[P.P.4C

S O U T H   A U S T R A L I A

Report

of the

Auditor-General

Supplementary Report

for the

year ended 30 June 2006

Tabled in the House of Assembly and ordered to be published, 23 November 2006

First Session, Fifty-First Parliament

State Finances and Related Matters: Some Audit Observations

By Authority: T. Goodes, Government Printer, South Australia

2006

Government of South Australia
Auditor-General's Department

9th Floor
State Administration Centre
200 Victoria Square
Adelaide SA 5000
DX 56208
Victoria Square
Tel +618 8226 9640
Fax +618 8226 9688
ABN 53 327 061 410
audgensa@audit.sa.gov.au
www.audit.sa.gov.au

22 November 2006

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

The Hon J J Snelling, MP
Speaker
House of Assembly
Parliament House
ADELAIDE SA 5000

Gentlemen

REPORT OF THE AUDITOR-GENERAL: SUPPLEMENTARY REPORT: STATE FINANCES AND RELATED MATTERS: SOME AUDIT OBSERVATIONS

Pursuant to section 36(3) of the *Public Finance and Audit Act 1987*, I herewith provide to each of you a copy of my Supplementary Report 'State Finances and Related Matters: Some Audit Observations'.

Yours sincerely,

K I MacPherson
AUDITOR-GENERAL

Report of the Auditor-General

Supplementary Report for the year ended 30 June 2006

TABLE OF CONTENTS TO STATES FINANCES AND RELATED MATTERS: SOME AUDIT OBSERVATIONS

Page

STATE FINANCES AND RELATED MATTERS: SOME AUDIT OBSERVATIONS

Report of the Auditor-General

Supplementary Report for the year ended 30 June 2006

TABLE OF CONTENTS TO STATES FINANCES AND RELATED MATTERS: SOME AUDIT OBSERVATIONS

Report of the Auditor-General

Supplementary Report for the year ended 30 June 2006

TABLE OF CONTENTS TO STATES FINANCES AND RELATED MATTERS: SOME AUDIT OBSERVATIONS

Report of the Auditor-General

Supplementary Report for the year ended 30 June 2006

TABLE OF CONTENTS TO STATES FINANCES AND RELATED MATTERS: SOME AUDIT OBSERVATIONS

STATE FINANCES AND RELATED MATTERS: SOME AUDIT OBSERVATIONS

1 INTRODUCTION

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

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

The commentary is reduced in some respects from previous years to avoid unnecessary duplication with the comprehensive information provided in the 2006-07 Budget Papers.

Limitations on Audit Analysis

Most of the audit analysis in this Report is based on data provided in the Budget Papers, particularly for the 2006-07 Budget, supplemented with information provided by the Department of Treasury and Finance.

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

- The Audit commentary in this Report is based on a review of the budget material and related information. It is not an audit in the same sense as work conducted to provide an audit opinion on financial statements. The budget data are estimates and are unaudited.
- This review considers the estimated result for 2005-06. 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.

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

2 OVERVIEW OF STATE FINANCES

2.1 OVERVIEW

This Section provides a broad overview of matters that are, in my opinion, currently relevant to the State's public finances. Further commentary follows in later sections.

2.2 FISCAL STRATEGY

In September 2004, Standard & Poor's credit ratings agency upgraded South Australia to a triple-A credit rating in recognition of improvements in the State's finances.

In the 2005-06 Budget, the Government stated that the marked improvement in the State's finances over a number of years had allowed some modification of its budgetary strategy (from that in operation from the 2002-03 Budget).

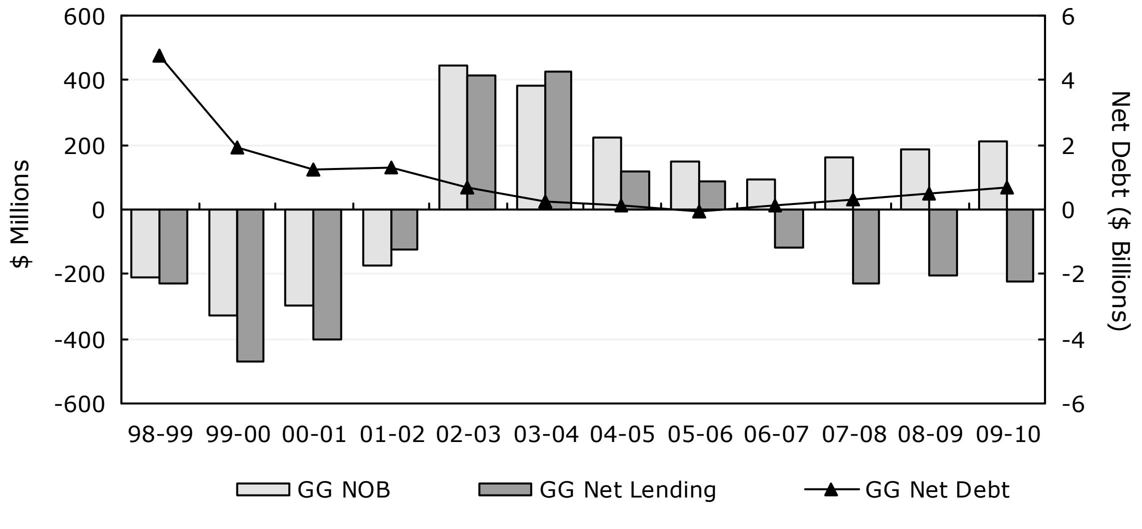
A major change from the previous strategy was to give focus to achieving a net operating balance in every year compared to seeking balanced budgets in net lending terms. This change allowed the Government to budget to undertake borrowings to fund a portion of its proposed capital investment each year.

The Government's fiscal targets include ensuring that risks to the State finances are managed prudently, to maintain a triple-A rating. The Government is also seeking to achieve net lending outcomes that ensure the ratio of net financial liabilities[1] to revenue continues to decline towards that of other triple-A rated States.

2.3 CHANGING FINANCIAL POSITION

The following chart shows changes occurring or anticipated in some of the key financial indicators over a 12 year period to 2009-10 for the general government sector.

Chart 2.1 — GFS - General Government Sector Net Operating Balance (NOB), Net Lending and Net Debt



---

[1] See Section 4.1.2 in this Report.

The chart highlights the very large surpluses in 2002-03 and 2003-04 that changed the previous trend of deficits. Revenue from distributions from public financial corporations of $332 million was central to the 2002-03 results compared to other years. Also shown is the very large reduction in net debt, due firstly to sales of electricity assets and then from surpluses, particularly in 2002-03 and 2003-04.

Prior to 2002-03, government fiscal targets were substantially different, focussing on cash results for the then defined, non-commercial sector.

The chart clearly displays the 2006-07 Budget strategy of net operating balance surpluses and net borrowing across the forward estimates, which in turn leads to rising net debt.

2.4 THE FOUR YEARS TO 2005-06

The closing of 2005-06 completed the four year budget cycle commencing with the 2002-03 Budget.

The following table summarises the changes in operating revenues and expenses over that four years by comparing actual results for 2001-02 to the estimated results for 2005-06.

Table 2.1 — GFS - General Government Sector Budget Comparison of 2001-02 Actual to 2005-06 Estimated Results

	2001-02 Result $'million	2005-06 Estimated Result $'million	Difference $'million	Difference Percent
GFS Revenue				
Taxation revenue	2 193	2 982	789	36.0
Grants*	4 713	5 699	986	20.9
All other	1 632	2 408	776	47.5
Total Revenue	8 538	11 088	2 551	29.9
Less: **GFS Expenses**				
Employee expenses	3 828	4 992	1 164	30.4
Other operating expenses	2 270	2 848	578	25.5
All other	2 613	3 102	489	18.7
Total Expenses	8 713	10 942	2 229	25.6
GFS Net Operating Balance	(174)	147	321	-
Less: **Net Acquisition of Non-Financial Assets**	(50)	59	109	-
GFS Net Lending (Borrowing)	(124)	88	212	-

* 2001-02 includes capital grants previously included in other revenue.

Note: Totals may not add due to rounding.

The table highlights the considerable increase in revenues over the period. The Government has benefited from substantial windfall property taxation revenue and from higher than budgeted Commonwealth current grants, particularly from GST revenues.

Most of this revenue was being spent in 2005-06 but the improvement in net results is apparent and has essentially allowed the elimination of net debt over four years.

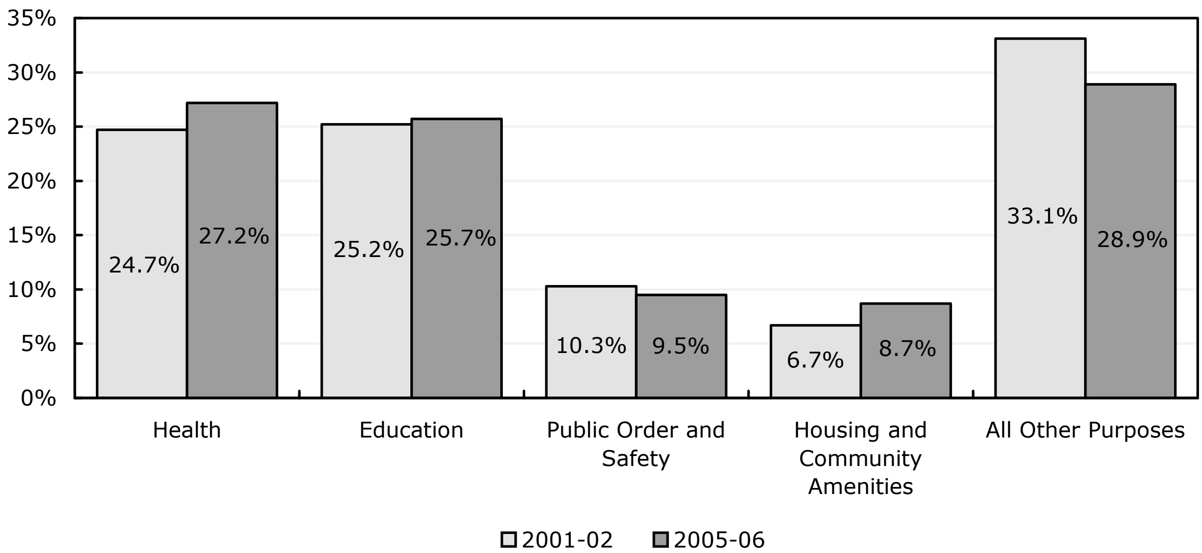
After allowing for inflation over that period, there remains real terms growth in total revenues of $1.4 billion (15 percent) and $1.1 billion (11 percent) in expenses.

2.4.1 The Nature of Expenses

Table 2.1 shows that the largest increases in expenses were for employee expenses and other operating expenses. It is useful to note where the expenditure has been applied.

GFS expense data is gathered on the basis of function and reported annually.[2] The following chart compares data for 2001-02 to the estimated results for 2005-06.

Chart 2.2 — GFS - Change in General Government Sector Expenses by Function 2001-02 to 2005-06



The chart highlights that most expenditure has consistently been applied to health and education with some increase in both these areas and in housing and community amenities. The total amount applied to all other purposes has declined over the four years.

2.5 OPERATING STATEMENT

2.5.1 Estimated Results for 2005-06

The 2006-07 Budget Papers show that the Government financial operations for 2005-06 are on target for a fourth consecutive net operating balance surplus. The estimated result is a surplus of $147 million (budget $51 million). Solid growth in revenues that exceed increases in expenses has again assisted in the achievement of better than budgeted targets. Net lending is estimated to be $88 million (budget $10 million).

The results exclude $100 million received from the Commonwealth for AusLink roadworks in June 2006. I have issued a qualified audit opinion for the Department for Transport, Energy and Infrastructure as, in my opinion, the financial reporting treatment of the grant monies did not accord with requirements of Australian Accounting Standards and the Accounting Policy Framework of the Department of Treasury and Finance. The

---

2 See for example, Budget Statement 2006-07, Table 2.21. Data does not align neatly with the administrative structure of portfolios.

nature of the qualification is contained in the agency section of Part B of the Auditor-General's Report for the year ended 30 June 2006, titled 'Department for Transport, Energy and Infrastructure'. The Budget is prepared on the GFS basis and the grants are recognised across the four years based on estimated completion of projects.[3]

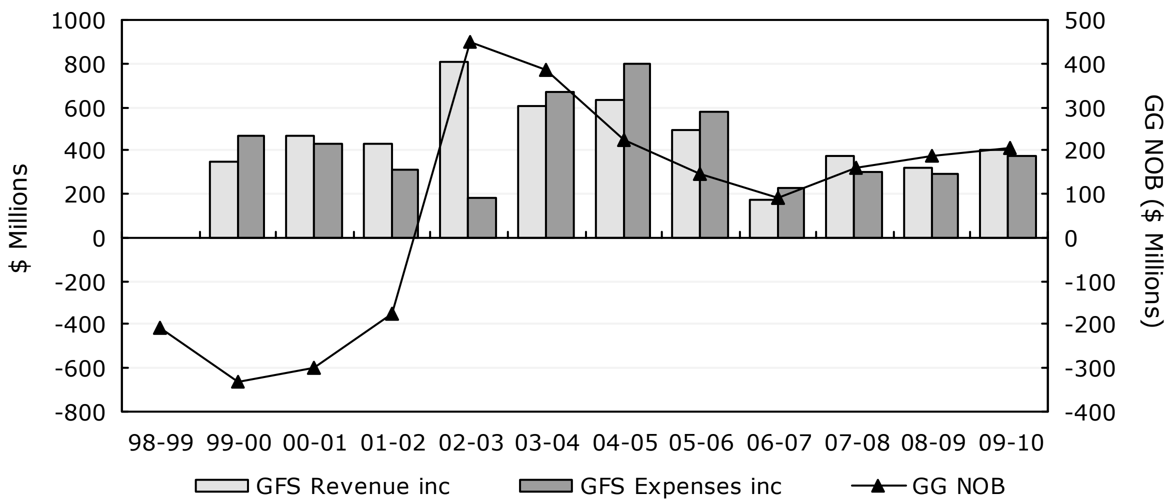
2.5.2 Budget Forecasts 2006-07 to 2009-10

Chart 2.1 shows the projected outcomes for the four years to 2009-10 as set out in the 2006-07 Budget.

Except for 2006-07 both the projected net operating balance surpluses and net borrowing (lending deficit) results targeted in the 2006-07 Budget are higher than previously budgeted.

The following chart shows projected changes in revenues and expenses in the 2006-07 Budget against recent experience with the trend of the Net Operating balance.

Chart 2.3 — GFS - Change in General Government Sector Revenue, Expenses and Net Operating Balance (NOB)



As shown, after 2002-03, annual expenses growth outstrips revenue growth up to 2006-07 with the natural consequence that the net operating balance trends down after 2002-03.

The 2006-07 Budget projects that this trend will reverse from 2006-07 with net operating balance results improving annually over the years to 2009-10.

This will depend on achieving revenue budgets and limiting expense growth to half or less than that experienced in the three years to 2005-06.

These results are predicated on essentially no real terms growth over the four years of the Budget.

3 The $100 million grant is recognised as 2006-07 $4 million, 2007-08 $25 million, 2008-09 $40 million and 2009-10 $31 million.

2.5.3 Interstate Comparison

The 2006-07 Budget compares key budget aggregates across jurisdictions. In 2006-07, most jurisdictions are forecasting general government net operating balance surpluses and net borrowing (lending deficits). Most jurisdictions are investing significant funds into infrastructure projects.

2.6 NON-FINANCIAL SECTOR BALANCE SHEET[4]

The State's Balance Sheet is expected to strengthen over the four years of the 2006-07 Budget.

2.6.1 Estimated Position for 2005-06 and Forward Years

The State has a substantial asset base. Assets are estimated to increase by over $900 million in 2005-06 to $31.7 billion, due mainly to revaluation increases for non-financial assets. Rising property values have had a marked positive influence on the Balance Sheet. Growth in the value of rental properties of the South Australian Housing Trust alone has contributed $2.5 billion over the four years to 2005-06. Total assets are expected to rise to $35.3 billion by 2009-10.

The major component of liabilities is unfunded superannuation liabilities that are estimated to decrease $1.1 billion to $6.1 billion as at 30 June 2006. The decrease was due principally to the rise in the discount rate, the government bond rate, to 5.9 percent from 5.2 percent and strong investment performance from equity markets.

Net debt was estimated to fall $185 million to $1.9 billion at 30 June 2006. The general government sector had negative net debt of $67 million at 30 June 2006. Net debt is estimated to rise to $2.8 billion by 2009-10 (General Government Sector $689 million).

Net worth, comprising total assets less total liabilities, is estimated to rise to $18.4 billion at 30 June 2006 and to $20.8 billion by 2009-10.

2.7 RISKS AND MANAGEMENT TASKS FOR THE 2006-07 BUDGET

As noted, the projections for the 2006-07 Budget forecast higher net operating balance surpluses and net borrowing (except for 2006-07) outcomes than the 2005-06 Budget.

The forecast net operating balance surpluses represent overall good financial outcomes, providing some flexibility and buffer against unfavourable outcomes to the Budget.

The deficit net lending is due to spending on non-financial assets (infrastructure).

---

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

2.7.1 Net Operating Balance

Each budget since the 2002-03 Budget has projected restraint in relation to expenses across the forward estimates. The 2006-07 Budget, in line with the previous years, indicates minimal growth, in real terms, in expenses between 2006-07 and 2009-10.

Chart 2.3 shows that recent experience is that spending has increased annually well beyond that set out in the 2006-07 Budget.

The Government is well aware of the risks to the Budget and considerable detail of risks is set out in the Budget papers. Similarly, the Government has a range of budget reporting and monitoring procedures in place, a summary of which is included in this Report.

Notwithstanding control processes, in the last four years revenue windfalls have meant many expenditure pressures, beyond original budgets, have been met while continuing to achieve fiscal targets.

