Report of the Auditor-General

Auditor-General's Department

Report 1 of 2019

State finances and related matters

Government of South Australia

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Report of the Auditor-General

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11 February 2019

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The Hon V A Tarzia MP
Speaker
House of Assembly
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Dear President and Speaker

Report of the Auditor-General:
Report 1 of 2019 'State finances and related matters'

As required by the *Public Finance and Audit Act 1987*, I present to each of you Report 1 of 2019 titled 'State finances and related matters'.

Content of the Report

The 2018-19 State Budget (2018-19 Budget) was tabled in Parliament in September 2018. It is the first Budget for the new SA Government following its election in March 2018. The 2017-18 estimated result in the 2018-19 Budget reflects the activities of the previous SA Government from July 2017 to March 2018, and the new SA Government from March 2018 onwards.

This report provides our observations on the State's public finances based on our review of the 2018-19 Budget and the December 2018 mid-year budget review, in particular:

- an overview of key matters currently relevant to the State's public finances
- an analysis of the State's financial performance. This primarily involves examining the results for the past year and the Budget and forward projections included in the Budget Papers
- a review of the State's financial position, including analysis of major assets and liabilities.

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

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

Yours sincerely

Andrew Richardson
Auditor-General

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1 Executive summary

1.1 Introduction

The 2018-19 State Budget (2018-19 Budget) was tabled in Parliament in September 2018. This Report provides our observations on the State's public finances based on our review of the 2018-19 Budget and the December 2018 mid-year budget review (MYBR), in particular:

- an overview of key matters currently relevant to the State's public finances
- an analysis of the State's financial performance. This primarily involves examining the results for the past year and the Budget and forward projections included in the Budget Papers
- a review of the State's financial position, including analysis of major assets and liabilities.

Section 2 provides further detail on the objective and scope of our review.

1.2 Key overall observations

1.2.1 The new SA Government's first Budget expands the State's capital program while introducing new operating savings and taxation policy measures

The 2018-19 Budget is the first Budget for the new SA Government following its election in March 2018. The 2017-18 estimated result in the 2018-19 Budget reflects the activities of the previous SA Government from July 2017 to March 2018, and the new SA Government from March 2018 onwards.

The new SA Government states its intent in the 2018-19 Budget as follows:

> *The Government believes that an efficient and focussed public sector, improved community services, targeted industry sector support and structural tax relief will provide support for the future growth of the South Australian economy, creation of additional jobs and ongoing improvement of living standards for South Australians.*

The 2018-19 Budget introduced a range of new policy measures that significantly impact taxation revenue, operating expenses and operating savings. We detail these policy measures in section 4.3.

The 2018-19 Budget also expanded the State's capital program. Estimated capital expenditure from 2018-19 onwards is relatively high compared to recent historical levels, being around or above $2 billion p.a. Further detail on the State's capital program is provided in section 7.1.

1.2.2 The 2018-19 Budget projects that the fiscal target of operating surpluses over all four years of the Budget will be met

The SA Government sets out its fiscal strategy and fiscal targets in the Budget, together with performance against those targets. The fiscal targets include achieving a net operating surplus in the general government sector every year.

The Budget forecasts small net operating surpluses in the general government sector for all four years. The budgeted 2018-19 surplus was $48 million, growing steadily to $211 million in 2021-22. The 2018-19 MYBR reduced the size of the surpluses across the forward estimates.

The Budget has demonstrated over many years that it is founded on largely reliable revenue sources.

As the net operating surpluses over the four years of the Budget are small, there are many risks and variables to be managed. This may influence the final outcome each year, and in particular may prevent the fiscal target of consistent operating surpluses being achieved. Risks that have historically affected outcomes include:

- GST revenue growth being less than expected owing to changes in the size of the national GST pool and South Australia’s share of that pool
- Health and Wellbeing portfolio savings targets not being achieved
- growth in employee expenses exceeding that allowed for in the forward estimates
- agency efficiency (saving) dividends not being achieved.

As an example, risks to GST revenues are not controllable by the State. This means variations that reduce GST revenue must be managed through other aspects of the Budget to achieve Budget results.

1.2.3 Revisions to GST revenue grants by the Commonwealth Government present a risk to achieving a net operating surplus in 2018-19

The Commonwealth Government’s Mid-Year Economic and Fiscal Outlook 2018-19 (2018-19 MYEFO), released on 17 December 2018, revised South Australia’s 2018-19 GST revenue grants down by $72 million, mainly due to a decrease in GST receipts collected. The downward revision is not reflected in the SA Government’s 2018-19 MYBR, which was released before the 2018-19 MYEFO.

As the 2018-19 estimated net operating surplus for the general government sector in the SA Government’s MYBR is small ($40 million), the downward revision to GST revenue grants presents a risk to achieving the projected net operating surplus in 2018-19. The SA Government has since confirmed its intent to manage the Budget to deliver modest surpluses.

1.2.4 Taxation policy measures reduce projected revenues compared to past budgets by $426 million

The new SA Government introduced policy measures in the 2018-19 Budget that will reduce taxation revenue between 2018-19 and 2020-21 by $426 million compared to past budgets. These measures are:

- the reinstatement of general fixed property remissions for the Emergency Services levy ($270 million)
- changes to payroll tax exemption thresholds and rates ($109 million)
- the reform of land tax thresholds and rates ($47 million).

These policy measures contribute to low growth in taxation revenue over the forward estimates and result in the SA Government relying increasingly on Commonwealth GST grant revenue. Section 1.2.9 provides further detail.

1.2.5 The fiscal target capping net debt as a percentage of total revenue has been removed

The SA Government aims to achieve a level of general government sector net debt in the 2018-19 Budget that is sustainable over the forward estimates. This is a change from the 2017-18 Budget where the target was set as a maximum ratio of net debt to revenue of 35%.

