and the whole-of-government financial statements, replacing budgetary reporting requirements previously held in AASB 1049.

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

The Treasurer's Statements are prepared under section 22 of the PFAA, and are reported in the Annual Report of the Auditor-General for the year ended 30 June 2017: Appendix (Volume 1).

A summary of information prepared on this basis is provided in chapter 8.

## Appendix 2 – Abbreviations used in this Report

Acronym	Description
AAS	Australian Accounting Standard <sup>23</sup>
AASB	Australian Accounting Standards Board
CTP	Compulsory third party
DSD	Department of State Development
DTF	Department of Treasury and Finance
FTE	Full-time equivalent
Funds SA	Superannuation Funds Management Corporation of South Australia
GFS	Government Financial Statistics
GST	Goods and services tax
HFE	Horizontal Fiscal Equalisation
MAC	Motor Accident Commission
MYBR	Mid-year budget review
NFPS	Non-financial public sector
nRAH	New Royal Adelaide Hospital
PFAA	<i>Public Finance and Audit Act 1987</i>
PFC	Public financial corporation
PNFC	Public non-financial corporation
Renewal SA	Urban Renewal Authority
ReturnToWorkSA	Return to Work Corporation of South Australia
SAFA	South Australian Government Financing Authority
SA Water	South Australian Water Corporation
TVSP	Targeted voluntary separation package

<sup>23</sup> 'Australian Accounting Standards' means accounting standards issued by the Australian Accounting Standards Board that are in force in relation to the reporting period to which the financial report relates.