Given the restraint projected for expenses, the 2006-07 Budget is sensibly constructed on conservative revenue growth. There are a number of factors beginning to figure into the economy, notably rising interest rates and drought, that may lead to a more testing environment for expenditure control.

Coinciding with these factors is the Budget premise of achieving savings over four years of $695 million. Savings initiatives include the development of shared services and the abolishment of the Department of Administrative and Information Services (DAIS), a very large scale restructuring of government departments, and the implementation of Future ICT (Information and Communications Technology) arrangements. There will be considerable risks to manage in each of these initiatives. DAIS involves devolvement of activities to four agencies, the development of shared services creates a new entity and Future ICT includes disengagement from the arrangements under the former contract with EDS.

I have made observations in previous Reports of some principles I believe to be important when pursuing savings initiatives. To recap, I remain of the view that:

- when implementing savings initiatives, it is necessary for agencies to fully understand and fulfil their legislative responsibilities;

- where seeking savings through shared services, such arrangements need careful planning and risk analysis to be successful in both efficiency of costs and effectiveness for controlling and managing operations. Roles and responsibilities of all parties need to be clearly set out in well constructed service level agreements. Audit experience has shown that lack of clarity in roles leads to failure in control systems.

The Government has specific monitoring processes identified for the savings targets. It will be essential that timely and accurate data is available for these processes.

2.7.2 Net Lending

The 2006-07 Budget estimates higher total net acquisition of non-financial assets (capital spending) than past years.

There may be a heightened risk to the proper control and management of those outlays. Major projects carry high inherent risks including cost estimating, escalations and timeliness of completion. Sustained higher capital outlays than have been made in past years, need to be supported by appropriate project management expertise, controls and information systems.

2.7.3 Public Private Partnership Projects

A feature of the 2006-07 Budget is the announcement that the Government proposes to undertake substantial public private partnership (PPP) projects for the provision of correctional and educational infrastructure for use by the public sector. Private sector capital expenditure for the projects is estimated to be over $600 million, well above recent PPP projects. The Government has gained experience in the use of PPPs through recent projects for police/court complexes but at a much lower scale.

Procurement processes for PPPs of this scale will need to be well controlled to ensure value for money is achieved for contracted risks and benefits to the public.

2.8 CONCLUDING OBSERVATIONS

The 2006-07 Budget has been prepared on a consistent basis to past years in that revenue predictions are conservative, and expense projections restrained. Recent experience is that the State has benefited from sustained strength in both the local and national economy with resultant unbudgeted revenue gains covering expenditure increases.

The Budget indicates savings initiatives, higher capital outlays and the use of PPPs are all significant elements of the Budget strategy. Each of these are to some degree new initiatives by nature or scale. All new and large scale initiatives commence with a higher inherent risk while experience is gathered.

The Budget is also framed at a time when new pressures are arising in the economy through, for example, interest rate rises, drought, the potential for falling property values, and the record levels of equity markets.

In summary, there remain a range of risks to be managed to facilitate successful budget outcomes. As always, strong and effective controls based on sound information systems, reporting integrity and effective monitoring, will be needed to support achievement of the Budget targets.

3 REPORTING FRAMEWORK

3.1 INTRODUCTION

There are three reporting frameworks that are now used for reporting on the State's finances, namely the:

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

To allow for the analysis of (1) the financial performance, and (2) the financial position of the State, it is necessary to understand the nature and the application of each framework.

The UPF framework is based on the reporting standards of the Australian Bureau of Statistics' (ABS's) accrual-based framework.

The major proportion of the discussion and analysis in this Report is directed at reviewing information that is reported on the UPF basis for the Budget. Reference to other reporting framework based information is included as may be relevant.

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

3.2 UNIFORM PRESENTATION FRAMEWORK (UPF)

3.2.1 Background

The UPF is a reporting standard based on the ABS's accrual-based Government Financial Statistics (GFS) framework.[5] The UPF has been adopted by all Australian Government jurisdictions for the preparation and presentation of supplementary information reported in Budget and Budget Result documents prepared by each jurisdiction.

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

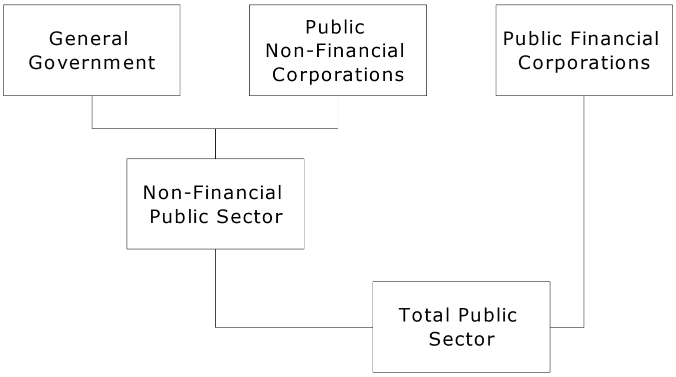
The GFS accrual reporting has many similarities to that under the AAS framework. There are, however, significant differences such as the GFS framework excludes revaluations from the GFS Operating Statement, as they are not transactions for the purposes of the GFS framework.

Notwithstanding these differences, the main statements emanating from GFS financial reporting are the (1) Operating Statement, (2) Balance Sheet and (3) Cash Flow Statement.

Another key aspect of the GFS framework is the identification of different sectors, recognising that state government responsibilities cover a wide range of activities.

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

Three sectors (which are then consolidated into two additional sectors) of government activity are identified in the following chart:



A description of the make-up of the three primary sectors is as follows.

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

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

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

The Budget Papers tabled in Parliament by the Government include a number of GFS financial statements as follows:

- General Government Sector Operating Statement and Balance Sheet.
- Public Non-Financial Corporation Sector Operating Statement and Balance Sheet.
- Non-Financial Public Sector Operating Statement and Balance Sheet.

Cash Flow Statements are also published for these sectors.

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

Key GFS Headline Amounts

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

- ***GFS Net Operating Balance*** — the excess of GFS revenues over GFS expenses.

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

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

- ***Net Debt*** — comprises certain financial liabilities less financial assets. The items included in this measure are discussed in depth in the Budget Papers.[6]

3.2.2 Scope of Audit Review of GFS Financial Statements

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

Work performed on the 2006-07 Budget year's GFS data has included some analytical procedures to ensure that the amounts presented are reasonably supported and where trends in data materially differ, that they can be adequately explained.

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

3.3 AUSTRALIAN ACCOUNTING STANDARDS (AAS)

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

3.3.1 Agency Financial Reports

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

Government agencies adopted Australian equivalents to International Financial Reporting Standards (AIFRS) for the first time in the published financial reports for the year ended 30 June 2006.

3.3.2 AAS Whole-of-Government Financial Statements

Whole-of-government financial reports for South Australia are prepared by the Department of Treasury and Finance (DTF) pursuant to Accounting Standard AAS 31 *Financial Reporting by Governments*.

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

---

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

3.3.3 Convergence of GFS and Australian Accounting Standards

The Australian Accounting Standards Board issued Australian Accounting Standard AASB 1049 *Financial Reporting of General Government Sectors by Governments* in September 2006.

AASB 1049 states its objective is:

> *to specify requirements for financial reports of the General Government Sector (GGS) of each government. These requirements are in addition to requirements for whole of government financial reports of each government. The Standard requires compliance with other Australian Accounting Standards except as specified in this Standard, and disclosure of additional information such as reconciliations to key fiscal aggregates determined in accordance with the ABS GFS Manual. Financial reports prepared in accordance with this Standard provide users with information about the stewardship of each government in relation to its GGS and accountability for the resources entrusted to it; information about the financial position, performance and cash flows of each government's GGS; and information that facilitates assessments of the macro-economic impact of each government's GGS.*

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

The Treasurer's Statements are prepared pursuant to the requirements of the *Public Finance and Audit Act 1987* (the Act) and reported as an Appendix to the Auditor-General's Report to Parliament.

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

4 SUMMARY OF KEY FISCAL MEASURES AND TARGETS

4.1 SOUTH AUSTRALIAN FISCAL TARGETS

The 2006-07 Budget Papers[7] indicate that the Government is committed to the following fiscal targets:

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

4.1.1 Net Operating Balance

The Government states that the cornerstone of the fiscal strategy for the future is the achievement of net operating balances or surpluses every year. This means that revenues are covering expenses, including interest and depreciation.

4.1.2 Ratio of Net Financial Liabilities to Revenue

Focus is also given to the ratio of net financial liabilities to revenue. Net financial liabilities is calculated as total liabilities less financial assets (excluding equity held in PNFCs and PFCs), such as cash, advances and investments. This measure is broader than net debt as it includes significant liabilities other than borrowings, such as unfunded superannuation and long service leave entitlements. The Government has stated that reductions in this ratio over time is desirable relative to other triple-A rated Australian states.

4.2 FISCAL MEASURES IN OTHER JURISDICTIONS

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

[7] Budget Statement 2006-07, Budget Paper 3, p1.5.

The following table summarises the current budget targets for each jurisdiction.

Jurisdiction	Budget Fiscal Objective/Strategy (a) (b)
Commonwealth	Maintain budget balance on average over the economic cycle (Fiscal Balance = 0).
	Maintaining surpluses over the forward estimates period while economic growth prospects remain sound.
NSW	Reduce the level of general government net financial liabilities as a share of GSP to 7.5 percent or less by 30 June 2010.
	Maintain general government underlying net debt as a share of GSP at or below its level as at 30 June 2005.
Victoria	Short Term: Target Operating Surplus of at least $100 million for the general government sector (measured on A-IFRS net result from transactions basis).
	Long Term: Maintain a substantial budget operating surplus.
Queensland	The Government will ensure that its level of service provision is sustainable by maintaining an overall general government operating surplus.
WA	Achieve operating surpluses for the general government sector.
Tasmania	Achieve, on average, a Net Operating Surplus for the General Government Sector.
	Maintain, on average, a Fiscal Surplus for the General Government Sector.
ACT	Achieve a General Government Sector Net Operating Surplus.
	Maintain Operating Cash Surpluses.
NT	To achieve a positive GFS operating balance in the general government sector by 2012-13.

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

4.3 SOME AUDIT OBSERVATIONS ON THE FISCAL MEASURES

There has been some change in other state's fiscal targets from the previous year. While it is evident that there is some variation between the jurisdictions, the most prevalent position is to target net operating surpluses in the general government sector, based on the GFS accrual method as is the position in this State.

NSW is the only other state to give specific focus to net financial liabilities.

5 BUDGET 2005-06 – ESTIMATED RESULT

5.1 OVERVIEW

The following section summarises the estimated GFS operating results for 2005-06.

5.2 ESTIMATED RESULT FOR 2005-06

5.2.1 General Government Sector

The estimated result for the year was a GFS net operating balance of $147 million (budget $51 million) and net lending result of $88 million (budget $10 million).

The following table shows 2004-05 financial year data and differences between the estimated result and budget for 2005-06.

Table 5.1 — GFS - General Government Budget Comparisons 2004-05 to 2005-06

	2004-05 Actual $'million	**2005-06 Budget $'million**	**2005-06 Estimated Result $'million**	Difference to Budget $'million	Difference to Budget Percent
GFS Revenue					
Taxation revenue	2 941	2 862	2 982	120	4
Current grants	5 206	5 427	5 502	75	1
Capital grants	212	182	197	15	8
Sales of goods and services	1 244	1 227	1 295	68	6
Interest income	161	154	155	1	1
Distributions from PFCs	125	115	115	-	-
Distributions from PNFCs	322	380	453	73	19
Other	382	373	390	17	5
Total Revenue	10 592	10 721	11 088	367	3
Less: **GFS Expenses**					
Gross operating expenses					
Employee expenses	4 649	4 780	4 992	212	4
Depreciation	453	456	456	-	-
Other operating expenses	2 805	3 014	2 848	(166)	(6)
Nominal superannuation interest expense	351	307	344	37	12
Other interest expense	248	242	221	(21)	(9)
Current transfers	1 824	1 853	1 978	125	7
Capital transfers	38	19	103	84	-
Total Expenses	10 368	10 670	10 942	272	3
GFS Net Operating Balance	224	51	147	96	-
Less: **Net Acquisition of Non-Financial Assets**					
Purchases of non-financial assets	695	636	653	17	3
Less: Sales of non-financial assets	119	139	138	(1)	(1)
Less: Depreciation	453	456	456	-	-
Add: Change in inventories	(18)	-	-	-	-
Total net acquisition of non-financial assets	105	41	59	18	44
GFS Net Lending (Borrowing)	119	10	88	78	-

Note: Totals may not add due to rounding.

As shown in the table, both the estimated net operating balance and net lending are lower than achieved in 2004-05. The reduction in the estimated result from the previous year's actual result was due to higher growth in expenses (up $574 million) than revenues (up $496 million) and lower purchases of non-financial assets (down $42 million).

The primary reasons for the changes from the original 2005-06 budget are as follows:

- ***Taxation Revenue*** — property taxes are expected to exceed budget, due mainly to stamp duties on conveyances, estimated to exceed budget by $116 million (24 percent) from a stronger than budgeted property market.
- ***Current Grants*** — the increase relates primarily to better than expected receipts of GST revenue grants (up $12 million) and specific purpose payments (up $51 million) from the Commonwealth.
- ***Sales of Goods and Services*** — the increase reflects better than expected receipts of regulatory fees (up $34 million) from land transfer fees.
- ***Distributions from PNFC's*** – due mainly to higher than expected distributions from Land Management Corporation (up $23.7 million), SA Water Corporation (up $23.4 million) and TransAdelaide (up $31 million).
- ***Expenses*** — up $272 million on budget, of which $212 million was employee expenses including $21 million for targeted voluntary separation payments.

5.2.1.1 Net Acquisition of Non-Financial Assets

The 2005-06 estimated result for purchases of non-financial assets is expected to exceed budget. The 2005-06 budget of $636 million for purchases of non-financial assets, included a slippage allowance[8] of $60 million. The practicality of capital works is that there are long lead times into commencement of projects and construction can be subject to delays.

Table 5.2 shows the composition of the budget and estimated results.

Table 5.2 — GFS – Purchases of Non-Financial Assets Budget to Estimated Result Comparisons 2005-06

	2005-06 Budget $'million	**2005-06 Estimated Result $'million**	Difference to Budget $'million
Gross purchases of non-financial assets	696	653	43
Less: Slippage	60	-	60
	636	653	17

The Budget Papers[9] show the estimated result for most portfolios was lower than budgeted. The total estimated result is due to slippage being lower than anticipated.

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

[8] Budget Statement 2006-07, Budget Paper 3, Table 2.24.

[9] Budget Statement 2006-07, Budget Paper 3, Table 2.24

5.2.2 Non-Financial Public Sector

The non-financial public sector (consolidating the general government and public non-financial corporations sectors) estimated result for the year was a GFS net lending result of $74 million, which is $178 million better than budget for the year.

The estimated result was $115 million lower than the previous year's result due to significantly higher estimated total expenses in 2005-06 compared to 2004-05.

The following table summarises the position.

Table 5.3 — GFS - NFPS Budget Comparisons 2004-05 to 2005-06

	2004-05 Actual $'million	**2005-06 Budget $'million**	**2005-06 Estimated Result $'million**	Difference to Budget $'million	Difference to Budget Percent
GFS Revenue	11 343	11 306	11 622	316	3
Less: **GFS Expenses**	11 029	11 290	11 512	222	2
GFS Net Operating Balance	314	16	110	94	-
Less: **Net Acquisition of Non-Financial Assets**	125	121	36	(85)	(70)
GFS Net Lending (Borrowing)	189	(104)	74	178	-

Note: Totals may not add due to rounding.

The key differences for the net operating balances are similar to those as explained for the general government sector, namely increases in taxation, current grants, sales of goods and services and spending on employee expenses and current transfers.

The net lending estimated result reflects underspending on purchases of non-financial assets by public non-financial corporations.

6 BUDGET 2006-07 OVERVIEW

6.1 OVERVIEW

The following focuses on the trends arising from the 2006-07 Budget tabled in Parliament in September 2006. It provides an overview of:

- the Budget for 2006-07 having regard to the estimated result for 2005-06;
- a longer term view of the forecast results going forward to 2009-10.

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

6.1.1 Matters of Significance to the 2006-07 Budget

Some matters of significance to the 2006-07 Budget estimates years, are:

- new expenditure initiatives totalling $1.4 billion over the next four years;[10]
- targeted savings totalling $695 million over four years;[11]
- revenues are expected to be $12.4 billion in 2009-10, a minimal increase in real terms compared to 2005-06;
- expenses are expected to be $12.1 billion in 2009-10, a minimal increase in real terms compared to 2005-06.

Total revenues and expenses for 2006-07 are higher than was budgeted in 2005-06. Total revenue for 2006-07 is now $11.3 billion, $296 million or 2.7 percent more than was estimated for 2006-07 in the previous, 2005-06 Budget.

Expenses, $11.2 billion for 2006-07 in the 2006-07 Budget are $283 million or 2.6 percent higher than was estimated at the time of the 2005-06 Budget.

The growth in revenue means that the Government was in a position to increase expenditure in the 2006-07 Budget to meet parameter and policy spending increases, while continuing to meet the new fiscal objective of at least a net operating balance for the general government sector.

6.2 GENERAL GOVERNMENT SECTOR – OPERATING STATEMENT

Both the budgeted net operating balance and the net borrowing result for 2006-07 are lower than the estimated results for 2005-06. The differences between the two years are set out in the following table.

[10] Budget Statement 2006-07, Budget Paper 3, Table 2.1.

[11] Budget Statement 2006-07, Budget Paper 3, Table 2.3.