The Budget does not define what is considered a sustainable level of debt. The Department of Treasury and Finance (DTF) advised us that the SA Government considers the forecast level of debt to be sustainable on the basis that:

- it has maintained operating surpluses while fully funding its election commitments and addressing the major budget pressures
- the net debt to revenue ratio of 41.1% by 2021-22 is comparable to triple-A rated interstate jurisdictions, which are forecasting net debt to revenue ratios that range up to 41.8% by 2021-22
- with the specific savings measures announced in the Budget, and revised savings targets for Health and Wellbeing, the SA Government is well placed to ensure the current levels of debt forecast in the Budget are maintained.

The estimated ratio of net debt to revenue for the general government sector is expected to increase from 28% as at 30 June 2018 to 41% at 30 June 2022. This ratio for the non-financial public sector (NFPS) is expected to increase from 64% to 76% during the same time period.

The increase in net debt over the forward estimates is due to the SA Government’s larger investing program resulting in successive net lending deficits. As the ratio of net debt to revenue increases over the forward estimates, there is a corresponding increasing risk the SA Government will have less capacity and flexibility for other services after meeting borrowing costs on its debt.

1.2.6 Standard & Poor's upgraded the State's credit rating while Moody's maintained a stable outlook

In September 2018 Standard & Poor's upgraded the State's credit rating from AA with a positive outlook to AA + with a stable outlook. Standard & Poor's indicated that this was because:

- they expect the State to achieve sustained operating surpluses
- the SA Government is taking material steps to achieve savings targets, which will contain expenditure growth and debt levels
- the State's ability to meet its short-term financial obligations with liquid assets continues to improve, supporting its financial management.

Moody's maintained the State's credit rating at AA1 with a stable outlook. Moody's acknowledged the well established institutional Commonwealth framework and noted the State's resilient, small economy. Moody's also highlighted that South Australia is heavily reliant on GST transfers and grants and this reduces fiscal flexibility in terms of the Government's ability to adjust in response to economic shocks.

1.2.7 2017-18 net operating balance deteriorated by $385 million between the original Budget and final budget outcome

The 2017-18 Budget estimated a net operating surplus for 2017-18 of $72 million. The estimated 2017-18 net operating balance result was revised downwards in the 2017-18 MYBR ($12 million operating surplus) and again in the 2018-19 Budget ($397 million operating deficit), before being revised upwards to reflect the 2017-18 final budget outcome ($313 million operating deficit).

The $385 million deterioration in the 2017-18 net operating balance between the 2017-18 Budget and 2017-18 final budget outcome (FBO) was mainly due to higher than budgeted expenses in the Department for Health and Wellbeing, Department for Child Protection and Department for Education. The key drivers of these overspends were the Central Adelaide Local Health Network Incorporated (CALHN) not achieving budgeted savings/efficiency improvements, additional costs for supporting children in care and increased State funding for non-government schools.

Section 4.1 provides further detail on the 2017-18 net operating balance.

1.2.8 Significant net lending deficits are expected for all four years of the 2018-19 Budget due mainly to higher capital spending

Significant net lending deficits are expected for the general government sector in all four years of the 2018-19 Budget. They range from $651 million to $928 million. The ongoing net lending deficits reflect the expansion of the SA Government's capital program in the Budget. We discuss this further in section 7.1.2.

The consistent net lending deficits over the four years are expected to result in a significant increase in borrowings, from $6.5 billion in 2017-18 to $10 billion in 2021-22.

1.2.9 The State expects to increasingly rely on Commonwealth GST revenue over the four years of the 2018-19 Budget

Over the four years of the 2018-19 Budget there is an upward trend in GST revenue received as a percentage of total revenue. This is expected to reach 37% in 2020-21. This trend reflects expected growth in the GST pool and South Australia's share of the pool, and is heightened by low growth in taxation revenue.

As GST revenue grants comprise an increasingly significant percentage of total revenues, the SA Government is particularly exposed to lower than expected growth in the GST pool. Further, changes to the methodology and data underlying the Horizontal Fiscal Equalisation (HFE) process for GST grant distribution have the potential to significantly impact (both positively and negatively) the State's revenue base and budget position. Section 5.2.4 provides further detail on the new GST distribution model effective from 2021-22.

1.2.10 Re-profiling of Commonwealth capital grant revenue significantly impacts budgeted operating surpluses

A total of $395 million in Commonwealth capital grant revenue has been brought forward in the 2018-19 Budget from out years,[1] due to changes in the timing of project milestones for capital projects. The change in funding profile has a significant positive impact on the net operating balance given the relatively small projected operating surpluses over the four years of the Budget.

1.2.11 The State's revenue base is becoming less diversified over the four years of the 2018-19 Budget

The previous SA Government initiated the commercialisation and sale of several government assets between 2012-13 and 2017-18, which we discuss in section 7.2.3. The total proceeds from these commercialisations and sales flowed through to net debt.

The other major impact of these transactions is on the State's revenue base, which is becoming less diversified over the period of the Budget, particularly for distributions from government owned corporations.

Distributions from government owned corporations are expected to decline from $650 million in 2017-18 to $329 million in 2021-22 as proceeds from the Motor Accident Commission (MAC) privatisation wind down. Dividends and income tax equivalent (ITE) income from the South Australian Water Corporation (SA Water) as a percentage of total distributions is projected to increase from 30% in 2017-18 to 77% by 2021-22 as other sources of contributions correspondingly fall.

Proceeds from sales of non-financial assets are also expected to be minimal after 2017-18 as no major future sales or commercialisations of government owned assets are included in the 2018-19 Budget.

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[1] From beyond the four years of the 2018-19 Budget (ie 2022-23 onwards).

As the State's revenue base becomes less diversified, and net debt becomes higher as a percentage of total revenue, it will have reduced capacity and flexibility to respond to economic shocks and downturns.