Table 6.1 — GFS - General Government Sector Budget Comparison of 2005-06 Estimate Results and 2006-07 Budget

	2005-06 Estimated Result $'million	2006-07 Budget $'million	Difference $'million	Difference Percent
GFS Revenue				
Taxation revenue	2 982	3 086	104	3.5
Current grants	5 502	5 572	70	1.3
Capital grants	197	220	23	11.7
Sales of goods and services	1 295	1 322	27	2.1
Interest income	155	171	16	10.3
Distributions from PFCs	115	29	(86)	(74.8)
Distributions from PNFCs	453	457	4	0.9
Other	390	407	17	4.4
Total Revenue	11 088	11 264	176	1.6
Less: **GFS Expenses**				
Gross operating expenses				
Employee expenses	4 992	5 215	223	4.5
Depreciation	456	481	25	5.5
Other operating expenses	2 848	2 948	100	3.5
Nominal superannuation interest expense	344	316	(28)	(8.1)
Other interest expense	221	204	(17)	(7.7)
Current transfers	1 978	1 897	(81)	(4.1)
Capital transfers	103	112	9	8.7
Total Expenses	10 942	11 173	231	2.1
GFS Net Operating Balance	147	91	(56)	(38.1)
Less: **Net Acquisition of Non-Financial Assets**				
Purchases of non-financial assets	653	780	127	19.4
Less: Sales of non-financial assets	138	90	(48)	(34.8)
Less: Depreciation	456	481	25	5.5
Total Net Acquisition of Non-Financial Assets	59	209	150	-
GFS Net Lending (Borrowing)	88	(118)	(206)	-

Note: Totals may not add due to rounding.

It can be seen from the above table that the difference for the 2006-07 year is due mainly to:

- total revenue rising less than inflation (CPI is forecast to be 3.25 percent for South Australia in 2006-07);[12]
- total expenses also rising less than inflation notwithstanding increases in major spending lines; employee expenses and other operating expenses, in line with or above the level of CPI for 2006-07;
- an increase in total net acquisition of non-financial assets of $150 million, noting that purchases of non-financial assets for 2006-07 is $127 million higher than 2005-06 after allowing for a provision for capital slippage of $90 million.

12 Budget Statement 2006-07, Budget Paper 3, Table 8.1.

A notable feature is the reduction in distributions from PFCs, down to $29 million, from $115 million in 2005-06.

More detail of the factors influencing the 2006-07 Budget is considered in the context of the longer-term trends discussed later in this Report.

6.2.1 Reconciliation of Variations since 2005-06 Budget

Each year a reconciliation is provided in the Budget Papers of the current budget estimates with the corresponding estimates for the previous year. This allows the reader to understand differences between budgets arising from what the Government categorise as parameter and policy changes.

'Parameter changes' are those that flow from other than policy choices. For revenue they include taxation changes from economic activity and revenue from the Commonwealth. For operating expenses they include carry over of expenses between years from timing effects, reclassifications and corrections.

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

The following table summarises all parameter and policy changes made since the 2005-06 Budget that affect the net operating balance.[13]

Table 6.2 — Reconciliation of General Government Sector Net Operating Balance

	2005-06 Estimated Result $'million	2006-07 Budget $'million	2007-08 Estimate $'million	2008-09 Estimate $'million
2005-06 Budget	**51**	**78**	**109**	**75**
Parameter and other variations				
Revenue - taxation	120	101	115	141
Revenue - other	252	185	184	218
Operating expenses	(155)	(116)	(130)	(189)
Net Effect of Parameter and Other Variations	**217**	**170**	**169**	**170**
Policy measures				
Revenue - other	(1)	1	7	8
Revenue - taxation	(6)	6	39	34
Revenue offsets	3	2	0	1
Operating expenses	(217)	(223)	(222)	(164)
Net Effect of Policy Measures	**(221)**	**(214)**	**(176)**	**(121)**
Use of Provisions Set Aside in the 2005-06 Budget and the 2005-06 MYBR				
Operating expenses	100	57	61	63
2006-07 Budget	**147**	**91**	**162**	**188**

Note: Totals may not add due to rounding.

13 Budget Statement 2006-07, Budget Paper 3, Table 1.7.

Revenues

The table shows that revenue changes since the 2005-06 Budget are almost entirely due to parameter changes.

The following table shows the components of revenue parameter changes.

Table 6.3 — Revenue Parameter Changes

	2005-06 Estimated Result $'million	**2006-07 Budget $'million**	**2007-08 Estimate $'million**	**2008-09 Estimate $'million**
Property related taxes	131	121	129	150
Distributions from PNFC's	80	80	34	52
Commonwealth SPP's	48	37	65	103
Royalties	29	24	21	22
Payroll tax	17	22	28	36
GST revenue grants	15	(29)	(9)	(7)
Other	52	31	31	3
Total	**372**	**286**	**299**	**359**

Operating Expenses

Table 6.2 shows that parameter effects are estimated to add operating expenses of $590 million over the four years to 2008-09.

Policy spending decisions have the greater effect on estimated results, adding $826 million to operating expenses over the four year period.[14]

Some of these increases are offset by the use of provisions set aside in the 2005-06 Budget.

6.3 PUBLIC NON-FINANCIAL CORPORATION SECTOR – OPERATING STATEMENT

The 2006-07 Budget projects a deficit in 2006-07 of $51 million ($37 million 2005-06) for the net operating balance and a net borrowing result for the public non-financial corporation (public trading enterprises) of $104 million ($14 million net borrowing in 2005-06). Both are lower than the estimated results for 2005-06.

Increased budgeted purchases of non-financial assets together with the budgeted net operating deficit result in the budgeted net borrowing of $104 million.

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

[14] Policy details are in Budget Statement 2006-07, Budget Paper 3, tables 2.6-2.18.

Table 6.4 — GFS - PNFC Budget Comparison 2005-06 and 2006-07

	2005-06 Estimated Result $'million	2006-07 Budget $'million	Difference $'million	Difference Percent
GFS Revenue				
Sales of goods and services	1 338	1 331	(7)	(0.5)
Other	596	576	(20)	(3.4)
Total Revenue	1 935	1 906	(29)	(1.5)
Less: **GFS Expenses**				
Gross operating expenses	1 352	1 325	(27)	(2.0)
Other expenses	619	630	11	1.8
Total Expenses	1 972	1 957	(16)	(0.8)
GFS Net Operating Balance	(37)	(51)	(14)	37.8
Less: **Net Acquisition of Non-Financial Assets**				
Purchases of non-financial assets	351	433	82	23.4
Less: Sales and depreciation	373	380	7	1.9
Total Net Acquisition of Non-Financial Assets	(23)	53	76	-
GFS Net Lending (Borrowing)	(14)	(104)	(90)	-

Note: Totals may not add due to rounding.

6.4 NON-FINANCIAL PUBLIC SECTOR – OPERATING STATEMENT

The result for the non-financial public sector reflects the combination of the general government and public non-financial corporation sectors. The budgeted result for the non-financial public sector is net borrowing of $222 million, that is a deterioration of $296 million from the 2005-06 estimated result as previously explained.

6.5 A LONGER TERM PERSPECTIVE OF FINANCIAL PERFORMANCE

The following sections provide additional details on individual elements of the GFS general government sector Operating Statement in a historical perspective.

6.5.1 General Government Sector Operating Statement Time Series

Table 6.5 provides a 10 year time series for those individual elements that contribute to the budget result.[15]

[15] Time series data for all sectors are available in the Appendices to the Budget Statement 2006-07, Budget Paper 3.

Table 6.5 — GFS - General Government Sector Operating Statement - Time Series

	2000-01	2001-02	2002-03	2003-04	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
						Estimated				
	Actual	Actual	Actual	Actual	Actual	Result	Budget	Estimate	Estimate	Estimate
GFS Revenue	$'million	$'million	$'million	$'million	$'million	$'million	$'million	$'million	$'million	$'million
Taxation revenue	2 197	2 193	2 431	2 806	2 941	2 982	3 086	3 179	3 294	3 410
Current grants	3 992	4 485	4 638	4 906	5 206	5 502	5 572	5 796	5 964	6 184
Capital grants [(a)]	221	228	209	191	212	197	220	270	249	286
Sales of goods and services	982	902	997	1 165	1 244	1 295	1 322	1 371	1 403	1 448
Interest income	169	131	146	172	161	155	171	167	171	178
Distributions from PFCs	44	50	332	96	125	115	29	22	22	23
Distributions from PNFCs	278	241	300	373	322	453	457	408	429	400
Other	225	308	293	246	382	390	407	422	420	422
Total Revenue	8 108	8 538	9 346	9 955	10 592	11 088	11 264	11 636	11 952	12 351
***Less:* GFS Expenses**										
Gross operating expenses										
Employee expenses	3 517	3 828	3 997	4 313	4 649	4 992	5 215	5 452	5 602	5 778
Depreciation	322	390	401	435	453	456	481	502	514	537
Other operating expenses	2 376	2 270	2 126	2 305	2 805	2 848	2 948	3 020	3 117	3 264
Nominal superannuation interest expense	248	244	299	354	351	344	316	317	317	317
Other interest expense	353	272	297	253	248	221	204	200	207	216
Current transfers	1 545	1 663	1 724	1 894	1 824	1 978	1 897	1 897	1 924	1 946
Capital transfers	43	44	54	16	38	103	112	86	83	84
Total Expenses	8 406	8 713	8 898	9 570	10 368	10 942	11 173	11 473	11 764	12 143
GFS Net Operating Balance	(297)	(174)	448	385	224	147	91	162	188	208
***Less:* Net Acquisition of Non-Financial Assets**										
Purchases of non-financial assets	457	508	474	530	695	653	780	955	982	1 055
Less: Sales of non-financial assets	30	171	41	124	119	138	90	61	74	88
Less: Depreciation	322	390	401	435	453	456	481	502	514	537
Add: Change in inventories	(3)	3	2	(10)	(18)	-	-	-	-	-
Total net acquisition of non-financial assets	102	(50)	34	(38)	105	59	209	392	393	430
GFS Net Lending/(Borrowing)	(399)	(124)	414	424	119	88	(118)	(230)	(206)	(223)

Note - Totals may not add due to rounding.

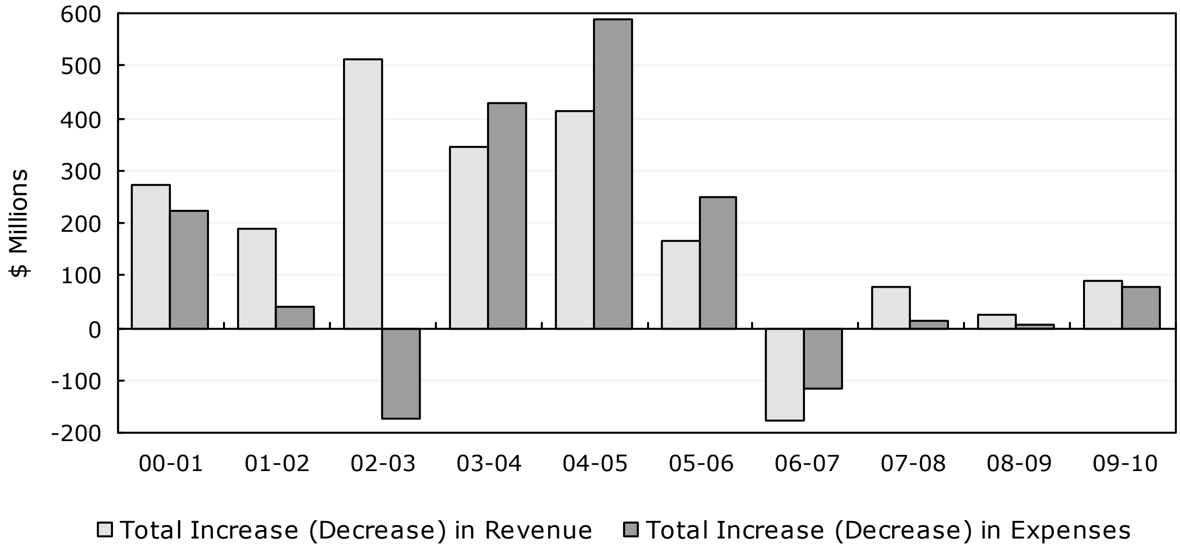
(a) Capital grants prior to 2002-03 are reported separately for the first time.

6.5.2 Net Operating Balance Influences

Net operating balances or surpluses are regarded as the cornerstone of the Government's revised fiscal targets. It is important to consider how the net operating balance, determined by GFS revenues less GFS expenses, is proposed to be achieved.

The following chart shows the increase or decrease, in real terms, of total revenue and total expenses to the previous year for the 10 years to 2009-10.

Chart 6.1 — Increase/Decrease of Total Revenue and Total Expenses to Previous Year [(a)]



(a) Estimated June 2006 values.

It can be seen that total revenues increased or are estimated to increase in real terms by varying amounts in each of the six years to 2005-06. Total revenues are then estimated to reduce in real terms in 2006-07 and then grow thereafter, although at much lower levels than earlier years.

In the six years to 2005-06, only in 2002-03 is there a decrease in expenditure in real terms. The 2006-07 Budget projects decreases in expenses in 2006-07 of $118 million in real terms from 2005-06.

Small increases are forecast in real terms after 2006-07.

The projected current operating surplus for the four years of the 2006-07 Budget is therefore subject to highly constrained expenditure. This was the case in the past budgets.

The chart, however, shows that experience to 2005-06 of achieving low growth or reductions in expenses is limited and indeed that growth in revenues has reduced the risk of expenditure increases to the budget bottom line. Given the forecast expectation that such revenue growth may not be sustained, control of expenses will be important.

7 REVENUE

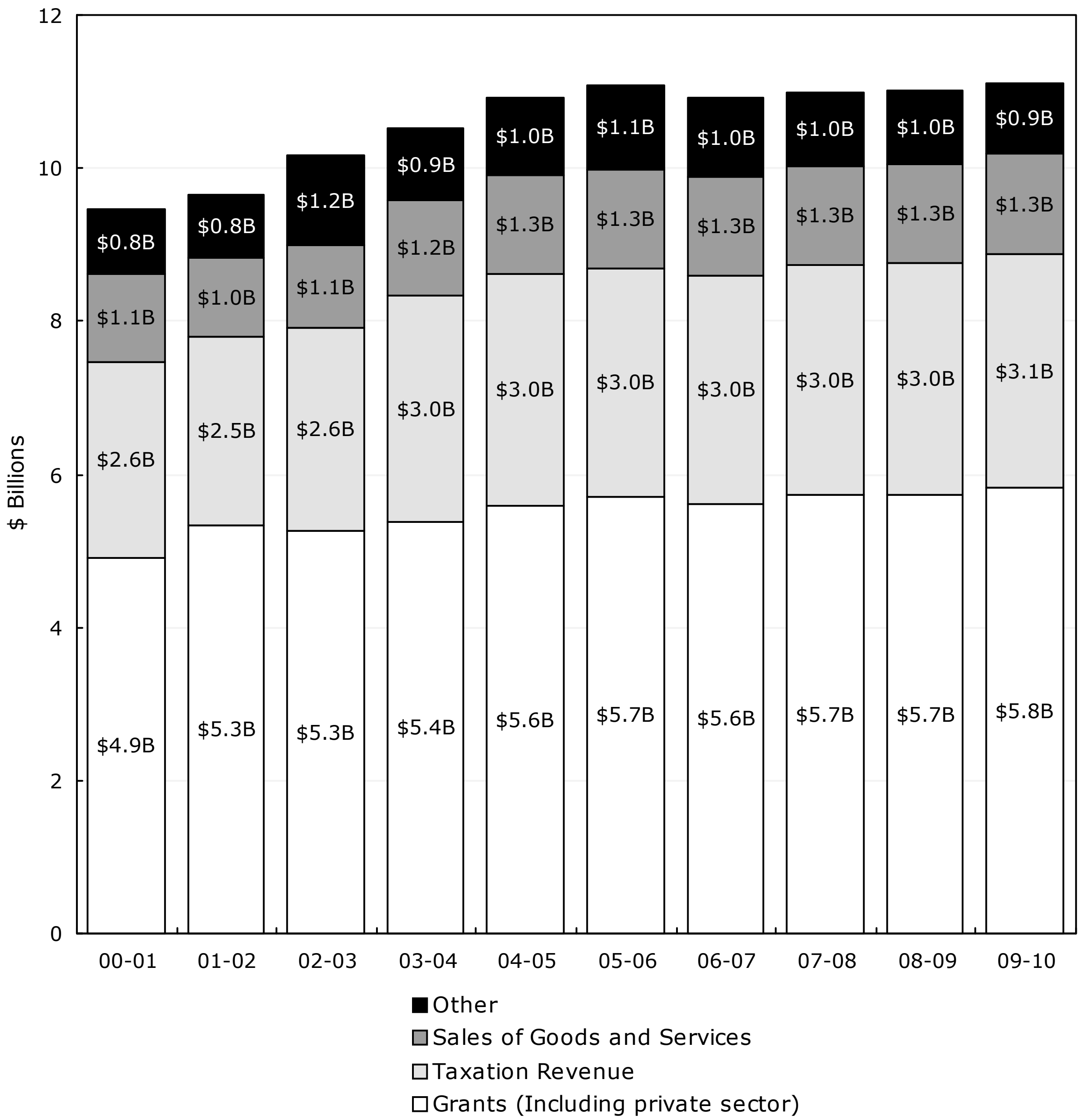
7.1 REVENUE OVERVIEW

Total General Government Sector GFS revenues are estimated to be $11.3 billion in 2006-07, an increase of $176 million (1.6 percent) over the previous year's estimated result

General Government Sector GFS revenues are estimated to rise to $12.4 billion in 2009-10.

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

Chart 7.1 — General Government Sector GFS Revenues (Real)[(a)]



(a) Estimated June 2006 values.

Notable trends for revenue are:

- There were very significant changes to the composition and amount of revenue in the period up to 2004-05.
- As from 2004-05 to the end of the forward estimate period in 2009-10 the level and composition of GFS revenue is projected to remain fairly stable in real terms.
- The State is reliant on Commonwealth grants. They represent 51 percent of total revenue.

The following commentary provides some additional analysis of the main revenue areas. Detailed commentary is provided in Chapter 3 of Budget Statement 2006-07.