1.2.12 The State continues to face challenges in meeting Health and Wellbeing portfolio savings targets

The 2018-19 Budget states that previous Health and Wellbeing portfolio savings targets were not realistic or achievable and aims to reset savings targets to more sustainable levels. It provides Health and Wellbeing with substantial additional funding to reduce Health and Wellbeing's savings target and make its savings task more achievable. The 2018-19 Budget includes additional funding of $70 million in 2017-18 and $730 million from 2018-19 to 2021-22, and reduces Health and Wellbeing's savings task by $135 million to $381 million by the end of the forward estimates.

Health and Wellbeing's savings task has been reduced by an additional $83 million in the 2018-19 MYBR due to worse than expected financial performance and the identification of additional inefficiencies.

Health and Wellbeing's savings task is underpinned by the goal to deliver hospital services across South Australia at the National Efficient Price (NEP) by the end of the forward estimates. To help achieve this, the SA Government engaged KordaMentha to review CALHN's financial operations.

My previous Reports detail the history of savings initiatives for the Health and Wellbeing portfolio. The Health and Wellbeing portfolio has repeatedly failed to achieve its savings targets or has experienced service demands requiring additional funding. Previous savings strategies, including Transforming Health, have not worked. Until there is a demonstrated history of achieving savings goals, we expect the Health and Wellbeing savings strategies to remain a challenge.

Section 6.6 provides further detail on savings initiatives in the Health and Wellbeing portfolio.

1.2.13 The 2018-19 Budget introduces several new specific savings initiatives in addition to adopting the previous SA Government's efficiency dividends

The 2018-19 Budget introduces a substantial savings task, on top of the previous SA Government's savings targets, to fund budget overruns in the areas of health and child protection and contain expenditure growth. The Budget plans to deliver annual savings of $864 million by 2021-22. This comprises $715 million of savings from prior budgets and $149 million in new savings measures.

While the 2018-19 Budget includes specific savings measures, agencies are also still required to find considerable additional operating efficiencies to contain expenditure growth. They will have discretion as to how these operating efficiencies are achieved, including the option of reducing employee numbers. The Budget includes $170 million in 2018-19 to help agencies meet targeted voluntary separation package (TVSP) and separation costs associated with workforce reductions.

2 Audit mandate, objective and scope

2.1 Our mandate

The Auditor-General has authority to conduct this review under section 36(1)(b) of the *Public Finance and Audit Act 1987*. This section allows the Auditor-General to report on matters that, in his opinion, should be brought to the attention of Parliament and the SA Government.

2.2 Our objective

The objective of this Report is to provide independent commentary and analysis on the 2018-19 Budget to highlight key matters, trends and risks associated with the State's public finances.

2.3 What we reviewed and how

We reviewed the 2018-19 Budget to identify key matters, trends and risks currently relevant to the State's public finances. This involved:

- reviewing the Budget against the SA Government's stated fiscal strategy
- reviewing credit rating agency reports on the State
- examining the estimated results for the past year, the Budget and the forward estimates included in the Budget Papers
- analysing major assets and liabilities.

Our analysis is based on data provided in the Budget Papers, particularly the 2018-19 Budget and 2018-19 MYBR, supplemented with information provided by DTF. Our work on the 2018-19 Budget year's Government Finance Statistics (GFS) data included analytical procedures to ensure unexpected trends can be adequately explained.

We reviewed the 2017-18 FBO released by DTF in December 2018 to confirm the actual 2017-18 results for the general government sector compared to the Budget.[2]

We expect to table a separate report on the 2017-18 Consolidated Financial Report, including the actual results for the whole of government, in March 2019.

[2] The figures quoted in this Report for 2017-18, including those in graphs and charts, are derived from the 2017-18 Estimated Result in 2018-19 Budget Paper 3 *Budget Statement* unless otherwise stated.

2.4 What we did not review

This Report primarily comments on GFS based information. The data and assumptions underlying this information are not subject to audit and no audit opinion is provided on the accuracy of either the historical or prospective figures presented in the 2018-19 Budget. We have not performed work to provide an opinion on the effectiveness of the SA Government's budgetary control.

3 Fiscal strategy and State credit rating

> Key points
>
> - The net operating balance fiscal target is expected to be met for all four years of the 2018-19 Budget.
> - The general government net debt fiscal target changed in the 2018-19 Budget.
> - Standard & Poor's upgraded the State's credit rating while Moody's maintained its previous credit rating.

3.1 Fiscal strategy

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

3.1.1 Net operating balance target expected to be met for all four years of the 2018-19 Budget

The SA Government has a target of achieving a net operating surplus in the general government sector every year. The Budget forecasts small net operating surpluses for all four years. The budgeted 2018-19 surplus is $48 million, growing steadily to $211 million in 2021-22. The 2018-19 MYBR reduced the size of the surpluses across the forward estimates.

3.1.2 General government net debt target changed in the 2018-19 Budget

The SA Government aims to achieve a level of general government sector net debt that is sustainable over the forward estimates. This is a change from the 2017-18 Budget where the target was set as a maximum ratio of net debt to revenue of 35%.

The Budget explains that the cap has been removed to focus on a sustainable level of net debt, on the basis that there can be variability in debt levels over time as decisions are made to invest in infrastructure or the budget responds to challenging short and medium-term fiscal circumstances.

The Budget does not define what is considered a sustainable level of debt. DTF advised us that the SA Government considers the forecast level of debt to be sustainable on the basis that:

- it has maintained operating surpluses while fully funding its election commitments and addressing the major budget pressures

- the net debt to revenue ratio of 41.1% by 2021-22 is comparable to triple-A rated interstate jurisdictions, which are forecasting net debt to revenue ratios that range up to 41.8% by 2021-22
- with the specific savings measures announced in the Budget, and revised savings targets for Health and Wellbeing, the SA Government is well placed to ensure the current levels of debt forecast in the Budget are maintained.