7.1.1 Commonwealth Grants

From 1 July 2000, foremost in the changes in the composition of revenue was the effects of the national tax reform and revised Commonwealth-State funding arrangements. Under these arrangements some State taxes have been abolished or reduced. These losses to the State are compensated by Commonwealth funding in the form of GST revenue grants and, up to 2002-03, transitional grants.

GST revenues are expected to be a growth tax that will provide revenue benefits to the State.

Total estimated Commonwealth funding to the State for 2006-07 is $5.7 billion. Funding in 2009-10 is expected to grow to $6.4 billion, (52 percent of GFS revenues) a real increase of $147 million over 2005-06.

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

7.1.1.1 General Purpose Payments

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

Over the forward estimates, GPPs are expected to grow from $3.6 billion in 2006-07 to $4.1 billion in 2009-10, a real increase of $164 million from 2005-06.

7.1.1.2 Specific Purpose Payments

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

Over the forward estimates, SPPs are expected to grow from $2.1 billion in 2006-07 to $2.3 billion in 2009-10, a real decrease of $17.7 million from 2005-06. The Commonwealth committed to not cutting aggregate SPPs as part of the national tax reform arrangements. The Budget Papers show that this commitment is being met in real per capita terms.[16]

[16] Budget Statement 2006-07, p4.12

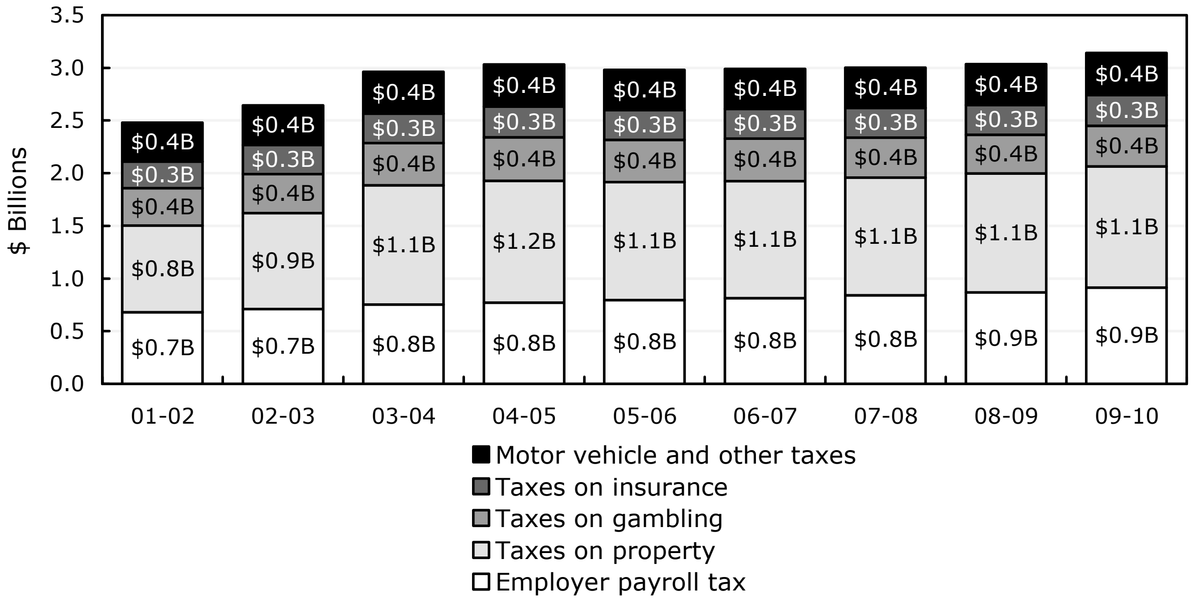
7.1.2 Taxation Revenue

Taxation revenue is the second largest source of revenue to the State and represents approximately 27 percent of GFS revenues in 2005-06. Taxation revenue comprises collections from a diverse range of activities, including payroll, property, motor vehicles and gambling activities.

The Government has a fiscal strategy to ensure the State has an effective tax regime having regard to the Government's social and economic objectives. Considerations in relation to the State's capacity to raise taxation revenue include the capacity of taxpayers to pay and the State's relative tax effort compared to other states and territories.[17]

The following chart examines the trend in the components of taxation receipts (in real terms) over the nine year period to 2009-10.

Chart 7.2 — Taxation Revenue (Real) (a)



(a) Estimated June 2006 values.

The chart demonstrates that taxation revenue increases in real terms over the period to 2004-05, falls in 2005-06 and rises steadily over the remaining forward estimates period.

Taxation receipts for 2006-07 are estimated to be $3.1 billion, a nominal increase of $104 million over the estimated result for 2005-06. Growth in other taxation revenues is sufficient to offset a projected fall in conveyance duty revenue resulting in an $8 million increase in taxation revenue in real terms for 2006-07.

Taxation revenue is expected to be $3.4 billion in 2009-10, a real increase of $85 million compared to $3.0 billion in 2005-06.

7.1.2.1 Property Taxes

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

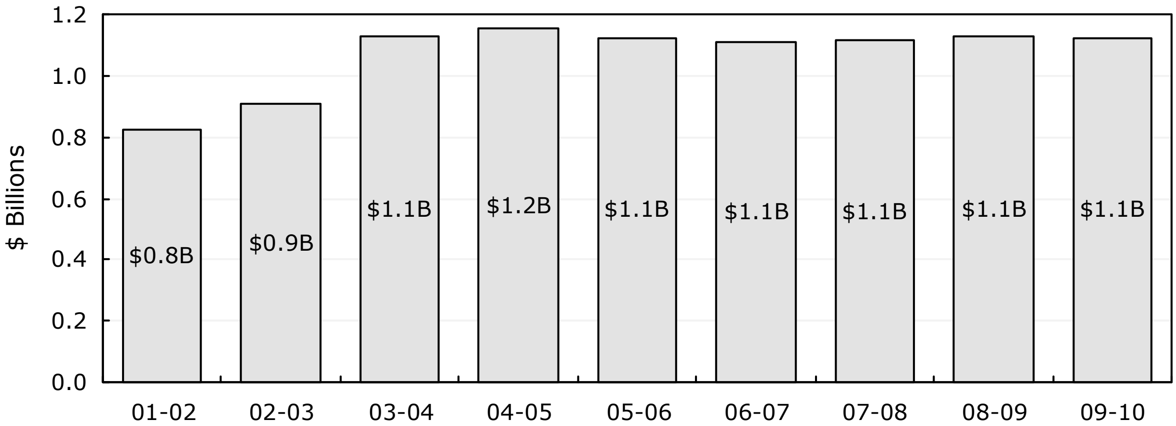
[17] Budget Statement 2006-07, p3.15-3.16 discusses South Australia's relative taxation effort.

Property taxes for 2006-07 are estimated to be $1.1 billion, a real decrease of $11 million from the estimated result for 2005-06, reflecting a projected weakening in property market conditions.

Property taxation revenue is expected to be $1.2 billion in 2009-10, no real increase compared to 2005-06.

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

Chart 7.3 — Taxes on Property (Real) [(a)]



(a) Estimated June 2006 values

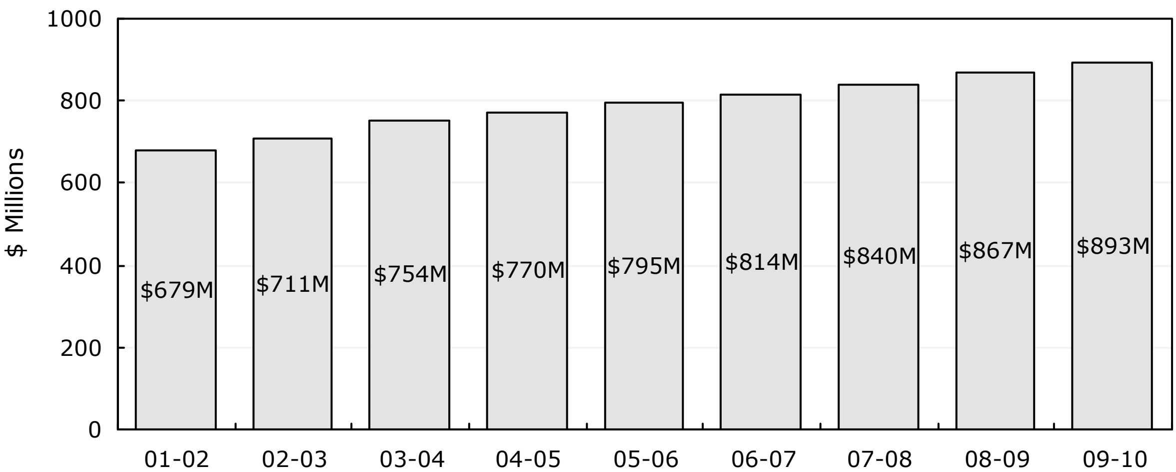
The chart shows that notwithstanding unexpected resilience in 2005-06, property taxes, in real terms, peaked in 2004-05.

The trend in the forward estimates period reflects an expectation that property prices will grow broadly in line with inflation and that property turnover is projected to fall in 2006-07 with a gradual return by 2009-10 to levels consistent with the long–term trend.

7.1.2.2 Payroll Tax

Payroll tax continues to be a principal source of taxation revenue. As indicated in the following chart, payroll tax revenue is anticipated to increase consistently in real terms over the forward estimates.

Chart 7.4 — Employer Payroll Tax (Real) [(a)]



(a) Estimated June 2006 values

Payroll taxes for 2006-07 are estimated to be $840 million, a real increase of $19 million from the estimated result for 2005-06.

Payroll taxes are expected to be $993 million in 2009-10, a real increase of $98 million compared to 2005-06.

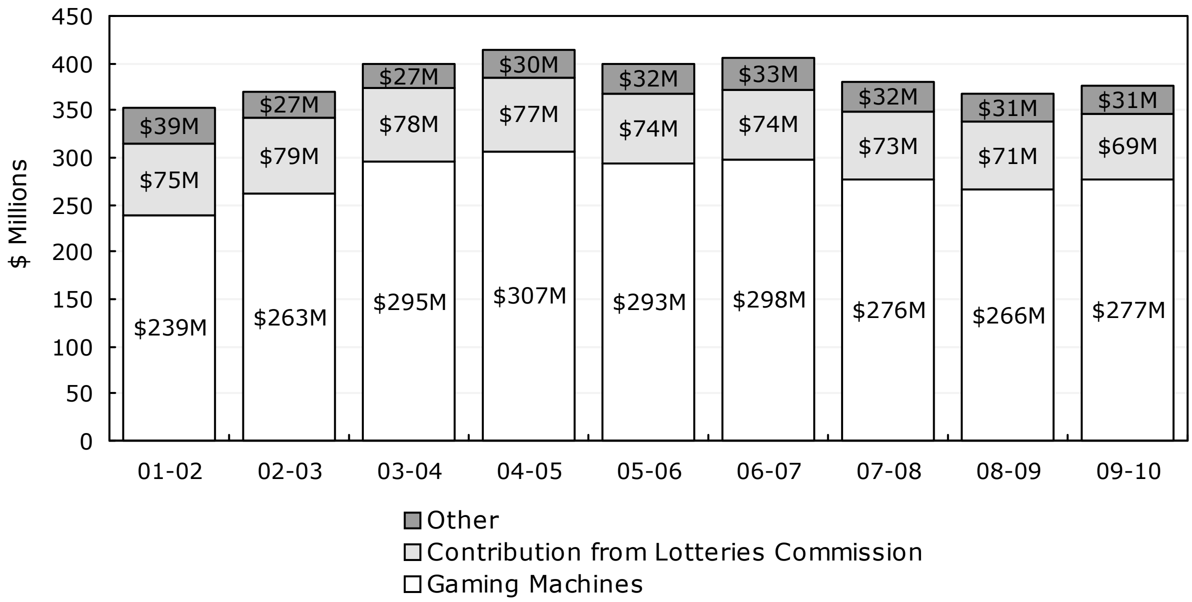
The growth in payroll tax revenue over the forward estimates period reflects estimated growth in the payroll tax bases of 5.5 percent per annum.

7.1.2.3 Gambling Taxes

Gambling taxes for 2006-07 are estimated to be $418 million, a real increase of $5 million from the estimated result for 2005-06. Gambling taxes are expected to be $420 million in 2009-10, a real decrease of $22 million compared to 2005-06.

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

Chart 7.5 — Gambling Taxes (Real) [(a)]



(a) Estimated June 2006 values

Gaming machine revenues which account for 73 percent of 2005-06 gambling taxes, are expected to decline in 2007-08 and 2008-09 before increasing broadly in line with household spending.

The projected decline in gaming machine revenue reflects the expected impact of 100 percent smoking bans in gaming venues from 31 October 2007.

7.1.3 Sales of Goods and Services

Revenue from sales of goods and services represented about 12 percent of estimated GFS revenues in 2005-06. Sales of goods and services by the general government sector include Government fees and charges which are set on a cost recovery basis and adjusted annually broadly in line with inflation.

Consequently, revenue from sales of goods and services is fairly stable over the forward estimates period at about $1.3 billion (real terms) through to 2009-10.

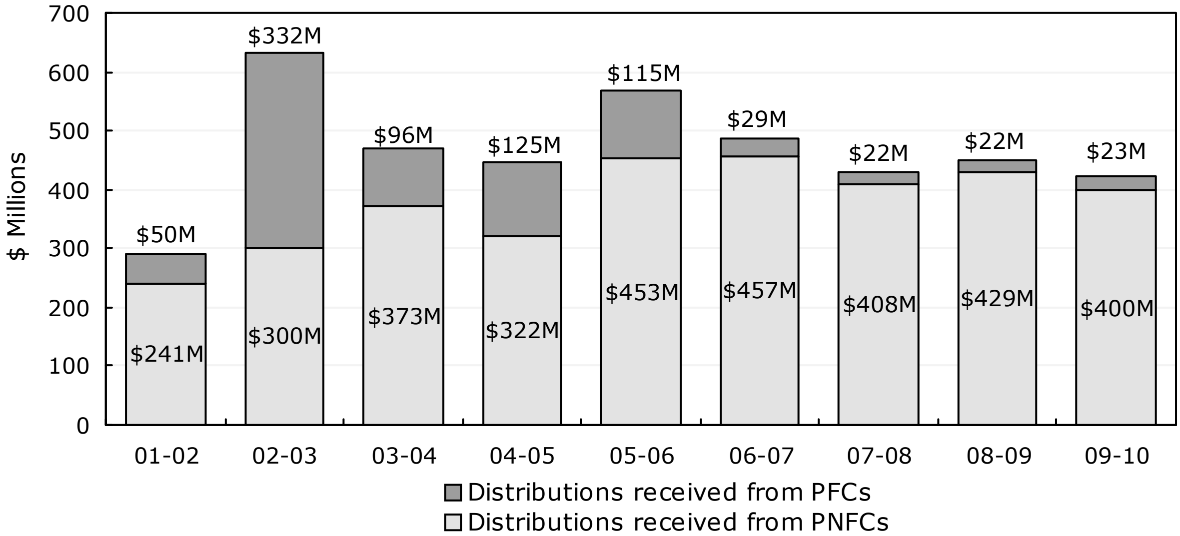
7.1.4 Other Revenue

The more significant components of Other revenue are the distributions received from public non-financial corporations (PNFCs) and public financial corporations (PFCs), which comprise essentially tax equivalent payments, dividends and returns of accumulated capital. Distributions from PNFCs and PFCs, are significant not only in terms of their size, but because in past years they provided an opportunity for the Government to 'manage' the bottom line given their discretionary nature. This flexibility is limited essentially only by amounts available.

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

Chart 7.6 shows the trend in distributions received from PNFCs and PFCs for the nine years to 2009-10.

Chart 7.6 — Distributions Received by the General Government Sector (Nominal)



The chart highlights the variability of revenue from PNFC and PFC distributions over the period.

7.1.4.1 Public Non-Financial Corporations

In 2005-06, distributions received from PNFCs are estimated to amount to $453 million, an increase of $132 million (41 percent) from the previous year's result and $73 million (19 percent) above budget. The increase mainly reflects higher dividend payments from TransAdelaide, SA Water, Land Management Corporation and Forestry SA.

The higher TransAdelaide dividend in 2005-06 is the result of proceeds received from the sale of tram infrastructure to the Department for Transport, Energy and Infrastructure.

A large part of the increased distribution from SA Water reflected the profit effect of an increase of $49 million in community service obligation funding to SA Water associated with new ownership arrangements introduced by the Government in 2005-06.[18]

---

[18] Budget Statement 2006-07, Budget Paper 3, page 6.2.

7.1.4.2 Public Financial Corporations

Up to 2005-06, the main source of revenue from PFCs was from the South Australian Assets Management Corporation (SAAMC) and South Australian Government Financing Authority (SAFA).

As seen in Chart 7.6, distributions from PFCs have varied greatly from year to year entirely at the discretion of the Government of the day.

Distributions from PFCs are budgeted to be $28.5 million in 2006-07[19] and reduce to around $22 million thereafter.

As at 30 June 2006 SAFA's capital and reserves totalled $123 million and SAAMC's capital and reserves was $61 million.

The distributions projected to 2009-10 are estimated to result in SAFA's total capital and reserves remaining around $123 million, and reduce SAAMC's capital and reserves to around $55 million.

As a result, the level of earnings that those entities could be expected to make in future periods (beyond the forward estimates) will not be able to sustain distributions at levels near those that have been reflected in the four years to 2005-06.

7.2 RISKS TO REVENUE

The Budget Statement 2006-07 provides quite detailed consideration of various risks to the amount and the flexibility of the revenue budget. Included in the risk analysis is:

- ***Taxation and Royalties*** — a variance of 1 percent in taxation and royalty revenue equates to about $32 million per annum.

- ***Commonwealth General Purpose Grants*** — A variance of 1 percent in GST revenue growth has a revenue impact of $33 million per annum.

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

  A 0.01 change in South Australia's GST relativity results in a change in GST revenue grants of $35 million.