DTF also indicated the debt target will be reviewed in 2018-19 in light of the implementation of the new accounting standard on the treatment of operating leases.

Figure 3.1: Net debt to revenue ratio and purchases of non-financial assets from 2017-18 to 2021-22

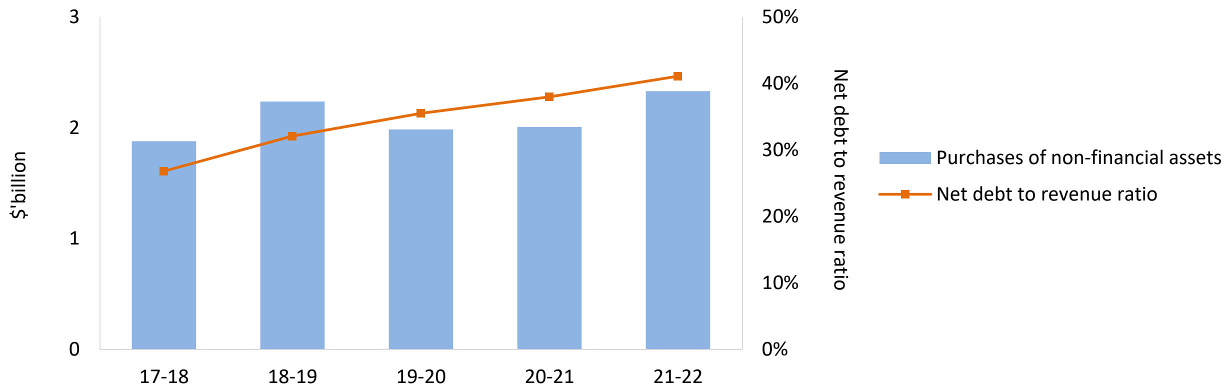


Figure 3.1 demonstrates a consistent upward trend in the net debt to revenue ratio over the four years of the Budget, rising from 32.1% in 2018-19 to 41.1% in 2021-22.

This reflects expected net lending deficits for all four years of the Budget due to a significant capital expenditure program. Purchases of non-financial assets range from $1.98 billion to $2.33 billion for each of these four years.

3.2 The State credit rating

3.2.1 Standard & Poor's upgraded the State's credit rating

In September 2018 Standard & Poor's upgraded the State's credit rating from AA with a positive outlook to AA+ with a stable outlook. Standard & Poor's indicated that this was because:

- it expects the State to achieve sustained operating surpluses
- the SA Government is taking material steps to achieve savings targets, which will contain expenditure growth and debt levels
- the State's ability to meet its short-term financial obligations with liquid assets continues to improve, supporting its financial management.

Standard & Poor's expects South Australia's stronger economic growth, larger than expected GST pool and savings targets to drive sustained operating surpluses beginning in 2019.

3.2.2 Moody's maintained a stable outlook for the State's credit rating

Moody's maintained the State's credit rating at AA1 with a stable outlook indicating the credit profile is underpinned by a strong institutional framework that incorporates support from secure and sizeable grants from the Commonwealth Government. Moody's also commented that although an upgrade is currently unlikely, a recovery in revenue growth combined with strong control over spending, resulting in a sustained period of budget surpluses and a material and sustained reduction in debt burden, could lead to upward rating pressure.

Moody's highlighted that South Australia is heavily reliant on GST transfers and grants from the Commonwealth Government, which are expected to account for 57.5% of total revenues in 2018-19, and that this reduces fiscal flexibility in terms of the SA Government's ability to adjust in response to economic shocks.

4 Operating statement

Key points

2017-18 result:

- The 2017-18 net operating balance deteriorated by $385 million between the original Budget and the FBO due mainly to overspends in CALHN and additional costs in child protection and education.
- The revised treatment of the land services commercialisation transaction in the FBO significantly changed the 2017-18 net lending result but has no impact on net debt.

2018-19 Budget:

- Small net operating surpluses are expected for all four years of the Budget.
- Large net lending deficits are expected for all four years of the Budget due mainly to the SA Government's significant capital program.
- Commonwealth GST revenue grants have been revised significantly upwards compared to the previous year's Budget.
- Significant policy initiatives introduced by the new SA Government include reductions in payroll and property taxes, savings relief for the Health and Wellbeing portfolio and measures aimed at achieving the NEP for CALHN health services.

4.1 Net operating balance

4.1.1 2017-18 net operating balance deteriorated by $385 million between the original Budget and the final budget outcome

Figure 4.1 shows the revisions made to the estimated 2017-18 net operating balance since the 2017-18 Budget and the FBO.

Figure 4.1: Revisions made to 2017-18 net operating balance

2017-18 net operating balance	Amount
2017-18 Budget estimate	$72 million surplus
2017-18 MYBR estimate	$12 million surplus
2018-19 Budget estimate	$397 million deficit
2017-18 FBO	$313 million deficit

The 2017-18 MYBR estimate was released by the previous SA Government in December 2017. The 2018-19 Budget estimate and 2017-18 FBO were released by the current SA Government in September 2018 and December 2018 respectively.

Figure 4.1 highlights that the estimated 2017-18 net operating balance result was revised downwards in the 2017-18 MYBR and again in the 2018-19 Budget, before being revised upwards to reflect the FBO.

The $385 million deterioration in the 2017-18 net operating balance between the 2017-18 Budget and 2017-18 FBO was mainly due to higher than budgeted expenses in the Department for Health and Wellbeing, Department for Child Protection and Department for Education. The key drivers of these overspends were CALHN not achieving budgeted savings/efficiency improvements, additional costs for supporting children in care and increased State funding for non-government schools.

This is partly offset by higher than budgeted other revenue, mainly due to recognising income received from the commercialisation of lands services and higher than expected revenues from contributed assets and fines and penalties.

Section 6.6 provides further detail on savings initiatives in the Health and Wellbeing portfolio.

4.1.2 Improvement in 2017-18 net operating balance between 2018-19 Budget and 2017-18 final budget outcome mainly due to higher than estimated sales revenue and other revenue

Figure 4.1 shows there was an $84 million improvement in the 2017-18 net operating balance between the 2018-19 Budget estimate and the 2017-18 FBO.

This improvement was due to a combination of higher than expected revenue ($146 million), partly offset by higher than expected expenditure ($62 million).

Operating revenues for the general government sector for 2017-18 were $146 million higher than estimated at the time of the 2018-19 Budget, largely due to higher than expected revenue from sales of goods and services ($85 million), other revenue ($92 million) and dividend and ITE revenue ($27 million), partially offset by lower grant revenue ($59 million). The increases in revenue were primarily due to:

- higher than expected recoveries from Land Services SA for seconded government staff services and use of ICT systems
- higher grant recoveries related to disability brokerage services
- additional revenue for the Pharmaceutical Benefits Scheme and Commonwealth Home Support Program
- higher than expected revenue from school materials and services fees and contributed assets, including donated art works

- higher than expected ITE revenue from SA Water
- recognising additional other revenue resulting from the revised accounting treatment for the land services commercialisation transaction.

Grant revenue was lower than estimated in the 2018-19 Budget mainly due to:

- lower than expected GST revenue grants resulting from lower than anticipated growth in the total GST pool available for distribution in 2017-18
- lower than anticipated national partnership payments, specific purposes payments and other contributions and grants from the Commonwealth, including payments under the National Health Reform Agreement and other health and education related revenue grants.

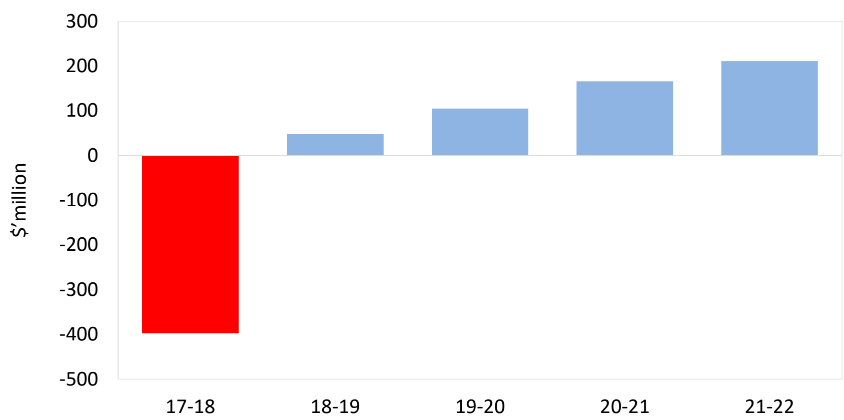
Operating expenses for the general government sector for 2017-18 were $62 million higher than estimated at the time of the 2018-19 Budget, largely due to:

- higher accrued interest expenses for the Treasurer's Loan from the South Australian Government Financing Authority (SAFA)
- higher other operating expenses due to the higher cost of caring for children in care, including backfilling of residential staff due to staff vacancies in the Department for Child Protection.

4.1.3 Small net operating surpluses expected for all four years of the 2018-19 Budget

Consistent small net operating surpluses are expected over all four years of the 2018-19 Budget. Figure 4.2 highlights that net operating surpluses are expected to trend upwards from 2018-19 to 2021-22, following the net operating deficit in 2017-18.

Figure 4.2: General government sector net operating balance from 2017-18 to 2021-22



The small net operating surpluses depend largely on growth in GST revenue grants and restraint in employee expenses.

Between 2018-19 and 2021-22, GST revenue grants are expected to grow in nominal terms between 3% and 8% p.a., and employee expenses are expected to decline in real terms by 6%.

These trends are discussed further in sections 5 and 6.

As the net operating surpluses over the four years of the Budget are small, ranging from $48 million in 2018-19 to $211 million in 2021-22, robust budget management will be needed to achieve the fiscal target of consistent operating surpluses. This includes limiting growth in employee expenses while achieving agency efficiency dividends and budgeted savings in the Health and Wellbeing portfolio. Further detail on these strategies is provided in section 6.

4.2 Net lending position

4.2.1 The final budget outcome for the 2017-18 net lending balance is a deficit of $977 million compared to an estimated surplus of $228 million in the 2017-18 Budget

Figure 4.3 shows the revisions made to the estimated 2017-18 net lending balance since the 2017-18 Budget and the FBO.

Figure 4.3: Revisions made to 2017-18 net lending balance

2017-18 net lending balance	Amount
2017-18 Budget estimate	$228 million surplus
2017-18 MYBR estimate	$1.065 billion surplus
2018-19 Budget estimate	$690 million surplus
2017-18 FBO	$977 million deficit

Figure 4.3 highlights that there has been significant variability in the estimated 2017-18 net lending balance during the year. This is mainly attributable to the land services commercialisation transaction, in particular the fact that:

- the proceeds of $1.605 billion from the transaction reflected in the 2017-18 MYBR were $855 million more than estimated in the 2017-18 Budget
- the deterioration between the 2018-19 Budget estimate and 2017-18 FBO is largely the result of a change in the accounting treatment for the transaction.

4.2.2 Revised treatment of land services commercialisation transaction in the final budget outcome has significantly changed the 2017-18 net lending result but has not impacted net debt

The SA Government received a $1.605 billion upfront payment in October 2017 for the land services commercialisation transaction.