- ***Commonwealth Specific Purpose Grants*** — Funding levels of SPPs are exposed to the risk of variability in the parameters that determine funding levels and variability in Commonwealth policy settings.

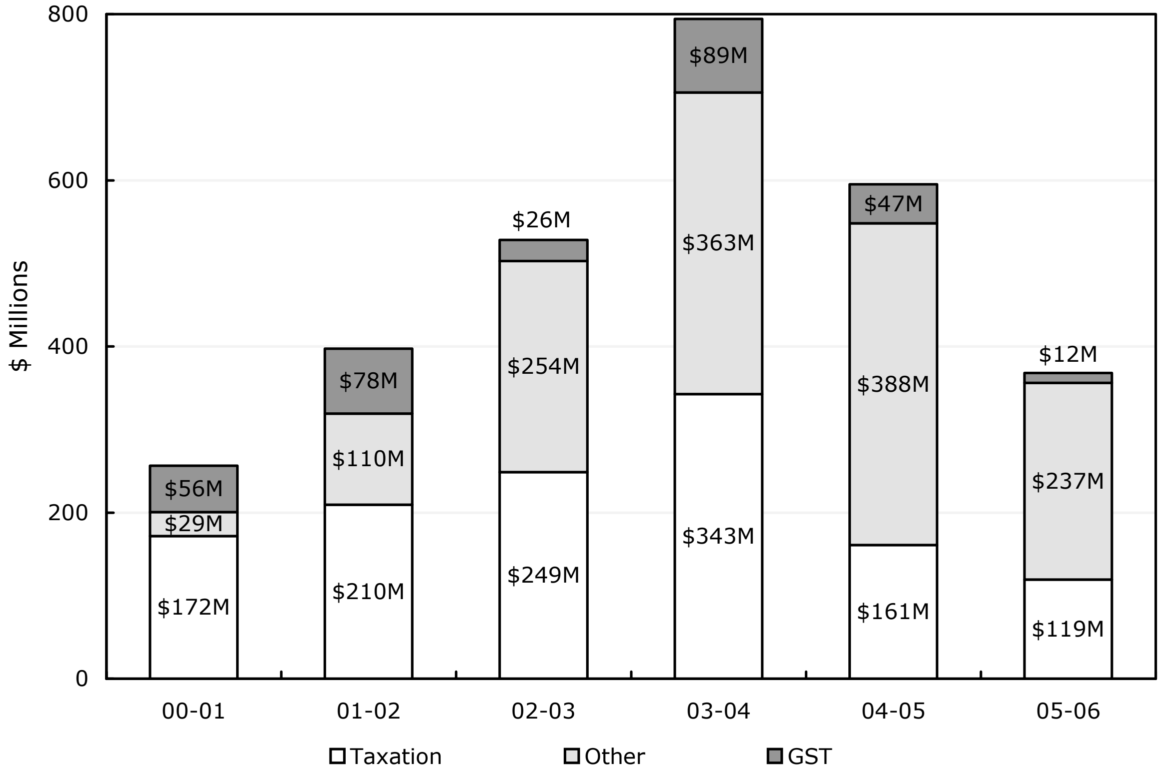
Readers are referred to the Budget Statement 2006-07, Budget Paper 3, Chapter 7 for the full details.

[19] Budget Statement 2006-07, Budget Paper 3, Table 3.14.

7.2.1 Past Revenue Outcomes

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

Chart 7.7 — GFS - Difference Between Budget and Actual Revenues*



* 2005-06 estimated result

The chart highlights that the main contributors to variations from budget are taxation and other revenue.

8 EXPENSES

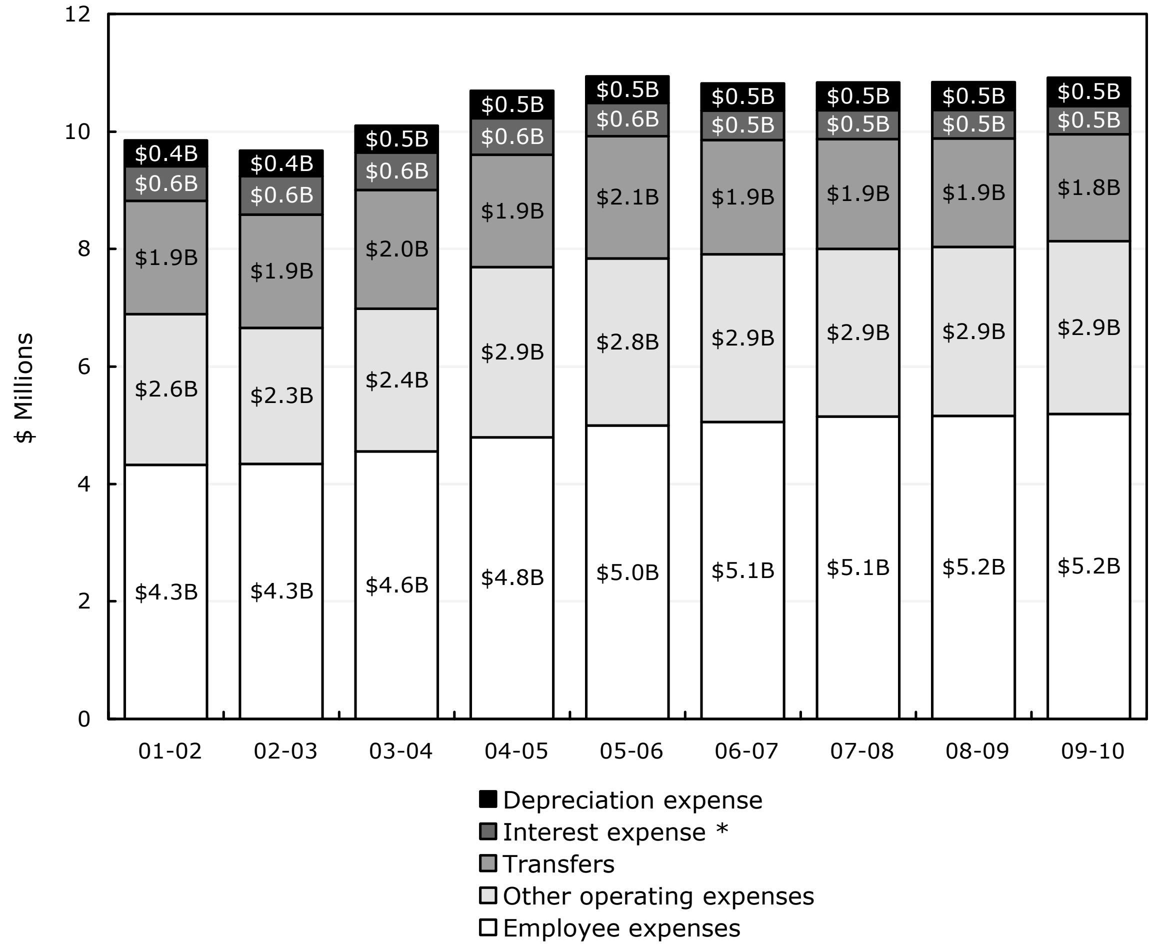
8.1 EXPENSES OVERVIEW

For 2005-06 estimated GFS expenses total $10.9 billion and exceed budget by $272 million or 2.5 percent.

Total GFS expenses for 2006-07 are budgeted to be $11.2 billion, $231 million or 2.1 percent higher than 2005-06 and grow to $12.1 billion in 2009-10, a real decrease of 0.2 percent from 2005-06.

The following chart highlights the trends in GFS expenses (in real terms) that have emerged since 2001-02.

Chart 8.1 — GFS - General Government Sector - Expenses (Real) (a)



(a) Estimated June 2006 values.
* Includes nominal superannuation interest expense.

The chart shows GFS expenses (in real terms) grew annually from 2002-03 to 2005-06 but are projected to remain relatively stable over the forward estimate period.

The following discussion focuses on some of the major components that make up GFS expenses. Detailed comments on expenditure are provided in Budget Statement 2006-07, Budget Paper 3, Chapter 2.

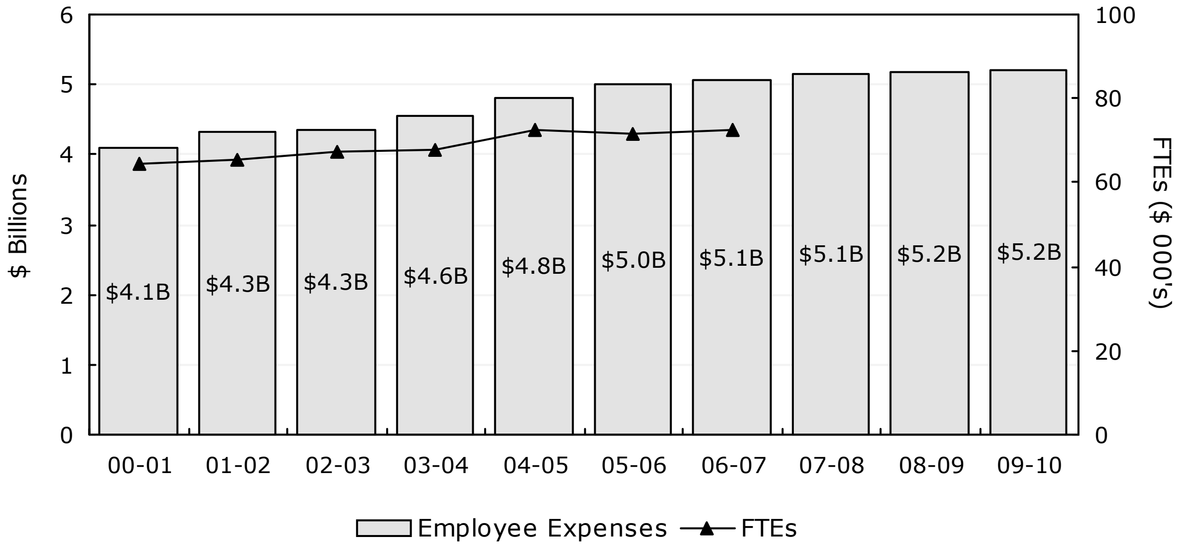
8.2 EXPENSES BY TYPE

8.2.1 Employee Expenses

Employee expenses (an estimated $5.0 billion in 2005-06) represent the highest proportion (46 percent) of GFS expenses. They are estimated to increase by 4.5 percent in 2006-07 and about 3.5 percent per year to 2009-10.

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

Chart 8.2 — GFS - General Government Sector – Employee Expenses (Real) and FTEs[(a)]



(a) 2005-06 and 2006-07 are Department of Treasury and Finance estimates. OPE data is derived for the sector and is the best available information for the periods shown.

The chart highlights the real terms growth in employee expenses right across the period charted. This growth coincides with FTE numbers up to 2004-05.

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

In the three years to 2005-06 employee expenses grew by about 4.8 percent per year. The 2006-07 Budget projects employee expenses to grow in real terms on an average of 1 percent, a much lower rate than in prior years.

The 2006-07 Budget provides for anticipated public sector wage increases over the forward estimates period, both in individual agency budgets, and as a contingency item in the 'Administered Items for Department of Treasury and Finance' to cover future enterprise agreement outcomes. The 2006-07 Budget includes contingency amounts of $20 million for employee entitlements, $50 million less than was included in the 2005-06 Budget. The reduction is partly explained by the recent settlement of number of enterprise agreement outcomes. Contingency funds may also be transferred from other lines where available (see following section on operating expenses) if necessary. The inclusion of contingencies is a consistent approach to previous Budgets.

The major risk to the Budget and, in particular the forward estimates, is the outcomes from enterprise agreements and control of FTE numbers. The main enterprise agreement to be renegotiated in 2006-07 is the Wages parity (salaried) group due in October 2006.

8.2.2 Other Operating Expenses

Other operating expenses include general purchases of goods and services.

The 2006-07 Budget allows for CPI growth over the forward estimates and incorporates a savings component. These expenses are estimated to be $2.9 billion for 2006-07, an increase of $100 million or 3.5 percent in nominal terms from 2005-06.

The projection for the forward years to 2009-10 is for no real growth in other operating expenses. As seen in Chart 8.1, this is consistent experience in 2004-05 and 2005-06.

Contingency amounts have also been incorporated into the budget to provide some flexibility if additional expenditure is required to be made by the Government. The 2006-07 Budget includes contingency amounts of $102 million for supplies and services, $50 million less than was included in the 2005-06 Budget.

8.2.3 Transfer Payments

Transfer payments from the general government sector represent payments to other sectors of government and the private sector. These transfers include:

- grants to non-government schools, local government and industry;
- appropriations for the South Australian Housing Trust and TransAdelaide; and
- community service obligation (CSO) payments to the South Australian Water Corporation and Forestry SA.

Transfer payments are estimated to be $2.1 billion for 2005-06, that is, $209 million or 11 percent above budget.

The increase in transfers included one-off grants being provided in 2005-06 to a number of organisations including; South Australian Cricket Association ($16 million); South Australian National Football League ($13 million); and an amount of Commonwealth Debt Redemption Assistance being paid to SAFA which was $26 million higher than the amount received in previous years.

8.2.4 Interest Expense

Estimated interest expense in 2005-06 was $221 million.

Interest expense is projected to increase marginally over the forward estimate period as a result of projected net lending deficits, to fund capital programs.

Further discussion in relation to debt movements is provided in the section under the heading ‘9.6 - Net Debt’.

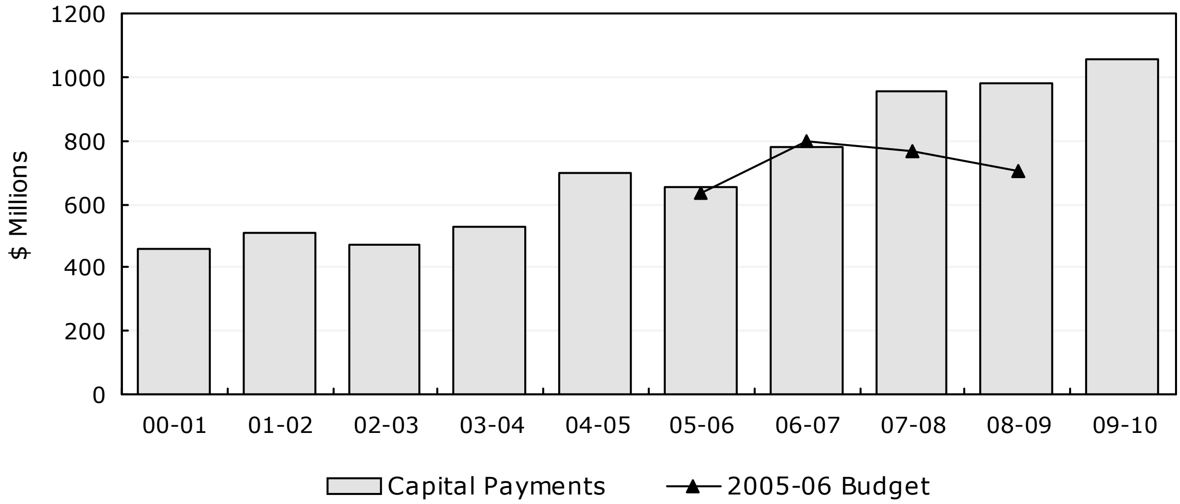
8.2.5 Capital Payments

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

Purchases of non-financial assets are estimated to be $653 million in 2005-06, increase to $780 million in 2006-07 and increase each year of the forward estimates.

The following chart shows purchase of non-financial assets over the 10 year period to 2009-10, overlayed with budgeted purchases from the 2005-06 Budget.

Chart 8.3 — GFS - General Government Sector Purchase of Non-Financial Assets (Nominal)



The chart shows the variability of the expenditure, both historically and in the forward estimates and the large increases projected for the 2006-07 Budget, particularly compared to that estimated for the 2005-06 Budget.

Although there will be components of future expenditure that have effectively been committed, the forward years contain funds contingent on future approvals of between $16 million (in 2006-07) and $517 million (in 2009-10).

To put this into perspective, although large amounts have been identified as contingent, or yet to be committed, this establishes a base of capital expenditure that is earmarked for this purpose. By this commitment there is recognition of the need for ongoing maintenance and improvement of public infrastructure.

8.2.5.1 Infrastructure Planning

I have previously commented that proper infrastructure planning is fundamental to the efficient and effective use of public resources.

The Strategic Infrastructure Plan for South Australia was released on 6 April 2005. The Plan has been used to guide new infrastructure development and the 2006-07 Budget includes funding for major infrastructure projects which form part of the Plan, including:

- major infrastructure development by the Port Adelaide Maritime Corporation to support the Air Warfare Destroyer program;
- extension of the light rail system to the Adelaide Railway Station and City West Campus;
- development of the Marion Interchange;

- the Northern Expressway; and,
- the South Road underpass of Anzac Highway.[20]

8.2.6 Public Private Partnerships (PPP)

The 2006-07 Budget features the announcement that the Government proposes to undertake substantial PPP projects for the provision of correctional and educational infrastructure for use by the public sector. Private sector capital expenditure for the projects is estimated to be over $600 million, well above recent PPP projects.

8.2.6.1 Financial Reporting of PPPs

The use of PPPs alters the financial reporting of costs associated with the construction and operation of relevant infrastructure.

Public acquisition of projects is included in capital payments as discussed in the preceding sections. The cost of assets acquired is included in the State Balance Sheet, together with debt where relevant. Related operating costs are included in relevant GFS expenses including depreciation, operating costs, and interest where applicable.

PPPs generally aim to be excluded from state Balance Sheets (be off-Balance Sheet) through their contractual arrangements and assignment of risks and benefits. PPP service payments are to recoup the service provider for the provision of accommodation and operational services. Service payments will cover all construction, financing and other operating costs (eg utilities, facilities management and maintenance) and profit margins, and are included in GFS expenses. This means that payments relating to construction costs would be met from GFS revenues under the current policy of achieving at least a net operating balance each year.