The 2018-19 Budget reflected the transaction as a sale of a non-financial asset (intangible asset) in the 2017-18 estimated result. This resulted in an investing receipt and improved the net lending position in the operating statement and net debt in the balance sheet. There was no net operating balance impact from the transaction.

The budget treatment for the transaction was revised in the 2017-18 FBO to reflect the final GAAP accounting treatment for the transaction in DTF's 2017-18 financial statements.

DTF determined the principles of AASB 1059 *Service Concession Arrangements: Grantors* should be applied to the land services commercialisation transaction. Under the concepts of AASB 1059, the following revised accounting treatment was applied to the total proceeds of $1.605 billion:

- $1.525 billion in proceeds were recognised as an unearned revenue liability, with the revenue recognised on a straight-line basis over the 40-year term of the arrangement. For the period October 2017 to June 2018, $27 million in revenue was recognised. $38 million is recognised for each subsequent year of the arrangement. This has a positive impact on the net operating balance in those years.

- The transaction is no longer treated as proceeds from the sale of an intangible asset and hence is no longer shown as a capital receipt. The accounting change results in a $1.6 billion deterioration in the net lending position compared to the 2018-19 Budget.

- $80 million in proceeds for the Exclusive Right to Negotiate was recognised as a payable (liability) reflecting the possible repayment to Land Services SA if the State does not proceed with the commercialisation of another State registry or award an additional seven years on the contract. This Exclusive Right to Negotiate needs to be settled within three years. When settled, the $80 million will be recognised as revenue if it does not have to be repaid to Land Services SA.

The South Australian Integrated Land Information System and infrastructure used to deliver the services was reclassified as a service concession asset and revalued to its current replacement cost.

Table 1.1 of the 2017-18 FBO shows the impact on key general government financial indicators of applying AASB 1059 to the land services commercialisation transaction compared with the estimates in the 2018-19 Budget.

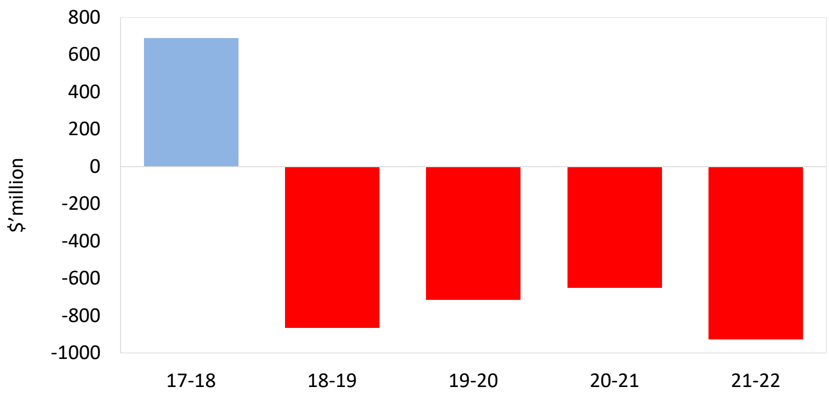
While the change in accounting treatment has affected the net operating balance and net lending, it has not altered the impact on net debt as the cash proceeds of $1.605 billion were received by the State on the execution of the commercialisation contracts in October 2017.

Auditor-General's Report 12 of 2018 *Land services commercialisation project* contains further information about the transaction and contract management arrangements.

4.2.3 Large net lending deficits expected for all four years of the 2018-19 Budget due mainly to the significant capital program

Figure 4.4 shows significant net lending deficits are expected for all four years of the 2018-19 Budget. The deficits range from $651 million to $928 million.

Figure 4.4: General government sector net lending balance from 2017-18 to 2021-22



The consistent net lending deficits over the four years are expected to result in a significant increase in borrowings, from $6.5 billion in 2017-18 to $10 billion in 2021-22.

The net lending deficits reflect the SA Government's significant capital program. The relationship between increases in net debt arising from consistent net lending deficits and the purchase of non-financial assets is highlighted in figure 3.1. Section 7.1.2 provides further detail on the SA Government's capital program.

4.3 Policy and parameter variations since 2017-18 Budget

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

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

Figure 4.5 summarises all parameter and policy changes made since the 2017-18 Budget that affect the net operating balance.[3]

[3] 2018-19 Budget Paper 3 *Budget Statement*, table 1.7.

Figure 4.5: Reconciliation of general government sector net operating balance

	2017-18 Estimated result $'million	2018-19 Budget $'million	2019-20 Estimate $'million	2020-21 Estimate $'million
2017-18 Budget estimated net operating balance	72	132	193	462
Parameter and other variations:				
Revenue – taxation	20	(9)	(30)	(38)
Revenue – other	83	293	384	285
Operating expenses	(49)	355	59	37
Net effect of parameter and other variations	54	639	413	284
Policy measures:				
Revenue – taxation	(92)	(187)	(213)	(268)
Revenue – other	(1)	(2)	1	5
Revenue – offsets	40	177	231	195
Operating expenses	(470)	(923)	(767)	(758)
Operating savings	1	213	248	244
Net effect of policy measures	(522)	(722)	(500)	(582)
2018-19 Budget estimated net operating balance	(397)	48	105	166

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

The new SA Government has introduced a range of new policy measures in the 2018-19 Budget that significantly impact taxation revenue, operating expenses and operating savings.

4.3.1 Revenue parameter variations

Figure 4.6 shows the components of revenue parameter changes.[4]

Figure 4.6: Revenue parameter changes since the 2017-18 Budget

	2017-18 Estimated result $'million	2018-19 Budget $'million	2019-20 Estimate $'million	2020-21 Estimate $'million
All State taxation	20	(9)	(30)	(38)
Commonwealth specific purpose and national partnership grants:				
Special purpose	61	(81)	(77)	(70)
National partnership	(125)	21	(112)	(58)
GST revenue grants	72	333	489	445
Sales of goods and services	(4)	(96)	(109)	(129)
Other contributions and grants	14	19	7	7
Dividends and income tax equivalents	58	58	127	70
Royalties	(14)	12	5	7
Other	22	27	54	13
Total	104	284	354	247

Note: Totals may not add due to rounding.