Whether PPPs are off-Balance Sheet and how the transactions will be represented in the various financial reports will be a matter to resolve when contractual arrangements are established.

8.2.6.2 PPPs in the 2006-07 Budget

Annual projections for PPP costs in the 2006-07 Budget are set out in the following table.

Table 8.1 — 2006-07 Budget PPP Costs

	2006-07 $'000	2007-08 $'000	2008-09 $'000	2009-10 $'000	Total $'000
Education Works					
– implementation teams	2 500	2 000	2 000	2 000	10 500
– PPP	-	-	9 560	13 070	22 630
Correctional Services					
– prison infrastructure project team	555	269	-	-	824
	3 055	2 269	11 560	15 070	33 954

The small payments relative to the announced private sector capital expenditure of $600 million, reflects the estimated timing of procurement processes and the spread of service payments over time.

[20] Capital Investment Statement 2006-07, Budget Paper 5, Page 2.

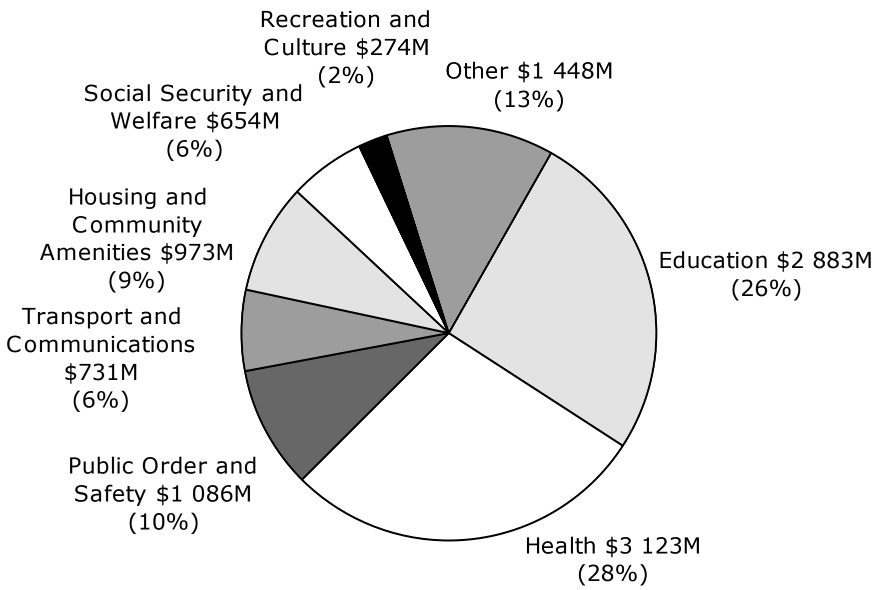
The PPP payments for education works assumes some schools will be operational in 2008-09.

The actual amount and timing of service payments will vary according to contractual arrangements agreed with service providers.

8.3 EXPENSES BY FUNCTION

The GFS reporting framework also provides information on expenditure (excluding capital payments) by its function for the General Government Sector. The following charts the 2006-07 Budget expenses and demonstrates the extent to which the health and education sectors dominate the overall expenditure by the State.

Chart 8.4 — GFS - General Government Sector Expenses by Function[21] ($'million)



8.4 RISKS TO EXPENSES

8.4.1 Overview

As with revenue, the Budget Statement 2006-07 provides detailed consideration of various risks to the expenditure budget and acknowledges the management task for achieving budgeted outcomes.[22]

Some of the key risks reported are:

- ***Change in service needs*** — demand for services may change as a result of numerous factors including age demographics. A variance of 1 percent in hospital activity increases expenditure by approximately $13 million per year.

[21] Budget Statement 2006-07, Budget Paper 3, Table 2.21.

[22] Budget Statement 2006-07, Budget Paper 3, Page 7.6

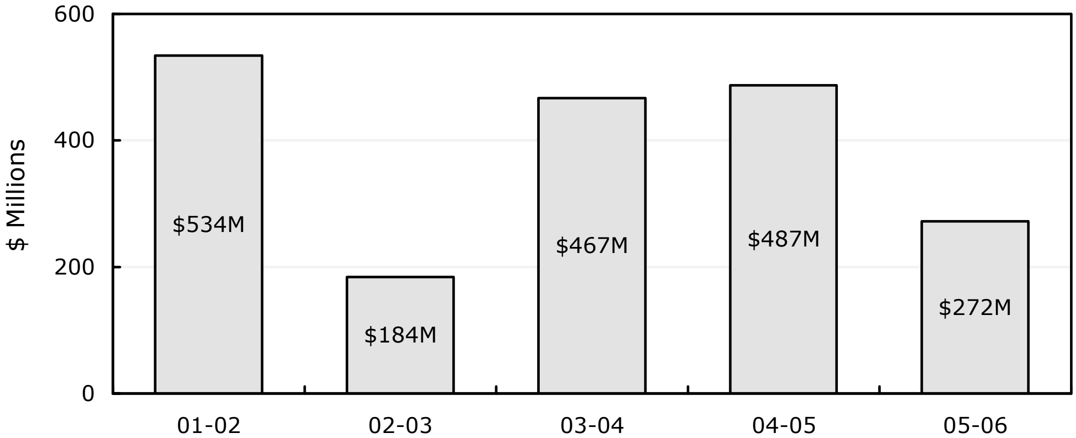
- ***Wages and salaries*** — An increase of 1 percent per annum above the amounts factored into the Budget would have an adverse impact of approximately $169 million in 2009-10**.**

- ***Price increases*** — increases in factors such as interest rates, inflation rates and foreign exchange rates can all adversely impact future spending costs through higher interest payments or the cost of goods and services. The combined impact of a 1 percent rise in interest rates and a 1 percent increase in CPI during 2006-07 would be approximately $50.2 million.

- ***Capital Investment Pressures*** — A number of departments including Health and Transport, Energy and Infrastructure have large capital investment programs over the forward estimates period. Historically there has been considerable cost escalation compared with original projections. As raw material prices increase and all states embark on significant infrastructure programs this risk increases. If cost escalations exceed the amounts included in the capital investment program, annual net lending outcomes will be impacted.

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

Chart 8.5 — Difference between Budget and Actual GFS Expenses [a]



(a) 2005-06 is the difference between budget and the estimated result.

The chart highlights that, notwithstanding classification changes, expenses have been consistently overspent from original budget GFS expense targets in the last five years.

8.4.2 Savings

The Budget includes savings identified by agencies, based on either achieving efficiency or reducing particular services, totalling $695 million over four years. A summary of those savings for all departmental portfolios is as follows:

Table 8.2 — Summary of Budget Savings

	2006-07 $'million	2007-08 $'million	2008-09 $'million	2009-10 $'million
Total Savings	48	148	223	276

The savings in Table 8.2 are in addition to the $75 million savings initiatives included in the 2005-06 Budget for the 2006-07 to 2008-09 forward years.

8.4.3 Nature of Savings Initiatives

The 2006-07 Budget provides a thorough account of proposed savings and revenue initiatives allowing any reader a detailed knowledge of the description of these initiatives.

The major savings initiatives include:

- the implementation of shared services arrangements which aim to save $130 million over four years (including savings from Future ICT and associated changes) but involve implementation costs of $60 million;
- savings from an efficiency dividend which are designed to save $128 million over the forward estimates period;
- departmental efficiencies with combined savings of $47 million over four years; and,
- identified savings as a result of proposed structural changes to government totalling $40 million over four years.

I have made some summary observations on savings initiatives in the Overview, Section 2 of this Report.

8.4.4 Savings Initiatives – DAIS and Shared Services

The Budget notes 'A significant savings measure arising from the Review of Priorities is the proposed abolition of the Department for Administrative and Information Services' (DAIS).

The abolition of DAIS requires the devolvement of its previous business units to four other government agencies.

The shared services initiatives are estimated to add net savings of $70 million, after implementation costs, over four years.

These initiatives are complex projects. Significant elements to the success of such exercises will be the governance arrangements established for implementation, identifying, assessing and managing implementation risks, planning, having or developing skilled resources and appropriate support systems, procurement management, communication processes and monitoring and review.

8.4.5 Control Environment

Adequate control of expenditure is fundamental to achieving budget targets. The following processes relevant to the setting and monitoring of the budget are worthy of note.

8.4.5.1 Budget Monitoring and Reporting

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

In response to an audit inquiry on budget monitoring processes, the Department of Treasury and Finance (DTF) have advised that a number of strategies are undertaken to monitor and control agency budgets. They include:

- monthly reporting by agencies of year to date budget outcomes and revisions to expected end of year outcomes allowing monitoring and action on over and underspending by DTF, the Treasurer and the Expenditure Review and Budget Cabinet Committee (ERBCC);
- quarterly reporting of progress of achieving budget initiatives through DTF to ERBCC. Specific reporting will be in place whereby portfolios will classify each amount in relation to whether the Budget initiative is proceeding or whether the initiative is at risk;
- reporting by agencies on the status of their Capital Investment Program at the project level as at the end of October, December and February through DTF to ERBCC;
- a carryover policy to identify under expenditure by agencies allowing Cabinet to approve carryovers or redirect funds. The carryover system categorises carryover requests as not approved, approved or conditional;
- a cash alignment policy to ensure agencies do not build up excessive cash balances to fund unauthorised expenditures;
- an end of year process where agencies and DTF meet to discuss financial performance and identify improvements as necessary.

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

9 BALANCE SHEET

9.1 INTRODUCTION

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

The information relates to GFS data for both the general government sector and also the non-financial public sector, which consolidates the general government and public non-financial corporations (including the South Australian Water Corporation, Forestry SA and TransAdelaide).[23]

9.2 OVERVIEW OF THE STATE'S FINANCIAL POSITION

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

9.2.1 GFS - General Government Sector Financial Position

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

Table 9.1 — GFS - General Government Sector Financial Position (Nominal Terms)

	2002-03 Actual $'million	2003-04 Actual $'million	2004-05 Actual $'million	2005-06 Estimated Result $'million	2006-07 Estimate $'million	2007-08 Estimate $'million	2008-09 Estimate $'million	2009-10 Estimate $'million
Total financial assets	14 157	15 661	16 915	17 815	18 073	18 431	18 861	19 574
Non-financial assets	11 788	11 917	12 505	12 489	12 745	13 179	13 618	14 090
Total assets	25 945	27 579	29 420	30 303	30 818	31 610	32 479	33 664
Liabilities	10 658	11 819	13 061	11 953	11 857	12 106	12 375	12 846
Net worth	15 288	15 760	16 359	18 350	18 960	19 505	20 105	20 818
Net financial worth	3 500	3 842	3 853	5 861	6 215	6 326	6 486	6 728
Net debt	666	224	144	(67)	107	284	471	689

Note: Totals may not add due to rounding.

Of note is the expectation that:

- financial assets increase across the forward estimates. This is essentially due to equity in PNFCs;
- non-financial assets increase over the period 2002-03 to 2009-10. This is mainly from asset revaluations of the State's land and buildings assets. Net acquisitions (gross fixed capital formation less depreciation), account for the majority of other movements from year to year;

[23] Budget Statement 2006-07, Budget Paper 3, Appendix D details agencies within the respective sectors.

- net worth (assets less liabilities) increases across the forward estimates. This is due to asset growth and a reduction in unfunded superannuation liabilities in 2005-06 from a valuation adjustment;
- although a negative net debt position of $67 million is estimated for 2005-06, net debt of $689 million is estimated in 2009-10.

9.2.2 GFS - Non-Financial Public Sector Financial Position

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

Table 9.2 — GFS - Non-Financial Public Sector Financial Position (Nominal Terms)

	2002-03 Actual $'million	2003-04 Actual $'million	2004-05 Actual $'million	2005-06 Estimated Result $'million	2006-07 Estimate $'million	2007-08 Estimate $'million	2008-09 Estimate $'million	2009-10 Estimate $'million
Total financial assets	3 100	3 574	3 450	3 606	3 533	3 676	3 868	4 267
Non-financial assets	24 098	25 309	27 363	28 122	28 873	29 617	30 270	31 082
Total assets	27 199	28 883	30 813	31 728	32 406	33 293	34 138	35 349
Liabilities	11 911	13 124	14 454	13 378	13 446	13 788	14 033	14 531
Net worth	15 288	15 760	16 359	18 350	18 960	19 505	20 105	20 818
Net financial worth	(8 811)	(9 550)	(11 004)	(9 773)	(9 913)	(10 112)	(10 165)	(10 263)
Net debt	2 696	2 285	2 126	1 941	2 244	2 470	2 592	2 802

Note: Totals may not add due to rounding.

This table highlights that:

- non-financial assets dominate the financial position;
- the value of non-financial assets are estimated to increase by $0.8 billion in 2005-06 to $28.1 billion, and a further $3.0 billion by 2009-10 to $31.1 billion. The main increases in 2005-06 are revaluations of SA Housing Trust rental assets, estimated to increase by $582 million in 2005-06;
- net financial worth is negative as financial liabilities exceed financial assets and is estimated to deteriorate slightly over the forward estimates period;
- net debt is estimated to increase over the forward estimates period.

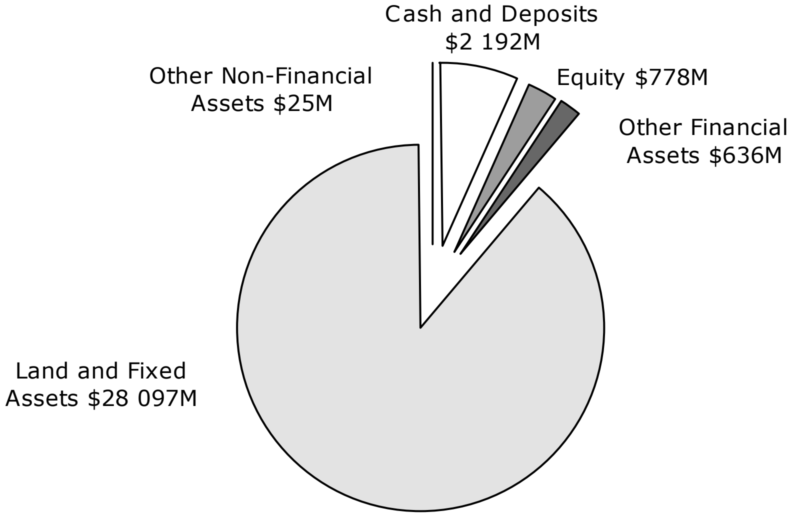
9.3 ASSETS

Historic information shows that the State's financial position does not materially vary from year to year in the absence of major asset disposals or revaluations. This position is similar to interstate jurisdictions, where similar trends are noted.

9.3.1 GFS - Non-Financial Public Sector Assets

The following chart shows the estimated composition of assets under the control of the State as at 30 June 2006 for the non-financial public sector.

Chart 9.1 — GFS - Non-Financial Public Sector Assets at 30 June 2006 ($'million)



Non-financial assets clearly represent the vast majority of State assets being 89 percent of the total. The State's non-financial or physical assets comprise mainly plant, equipment and infrastructure (including roads and water infrastructure) and land and improvements. These assets are divided between the general government and public non-financial corporations sectors. Assets in the general government sector tend not to be used for revenue raising purposes.

In accordance with the Treasurer's Accounting Policy Statements, major assets are subject to regular revaluation. Valuation of public sector assets, particularly general government sector assets, is a subjective process. Valuations will reflect the specific circumstances of individual government entity operations. The general purpose is to provide users of financial reports with an understanding of the extent of assets employed by government agencies in their operations. In this regard the majority of general government sector assets will not reflect market values. Further most assets are not realisable. These are vastly different circumstances than that applying to financial assets.

9.3.1.1 Revaluation of Non-Financial Assets

Revaluations of non-financial assets will generally have the most influence in the improvement of the State's net worth. To illustrate, the following chart summarises asset value changes over the four year period 2002-03 to 2005-06 for the major agencies in the general government and public non-financial corporations sectors.

Table 9.3 — Revaluation of Non-Financial Assets

	2002-03 $'million	2003-04 $'million	2004-05 $'million	2005-06 $'million	Total $'million
General government	223	113	421	859	1 616
Public non-financial corporations	736	870	1 363	725	3 694
Total	959	983	1 784	1 584	5 310

Revaluation of the assets of the major agencies added $5.3 billion to the total value of non-financial assets over the four year period to 2005-06.

The rental properties of the South Australian Housing Trust alone contributed $2.5 billion of this as the value of housing stock rose from $3.1 billion in 2001-02 to $5.6 billion as at 30 June 2006.

9.3.2 Public Financial Corporations Financial Assets

The majority of the Government's financial assets are held by agencies mainly classified as financial institutions (ie public financial corporations). The gross value of those financial assets is not directly evident in the general government sector financial statements.

The following table shows the major holdings of investment assets as at 30 June 2006 for public financial corporations:

Table 9.4 — Investments held by Public Financial Corporations[(a)] [(b)]

	Domestic Equities $'million	International Equities $'million	Fixed Interest $'million	Other Investments $'million	Total 30 June 2006 $'million	Total 30 June 2005 $'million
Funds SA [(c)]	3 288	3 288	784	2 963	10 323	7 932
MAC	432	154	1 145	162	1 893	1 703
SAICORP	78	53	58	37	226	206
SAFA	-	-	2 566	-	2 566	2 963
Total	3 798	3 495	4 553	3 162	15 088	12 804

(a) Market values have been used in determining the above amounts and are sourced from their respective financial statements for the year ending 30 June 2006.
(b) Excludes WorkCover.
(c) These amounts relate to superannuation assets set aside for funding future superannuation benefit payments.

As shown above, a large proportion of the State's investment assets are placed in both domestic and international equities. Investments of this type and nature are managed through the development of agency specific investment strategies, which are ratified by the relevant agencies' Boards. International and domestic equity investments are subsequently managed by external fund managers on behalf of the organisations. More detailed comment is included in the relevant sections of Part B of the Auditor-General's Report for the year ended 30 June 2006 to Parliament.

9.4 LIABILITIES

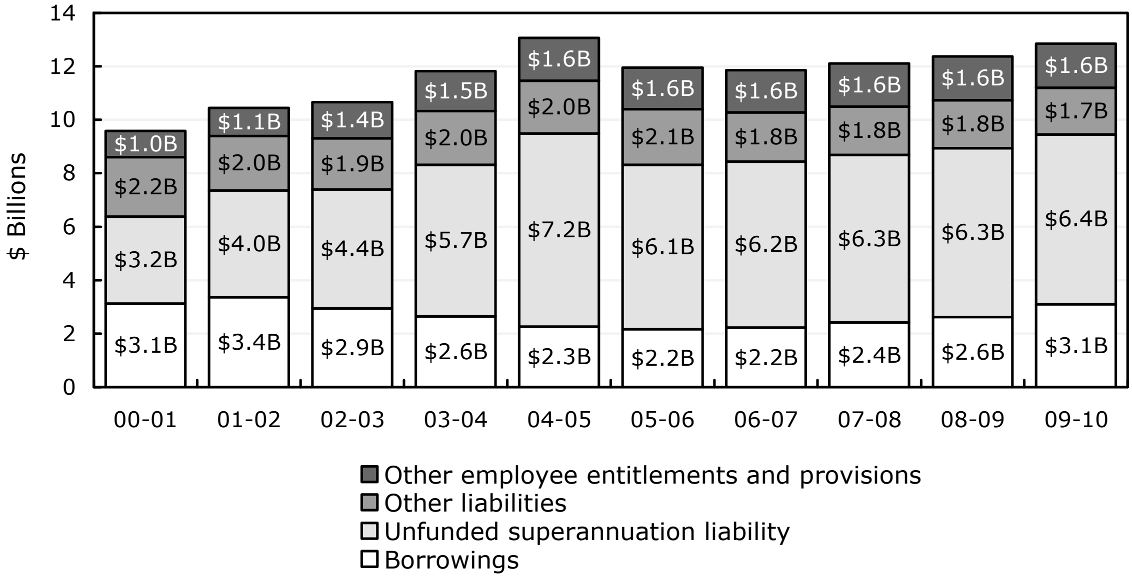
Time series data is presented in the Budget Statement.[24] That data is used as relevant in this section.

9.4.1 GFS - General Government Sector Liabilities

The following chart shows trends in the main elements of total liabilities for the 10 years to 2009-10.

[24] Budget Statement 2006-07, Budget Paper 3, Chapter 5 and Appendix B.

Chart 9.2 — GFS - General Government Sector Liabilities (Nominal Terms)



Total liabilities are estimated to decrease by $1.1 billion or 8.5 percent to $12 billion in 2005-06. This is due mainly to a decrease in the unfunded superannuation liability.

Total liabilities are expected to increase $893 million or 7.5 percent to $12.8 billion over the period of the forward estimates. This is due mainly to increases in borrowings, up $930 million and the superannuation liability, up $206 million, offset by decreases in other liabilities, down $334 million, over the four years to 2009-10.

9.4.2 GFS - Non-Financial Public Sector Liabilities

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

Total liabilities are expected to increase $1.2 billion or 8.6 percent to $14.5 billion over the period of the forward estimates. A $1.1 billion or 7.4 percent decrease in total liabilities in 2005-06 is due to a decrease in superannuation liabilities ($1.1 billion or 14.9 percent) offset by an increase in other liabilities of $144 million or 7.6 percent.

9.5 UNFUNDED SUPERANNUATION

9.5.1 Background to Unfunded Superannuation Liabilities

Superannuation liabilities are regarded as unfunded when specific assets have not been set aside to meet the estimated value of accrued superannuation liabilities.

Superannuation liabilities are determined on long-term estimates of total liabilities - they are not liabilities that will be called on in total in the immediate future - thus there is the ability to seek to fund them over many years. This State has a long-term funding strategy in place.

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

9.5.2 Estimated Unfunded Superannuation Liability at 30 June 2006

The following table sets out the major elements that comprise the movement from the actual unfunded superannuation liabilities at 30 June 2005 to the 30 June 2006 estimated liability.

Table 9.5 — Estimated Unfunded Superannuation Liabilities as at 30 June 2006

		$'million	$'million
Actual 30 June 2005			7 227
Add:	Nominal interest	344	
	Past service payments	(260)	
	Movement in discount rate	(1 048)	
	Higher earnings against assumed	(505)	
	2005 Police Superannuation Scheme review	182	
	Variation between actual and expected experience	223	
	Other	(16)	
	Total changes		(1 080)
Estimated Closing Balance June 2006			6 147

Superannuation Funding

In 2006-07, total superannuation funding is budgeted to be $765 million, a significant part of cash outlays. Payments comprise amounts paid from agencies as contributions with respect to current employment new service and contributions reflecting lack of funding for current employment in previous years ('past service' contributions).

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

The past service superannuation liability cash payment for 2006-07 is estimated to be $252 million.[25] This is $1 million per year higher than was estimated in the 2005-06 Budget.

Discount Rate

The table highlights the significance of movements in the discount rate. A discount rate of 5.9 percent has been applied in the 2006-07 Budget to value the superannuation liability, compared with 5.3 percent at the time of the 2005-06 Budget. This movement reduces the estimated liability by $1 billion.

Earnings

Funds SA is responsible for managing the investment of superannuation assets. Investment earnings on superannuation assets are very much susceptible to economic conditions, financial markets and Funds SA's investment strategy. Further detail on investment performance is provided under 'Superannuation Funds Management' (Funds SA) in Part B of the Auditor-General's Report for the year ended 30 June 2006 to Parliament.

[25] Budget Statement 2006-07, Budget Paper 3, Table 5.6

Higher earnings were estimated to be achieved against the assumed investment earnings. In the 2006-07 Budget an earnings rate of 19.2 percent was estimated for 2005-06. This rate is substantially higher than the long-termed assumed earnings rate of 7.0 percent.

9.5.3 Long Term Funding of Superannuation Liabilities

The commitment to fully fund unfunded liabilities was reaffirmed by the Government in the 2006-07 Budget Papers, with the position as at 30 June 2006 remaining consistent with the plan to eliminate unfunded superannuation liabilities by 2034.

On current projections, unfunded liabilities are expected to increase until peaking around the period 2011-12. It is estimated that benefit payments will peak in 2023-24.

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

9.6 NET DEBT

Since the collapse of the State Bank, management of net debt has been a major focus of fiscal strategy. The achievements over a number of years of restructuring the State's finances have reduced net debt to historically low levels and the Government now focuses on total liability data.

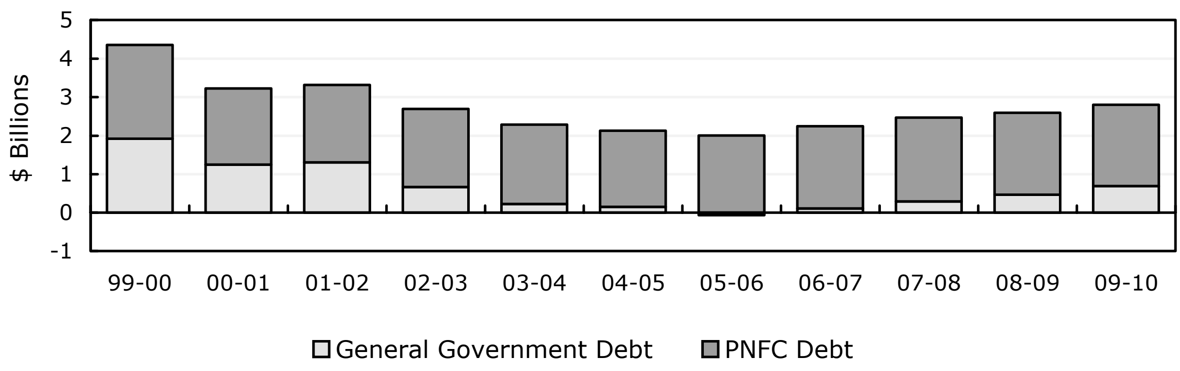
9.6.1 Definition of Net Debt

Net debt[26] equals certain financial liabilities (the sum of deposits held, advances received and borrowing) minus financial assets (the sum of cash and deposits, advances paid, and investments, loans and placements) as defined in the GFS framework.

9.6.2 Longer Term Trends in the Level of Debt

The following chart shows data on a long-term basis to the end of the forward estimates. Public sector net debt has reduced by $2.4 billion to $1.9 billion (3.0 percent of South Australia's Gross State Product) in the period 1999-2000 to 2005-06. Forward estimates show that net debt is projected to rise to $2.8 billion in 2009-10 (3.6 percent of South Australia's Gross State Product).

Chart 9.3 — GFS - South Australian Public Sector Net Indebtedness 2000 to 2010



26 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.

In real terms, total net debt is projected to increase over the forward estimate period.

General government sector is estimated to have negative net debt of $67 million for 2005-06. Over the forward estimates net debt increases in this sector by $756 million to $689 million due to projected budget deficits.

Net debt of the public non-financial corporations increases by $105 million over the same period to $2.1 billion.

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

9.6.3 Debt Affordability and Servicing

Chart 9.3 clearly highlights the affordability of general government net debt as at 2005-06 and why this was one of reasons the Government was able to consider revision of its fiscal targets.

At the end of 2005-06 total public sector net debt is estimated to represent 3.0 percent of gross state product compared to 9.9 percent in 1999-2000.

9.6.4 Debt Management Policy

The South Australian Government Financing Authority (SAFA) has been delegated the responsibility for managing the debt of the South Australian Treasurer.

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

The Treasurer’s approved policy for benchmark duration applied during the 2005-06 financial year is between 1 to 1.5 years.

Lower duration benchmarks offer lower average interest costs over the long-term but with possible higher short-term budget volatility.

For further details on the debt management policy, refer to the financial statements of the South Australian Government Financing Authority (SAFA) in Part B of the Auditor-General’s Report for the year ended 30 June 2006 to Parliament.

9.7 OTHER NON-FINANCIAL PUBLIC SECTOR LIABILITIES

Other liabilities include provisions for other employee entitlements (in particular long service leave provisions), $1.6 billion for 2005-06 and workers compensation and other liabilities of entities including outstanding insurance claims, $2.0 billion for 2005-06.

By their nature these liabilities tend to increase at a steady but manageable rate.

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

- estimated long service leave provisions amounting to $943 million for 2005-06 and $967 million in 2006-07. Long service leave is calculated by an estimation process in most cases subject to guidelines issued by the Department of Treasury and Finance;
- estimated workers compensation totalling $319 million for 2005-06 and $317 million in 2006-07;
- outstanding claims payable to entities external to SA Government for the South Australian Government Captive Insurance Corporation (SAICORP) amount to $216 million for 2004-05 and $244 million in 2005-06. The majority of these liabilities are funded. There are two separate funds operated by SAICORP. The fund dealing with claims prior to 1 July 1994, when arrangements were formalised is not fully funded with the fund having a net negative equity of $69 million at 30 June 2006 (negative $62 million at 30 June 2005). Details of SAICORP's operations are included in Part B of the Auditor-General's Report for the year ended 30 June 2006 to Parliament.

9.8 CONTINGENT LIABILITIES

As reported in the Budget Papers[27] contingent liabilities are those that have not been recognised in the Balance Sheet, but rather in notes to the accounts, for one of the following reasons:

- There is significant uncertainty as to whether a sacrifice of future economic benefits will be required.
- The amount of the liability cannot be measured reliably.
- There is significant uncertainty as to whether an obligation presently exists.

Contingent liabilities of the Government can arise from:

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

Guarantees and contingent liabilities of the Government of South Australia as at 30 June 2005 were valued at $950 million ($1.3 billion as at 30 June 2004). This is at nominal values without adjustment for the probability of actual liabilities occurring.

[27] Budget Statement 2006-07, Budget Paper 3, p7.10 – 7.19 provides a detailed summary of contingent liabilities.

The $350 million decrease is due mainly to the extinguishing in November 2004 of a guarantee associated with the State Government Insurance Commission (SGIC).

Service Risks and Contingent Liabilities

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

10 COMPARISON WITH OTHER STATES

10.1 SOME QUALIFYING OBSERVATIONS

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

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

Importantly before drawing conclusions, any assessment needs a sound understanding of the specific circumstances prevailing in different states. I have not sought to provide all of the relevant information in this Report. Rather I take the opportunity to show what each State is forecasting through to 2010.

The following table shows 2006-07 budgeted GFS total revenue for each state.

Table 10.1 — 2006-07 Budgeted GFS Total Revenue by State

State	NSW $'million	VIC $'million	QLD $'million	WA $'million	SA $'million	TAS $'million
GFS Total Revenue	44 598	32 442	29 070	16 510	11 264	3 532

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

10.2 OPERATING STATEMENT

The following charts compare some trends in the GFS accrual information with most other States using 2006-07 budget data.

Chart 10.1 — General Government Sector Net Operating Balance as a Proportion of GFS Total Revenue

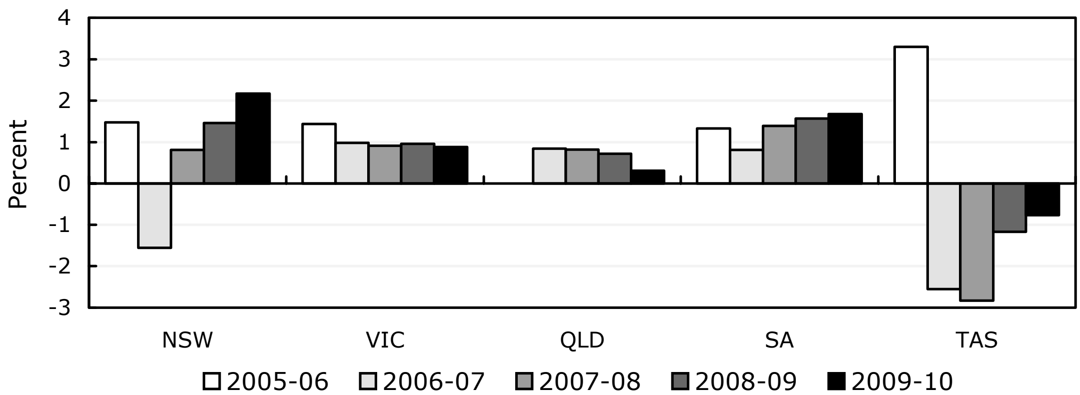
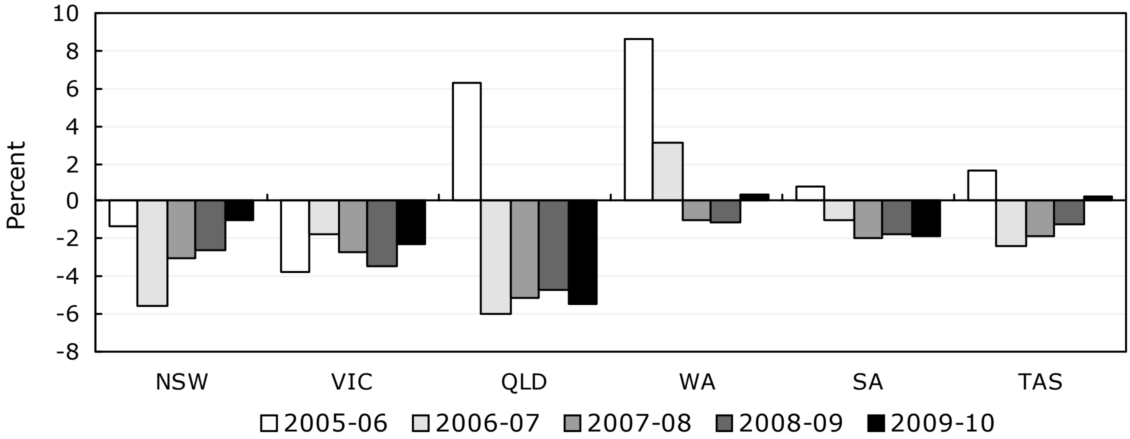


Chart 10.1 shows that South Australia's net operating balance as a ratio to total revenue compares very favourably with most other states. Note that Queensland's ratio for 2005-06 and Western Australia are omitted due to the size of those results to assist legibility.

Chart 10.2 — General Government Sector Net Lending (Borrowing) as a Proportion of GFS Total Revenue



As detailed in chart 10.2, all States are estimating net borrowing (deficit) outcomes for all or most of the four years to 2009-10.

Chart 10.2 shows that South Australia's net borrowing as a proportion of GFS total revenues is lower than most States. Given the net operating balance outcomes in chart 10.1, this indicates South Australia's relative capital payments are lower than the other states.

The reasons for the differences will be varied but are likely to include differing capital policies and needs, reflecting population growth and demand differences and differing needs for renewal of capital assets.