[4] Sourced from 2018-19 Budget Paper 3 *Budget Statement*, table 1.9 and 2017-18 MYBR, table 1.7.

Commonwealth GST revenue grants revised significantly upwards

GST revenue has been revised significantly upwards over all four years since the 2017-18 Budget. The cumulative total of GST write-ups from 2017-18 to 2020-21 is $1.3 billion. The write-ups reflect the impact of the Commonwealth Grants Commission's 2018 update on South Australia's grant share,[5] as well as an upward revision of national GST pool estimates across all years included in the Commonwealth Government's 2018-19 Budget.

GST revenue grants, including the Commonwealth framework for calculating the grants, are discussed further in section 5.

Other Commonwealth grants revised downwards

Commonwealth Government specific purpose grants have been revised up in 2017-18 and down in all other years. The increase in 2017-18 mainly reflects additional funding received under the National Health Reform Agreement. The downward revisions in future years are primarily due to the removal of funding received under the National Affordable Housing Specific Purpose Payments in the new National Housing and Homelessness Agreement. This change has been reflected as a specific policy measure rather than a parameter variation and there is no overall impact on housing funding.

Commonwealth Government national partnership grants have been revised up in 2018-19 and down in all other years. The upward revision in 2018-19 mainly reflects delays in Commonwealth payments for projects originally budgeted for in 2017-18 but now expected in 2018–19. The downward revision in future years mainly reflects better estimates of Commonwealth funding, including confirmation of 50:50 funding for the North–South Corridor Regency Road to Pym Street project.

Dividend and income tax equivalent revenue revised upwards

Dividend and ITE revenue has been revised up in all years. This is mainly due to:

- higher than expected distributions from SAFA arising from treasury, fleet and insurance operations
- dividends from MAC reflecting the performance of assets under management and the release of risk margins held in liability provisions as claims settlements occur
- higher SA Water distributions from 2018-19, reflecting lower than expected operating costs.

4.3.2 Operating expense parameter variations

Figure 4.5 shows that parameter effects are estimated to decrease operating expenses by $402 million over the four years to 2020-21. This is mainly due to:

- nominal superannuation interest expenses being revised downward due to movements in the discount rate used to calculate the expense

[5] Commonwealth Grant Commission, *Report on GST Revenue Sharing Relativities, 2018 update*, Canberra, March 2018.

- moving expenditure between budget years, including timing changes for Commonwealth funded programs
- expected changes to expenditures driven by demand for government services.

4.3.3 Revenue policy variations

Policy variations introduced by the new SA Government in the 2018-19 Budget will reduce taxation revenue between 2018-19 and 2020-21 by $426 million. This mainly reflects:

- the reinstatement of general fixed property remissions for the Emergency Services levy ($270 million)
- changes to payroll tax exemption thresholds and rates ($109 million)
- reform of land tax thresholds and rates ($47 million).

4.3.4 Operating expense policy variations

Figure 4.7 shows the value of operating expense policy measures taken in each of the past five years after presenting the Budget for the year.[6]

Figure 4.7: Policy spending decisions

	2013-14 $'million	2014-15 $'million	2015-16 $'million	2016-17 $'million	2017-18 $'million
Policy measure operating expenses	226	164	272	247	470

Figure 4.7 shows that $1.379 billion in total was added to spending for the past five years at an average of $276 million p.a.

Policy spending decisions since the 2017-18 Budget are expected to add a further $2.9 billion to operating expenses over the four years to 2020-21. The more significant operating expense policy variations introduced by the new SA Government between 2017-18 and 2020-21 are:

- savings relief in the Health and Wellbeing portfolio ($619 million)
- establishing the Skilling South Australia initiative to create additional apprenticeships and traineeships ($148 million)
- energy solution reforms aimed at improving the reliability, affordability and security of the State's energy supply ($145 million)
- establishing the Economic and Business Growth Fund ($70 million)
- continuing the TVSP scheme across government to meet the costs of TVSPs and/or separation payments offered by agencies to meet their budget savings targets ($150 million).

6 2018-19 Budget Paper 3 *Budget Statement*, table 1.7.

4.3.5 Operating savings policy variations

The new SA Government has introduced several new operating savings policy variations, totalling $705 million between 2018-19 and 2020-21. The agencies with the most significant savings include the Department for Correctional Services, Department for Environment and Water, Department for Health and Wellbeing, Department of Planning, Transport and Infrastructure, Department of the Premier and Cabinet and DTF.

The more significant operating savings policy variations introduced by the new SA Government between 2017-18 and 2020-21 include:

- implementing reforms to ensure more health services are delivered at the NEP ($136 million)
- rationalising staffing resources across DTF, including a reduction in accommodation expenditure and general efficiencies ($59 million)
- implementing operating efficiencies for the Department of Planning, Transport and Infrastructure by rationalising lower priority services and reviewing corporate, operational support and road management functions ($32 million).

Savings initiatives are discussed further in section 6.