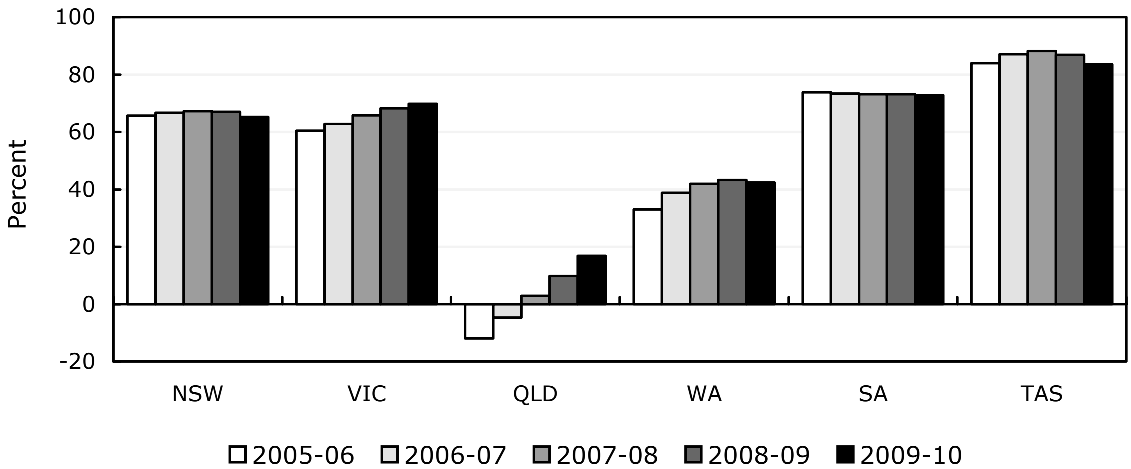
10.3 BALANCE SHEET

10.3.1 Ratio of Net Financial Liabilities to Revenue

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

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

Chart 10.3 — Ratio of Net Financial Liabilities to Revenue



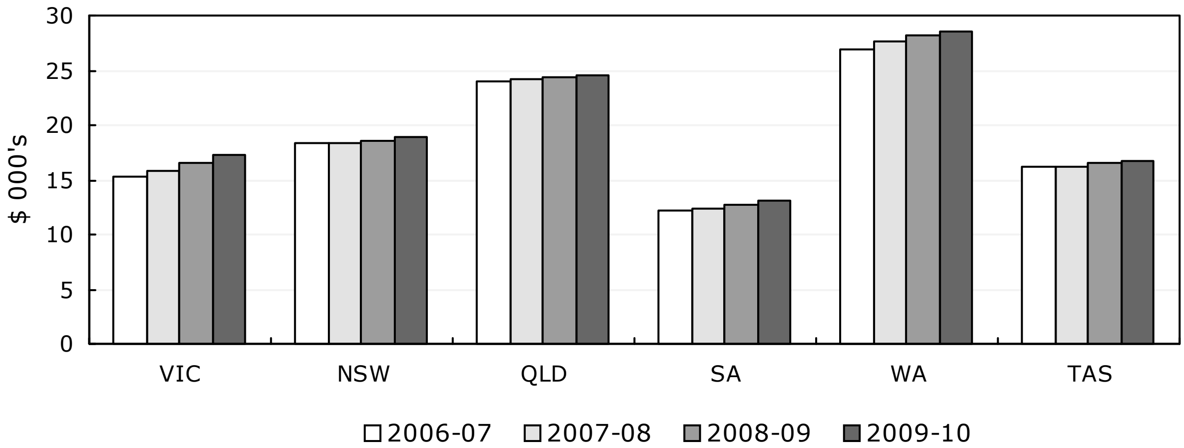
The Government projects that revenue growth ensures that the ratio of net financial liabilities to revenue improves over the forward estimates period.

10.3.2 Net Worth Per Capita

General government sector net worth is calculated as total assets (physical and financial) less total liabilities (debt, superannuation, other) and therefore highlights the net change in these items. Changes in net worth arise from transactions, the operating result and from revaluations of assets and liabilities.

The following chart plots the Budget data for all States.

Chart 10.4 — GFS - General Government Sector Net Worth per Capita



The chart shows the increase in net worth in this State through to 2009-10 based on current budget settings. This is consistent with the projections for other states.

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

11 TREASURER'S STATEMENTS

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

The Treasurer's Financial Statements are prepared pursuant to the *Public Finance and Audit Act 1987* (the Act) to report on transactions and balances in the public accounts.

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

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

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

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

The Treasurer's Financial Statements are reported, in full, in an Appendix to Volume V of Part B of the Report of the Auditor-General for the year ended 30 June 2006.

11.2 SCOPE OF AUDIT OF THE TREASURER'S STATEMENTS

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

- testing of appropriations from the Governor's Appropriation Fund, Contingency Funds and other payments;
- establishment and changes to Treasurer's Special Deposit Accounts and Deposit Accounts;
- updating and recording of the Treasurer's Loans;
- maintenance of the Central General Ledger.

11.2.1 Audit Findings and Comments

The results of audit work undertaken indicated that while internal controls were in general operating satisfactorily, there were a number of minor areas where improvements could be made.

In addition to the matters above, observations were also made on two matters reported on last year:

- the Accrual Appropriation Excess Fund Account;
- Appropriation of administered items of departments.

Follow-up review findings are discussed in detail under the Audit Findings and Comments heading for the Department of Treasury and Finance in Part B of the Report of the Auditor-General for the year ended 30 June 2006.

11.3 THE CONSOLIDATED ACCOUNT OUTCOME

The following table sets out total appropriation authority and actual payments for the Consolidated Account in 2005-06.

Table 11.1 — 2005-06 Appropriation Authority and Payments

	Appropriation Authority $ million	Actual Payments $ million
Appropriation Act 2005	7 420	7 283
Public Finance and Audit Act 1987 – Section 15	125	125
The Governor's Appropriation Fund	207	145
Specific appropriations authorised in various Acts	118	118
Total	7 870	7 671

The result on the Consolidated Account for 2005-06 was a surplus of $24 million ($377 million in 2004-05) exceeding the budgeted deficit amount by $108 million. The surplus was used to repay borrowings from SAFA. This is reflected in the reduction in net debt serviced from the Consolidated Account as shown in Statement J of the Treasurer's Statements .

Total receipts of $7.7 billion exceeded budget by $249 million. Total payments exceeded budget by $141 million.

The key differences between actual and budgeted amounts were:

- ***Receipts*** — large increases in stamp duty receipts of $126 million due to higher than expected activity in the property sector.

- ***Payments*** — Higher payments from Administered Items for Department of Treasury and Finance and the Department for Transport, Energy and Infrastructure. The main increases are discussed in the following section on appropriation flexibility.

Details of the budget and actual data are presented in Statement A 'Comparative Statement of the Estimated and Actual Payments from the Consolidated Account of the Government of South Australia'.

11.4 APPROPRIATION FLEXIBILITY

Flexibility in appropriation authority arises from the provision of sources of funds for additional/new initiatives or unforeseen cost pressures that can be used without a requirement to return to Parliament for additional appropriation authority.

This flexibility is provided by a combination of legislative provisions and budget practices.

The following table sets out relevant items for 2005-06.

Table 11.2 — Appropriation Flexibility

	Authority/ Budget $'million	Actual Payments $'million
Governor's Appropriation Fund	207	145
Contingency provisions in Administered Items for the Department of Treasury and Finance	230	60
Public Finance and Audit Act 1987 – Section 15	125	125
Total Flexibility	562	330

Use of both the contingency provisions and the Governor's Appropriation Fund requires the Treasurer's approval. Use of contingency provisions does not affect the budget result as they are already figured into that result. Use of the Governor's Appropriation Fund or Section 15, on the other hand, can be an additional expense for the Budget.

11.4.1 Governor's Appropriation Fund and Contingency Provisions

Section 12 of the *Public Finance and Audit Act 1987* provides for the Governor's Appropriation Fund (GAF).

Details of the purpose of appropriations from the GAF are provided in Statement K - Governor's Appropriation Fund of the Treasurer's Statements. The main items were payments of $39 million to the Department for Transport, Energy and Infrastructure, (for a range of activities), $26 million to Department of Health (mainly for activity growth) and $19 million to the Department for Families and Communities (for a range of activities).

11.4.2 Contingency Provisions

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

Details of payments from the contingency funds are provided in Statement L – Statement of Transfers from Contingency Provisions of the Treasurer's Financial Statements. Payments are transfers of additional funding to agencies. The major items were for payments totalling $62 million to the Department of Education and Children's Services and $54 million to the Department of Health, both mainly for settlement of enterprise bargaining agreements.

11.4.3 Appropriation by the Treasurer for Additional Salaries

Section 15 of the *Public Finance and Audit Act 1987* provides that the Treasurer may appropriate from the Consolidated Account an amount sufficient to cover increases in public sector salaries, wages, allowances, payroll tax or superannuation contributions arising by reason of the award, order or determination of a court, tribunal or other body empowered to fix salaries, wages or allowances.

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

In 2005-06 $125 million was appropriated by the Treasurer pursuant to Section 15. This was the first time in many years that this provision has been used and related to the settlement of enterprise bargaining arrangements referred to above. This amount was added to the line 'Administered Items for Department of Treasury and Finance'. Payments are reflected against that line.

11.4.4 Appropriation Transfers

In addition to the preceding provisions, appropriation can be transferred between agencies. Section 13 of the *Public Finance and Audit Act 1987* provides authority where excess funds exist for one agency and are necessary for another. Section 5 of the *Appropriation Act* provides authority where restructuring of an agency occurs so that appropriation related to transferring functions may in turn be transferred. There were no Section 13 transfers in 2005-06. Section 5 transfers are detailed in Statement A of the Treasurer's Statements.

11.5 SPECIAL DEPOSIT ACCOUNTS AND DEPOSIT ACCOUNTS

Most appropriation from the Consolidated Account is transferred to Special Deposit Accounts and Deposit Accounts established pursuant to the *Public Finance and Audit Act 1987*. Under related provisions, monies credited to those accounts can be spent without further appropriation from Parliament. This is of significance in that monies appropriated in one year and transferred to a deposit account need not actually be expended in that year, that is, they may be carried over into the next year unless required by the Treasurer to be paid to the Consolidated Account.[28]

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

It is now probable that agencies will not build up such significant cash balances in the future as a result of the cash alignment policy.

11.5.1 Cash Alignment Policy

In 2004-05 the Government first applied a cash alignment policy with respect to aligning agency cash balances with appropriation and expenditure authority. Pursuant to the policy, payments are required to be made to return surplus cash to the Consolidated Account. An implication of this policy is that agencies may have an incentive to spend the cash allocated to them to avoid having surplus cash.

A total of $49 million of surplus cash was returned to the Consolidated Account during 2005-06, including return of equity. The main items were $23 million from South Australia Police and $14 million from the Department for Families and Communities.

[28] *Public Finance and Audit Act 1987* Section 8 (5) Any surplus of income over expenditure standing to the credit of a special deposit account must, at the direction of the Treasurer, be credited to the Consolidated Account.

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

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

Due to the timing of the preparation of the whole-of-government statements, the last completed statements relate to the year ended 30 June 2005, and the following commentary has therefore been kept purposely brief.

12.1 AAS 31 WHOLE-OF-GOVERNMENT FINANCIAL STATEMENTS

Whole-of-government financial reports for South Australia are prepared by the Department of Treasury and Finance (DTF) pursuant to AAS 31.

The basis for consolidation is Australian Accounting Standard AAS 24 *Consolidated Financial Reports*, which details the principles for determining what makes up the economic entity. As a result of using the control concept from the standard, the accounts exclude local government bodies, universities, most marketing and professional regulatory authorities, the Legislature, and associations and financial institutions incorporated under State statute but not controlled by the Government.

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

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

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

The key features of the audit undertaken of the financial statements include a review of:

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

Limitations still exist with the current reporting process. Notwithstanding these limitations, the usefulness and importance of these reports in providing an understanding of the broad structure of the State's financial position is recognised as a key reporting tool of the Government. This usefulness would be significantly improved by the more timely completion of the financial statements.

12.2.1 Audit Findings and Comments

Following the Audit review of the financial statements for 2004-05, a management letter was forwarded to the DTF in May 2006 that contained important reporting and operational considerations that would need to be addressed in order to provide an unqualified audit opinion for whole-of-government financial statements. This would, of course, require legislation changes requiring such an opinion to be issued. The Audit management letter was reproduced in full in the whole-of-government financial statements published by the DTF.[29]

The matters raised included:

- measurement of unfunded superannuation liabilities using a discount rate consistent with Australian Accounting Standard AASB 119 *Employee Benefits*, a new standard under Australian equivalents to International Financial Reporting Standards. This new standard did not apply until reporting periods commencing on or after 1 January 2005.

- timeliness issues with the preparation of whole-of-government financial statements. In particular, it was noted that a number of other States had been able to finalise and publish their whole-of-government financial statements many months before South Australia, which did so in May 2006;

- the inclusion of a number of material account balances from government entities that received qualifications;

- the use of unaudited health services' data in the preparation of the whole-of-government financial statements.

- recommendations for DTF to review its process of verifying information received from government agencies.

Departmental Response

The Department responded positively to each of the issues raised. In particular, it advised that the Department had underway, since April 2004, a financial reporting improvement project that aims to implement technology and systems changes to improve the quality and timeliness of consolidated whole-of-government reporting. An initial step of deploying on-line software, called Upstream, to facilitate a rapid and relatively seamless transfer of agency general ledger financial data to the DTF, had been completed across most agencies, many of which have been on-line from September 2005. Further in-house development of software allowing the DTF to collect supplementary notes to the financial reports had also been achieved. The implementation of this software and the training of agency staff was to occur in July and August 2006. The successful implementation of each of the above software packages would help reduce the time it takes for agency data to be accessed by the DTF and to

[29] Government of South Australia, Consolidated Financial Statements for the year ended 30 June 2005.

assist in ensuring consistency exists between data received by the DTF and data included in audited financial reports. Benefits of this project were expected to be seen in 2005-06. The DTF would also seek further internal efficiencies, including the earlier completion of some of the Notes to the whole-of-government financial statements.

12.3 AAS 31 FINANCIAL PERFORMANCE

The following briefly discusses the financial result of the AAS 31 statements as at 30 June 2005. As previously discussed, data for the current year (due to the time needed for preparation) is not available at the time of this Report. It is included for reference only. Full details and analysis are published by the Department of Treasury and Finance.[30] This data provides the opportunity to observe the financial result of the Government using a full accrual accounting basis, and the consolidation of all sectors. The consolidation process means that all inter-sector transactions are eliminated.

The following table summarises the financial result for the year ending 30 June 2005, with comparative amounts for the preceding four years.

Table 12.1 — AAS 31 Financial performance (2001-2005)

	2001 $'million	2002 $'million	2003 $'million	2004 $'million	2005 $'million
Revenues					
Taxation	2 024	2 037	2 285	2 651	2 760
Grants	4 361	4 807	5 010	5 289	5 589
Sale of goods and services, fees and levies	3 321	2 571	2 898	3 282	3 305
Investment revenues	871	811	878	1 757	1 737
Net revenues from asset disposals	268	63	28	41	-
Other	525	1 010	893	738	820
Total Operating Revenues	11 370	11 299	11 992	13 758	14 211
Expenses					
Employee expenses	3 526	4 942	5 032	6 057	6 710
Supplies and services	3 008	2 665	2 713	2 305	2 307
Grants and subsidies	1 356	1 380	1 395	1 466	1 661
Borrowing cost expenses	921	757	761	737	688
Other	1 734	2 581	3 000	3 856	4 324
Total Operating Expenses	10 545	12 325	12 901	14 421	15 690
Net Surplus (Deficit)	825	(1 026)	(909)	(663)	(1 479)
Increase in asset revaluation reserve	1 184	666	1 495	1 234	2 053
Increase (Decrease) in adoption of new standard	348	2	(10)	(20)	(19)
Total Changes in Equity	2 357	(358)	576	551	555

The table highlights that notwithstanding significant growth in revenues over the three years to 2005, this has been exceeded by growth in expenses and deficits have been incurred.

[30] Government of South Australia Consolidated Financial Report for the year ended 30 June 2005.

The main increases in expenses in 2004-05 were as follows:

- ***Employee Expenses*** — increased by $653 million due mainly to:
  - — a $256 million increase in salaries and wages; and
  - — a $415 million increase in superannuation expense due mainly to:
    - ▪ a risk free rate of 5.2 percent being applied in 2004-05 to the superannuation liability compared with 6 percent in 2003-04. The effect was to increase the 2004-05 liability by $1 billion compared to the $1.4 billion increase in 2003-04.
    - ▪ changes in actuarial assumptions of $777 million in 2004-05 compared to $12 million in 2003-04.
- ***Grants and Subsidies*** — increased by $195 million reflecting:
  - — a $162 million increase in recurrent grants;
  - — an $89 million increase in other current transfer payments; and
  - — a $78 million decrease in subsidies.
- ***Other Expenses*** — increased by $468 million reflecting:
  - — a $46 million increase in self-insurance claims;
  - — a $70 million decrease in property, plant and equipment revaluation decrements.
  - — a $54 million increase from revaluation of workers compensation liabilities;
  - — a $56 million increase in workers compensation related payments;
  - — a $72 million increase due to the effect of accounting for profits made by Funds SA which are payable to State superannuation funds. Such profits are recorded as an expense in the whole-of-government statements; and
  - — a $351 million increase in other expenses.

12.4 AAS 31 FINANCIAL POSITION

The following summarises the financial position for the six financial years 1999-2000 to 2004-05.

Table 12.2 — AAS 31 (Whole-of-Government Financial Statements) Financial Position Data (Nominal Terms)

	2000 $'million	2001 $'million	2002 $'million	2003 $'million	2004 $'million	2005 $'million
Assets						
Cash and investments	7 577	4 987	4 658	6 423	6 761	6 971
Superannuation assets	4 916	5 175	5 057	5 277	6 517	7 812
Physical assets	20 817	21 934	22 621	24 234	25 261	27 360
Other	3 587	2 199	2 460	2 063	1 869	1 888
TOTAL ASSETS	36 897	34 295	34 796	37 997	40 408	44 031

	2000 $'million	2001 $'million	2002 $'million	2003 $'million	2004 $'million	2005 $'million
Liabilities						
Unfunded superannuation	3 544	3 262	3 987	4 445	5 668	7 227
Borrowings	11 173	6 992	6 754	7 468	6 781	6 561
Employee entitlements	1 024	1 108	1 208	1 440	1 595	1 699
Superannuation liabilities	5 117	5 300	5 183	5 411	6 635	7 934
Other	4 110	3 347	3 736	4 729	4 674	5 000
TOTAL LIABILITIES	24 968	20 009	20 868	23 493	25 353	28 421
NET ASSETS	11 929	14 286	13 928	14 504	15 055	15 610

The $555 million increase in net assets for 2004-05 was due mainly to an increase in Superannuation Assets ($1.3 billion) and Physical Assets ($2.1 billion), offset by increases in Superannuation Liabilities ($1.3 billion) and Unfunded Superannuation Liabilities ($1.6 billion).