5 Operating revenues

Key points

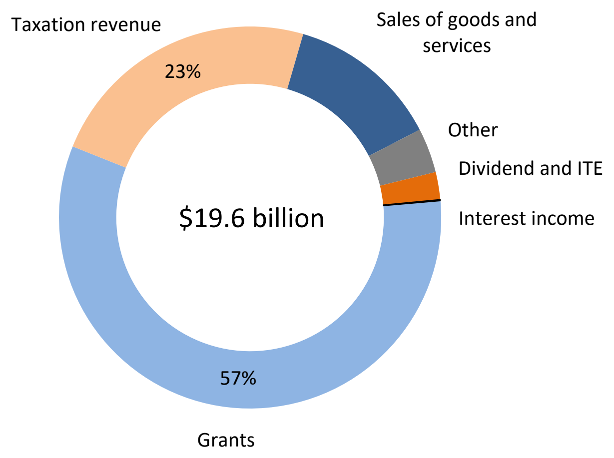
- Projected revenue growth is low compared to prior years, averaging 2.7% p.a. from 2017-18 to 2021-22.
- Strong growth is expected in GST revenue grants in 2018-19 at 8%, before declining to 2.8% growth in 2021-22.
- GST revenue is estimated to contribute at least 35% of total revenue across all four years of the 2018-19 Budget and represents an increasing proportion of total revenue.
- Revisions to South Australia's share of GST revenue in the Commonwealth Government 2018-19 MYEFO presents a risk to achieving a net operating surplus in 2018-19.
- Revisions to the funding profile for major infrastructure projects have had a favourable impact on the net operating balance from 2018-19 to 2020-21. $144 million in capital revenue has been brought forward to 2018-19 and $395 million in total from out years due to construction timing.
- Taxation revenue is projected to grow by around 3% p.a. on average from 2017-18 to 2021-22. Growth in taxation revenue is limited by policy changes to payroll tax, land tax and the Emergency Services levy.
- Distributions from SA Government owned corporations are expected to decline from $650 million in 2017-18 to $329 million in 2021-22.
- SA Water is becoming the main source of distributions income over the forward estimates as distributions from MAC diminish. Distributions from SA Water are expected to grow from 30% of total distributions in 2017-18 to 77% in 2021-22.

5.1 Total operating revenues – trends and issues

5.1.1 Grant revenue and taxation revenue represent 80% of total operating revenues

Figure 5.1 shows budgeted revenue in 2018-19 primarily comprises grants (57%) and taxation revenue (23%). Payroll tax and property taxes make up 66% of taxation revenue.

Figure 5.1: 2018-19 general government revenue by class



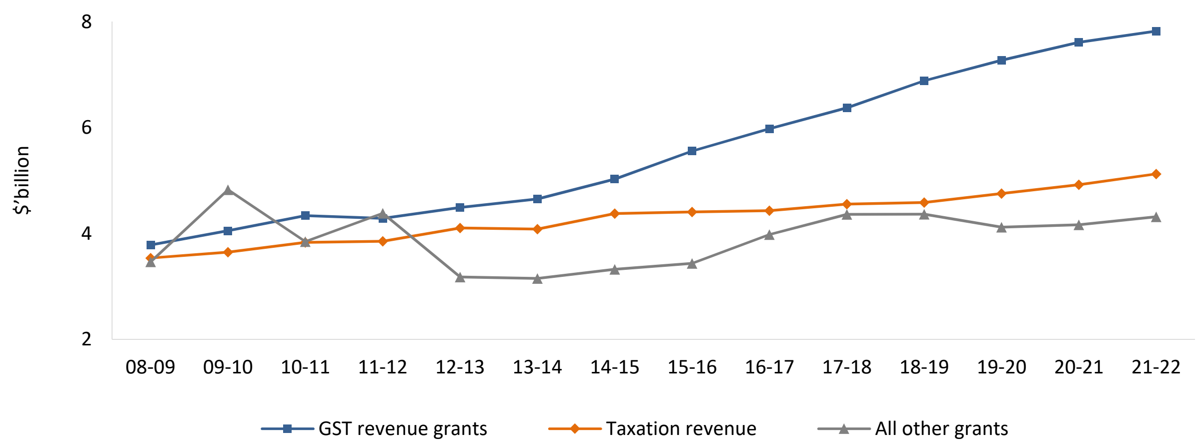
5.1.2 Low projected revenue growth compared to prior years

The Budget notes total general government revenues are projected to grow by 2.7% p.a. (0.3% p.a. real) on average from 2017-18 to 2021-22. This relatively low growth compared to prior years reflects the following offsetting factors:

- the introduction of taxation relief measures in the 2018-19 Budget
- declining dividend revenue from the MAC (refer to section 5.5 for further discussion)
- declining Commonwealth Government national partnership grants, reflecting the expected completion of numerous major infrastructure projects
- growth in GST revenue grants.

Figure 5.2 shows expected trends for the major revenue items in the 2018-19 Budget against the experience of the 10 years to 2017-18.

Figure 5.2: General government sector Commonwealth grants and taxation revenue



The trends in GST revenue grants, taxation revenue and other grants are discussed further in the sections that follow.

5.2 GST revenue grants

5.2.1 Growth in GST revenue grants expected to be strong in 2018-19 before lower growth over the forward estimates

Figure 5.2 shows the significant growth in GST revenue grants from 2015-16 to 2018-19. There is then growth at a declining rate through to 2021-22. Growth of 8% is estimated in 2018-19 before declining to 2.8% in 2021-22.

As noted in section 4, parameter variations revised GST revenue upwards across all four years of the Budget. The cumulative increase in GST from 2017-18 to 2020-21 is $1.3 billion. The increase reflects the impact of the Commonwealth Grants Commission's 2018 update on South Australia's grant share, as well as an upward revision of national GST pool estimates across all years included in the Commonwealth Government's 2018-19 Budget.

South Australia's per capita relativities for the distribution of GST revenue grants increases in 2018-19, resulting in South Australia receiving 10.3% of the GST pool in 2018-19 compared to 10.1% in 2017-18. The Budget Papers indicate that, based on the new relativity and current GST pool estimates for 2018-19, South Australia will receive around $2 billion more than it would if funding was distributed on a simple population share basis.

After 2018-19, South Australia's GST relativity is expected to be impacted by moderation in eastern States' property markets, changes in the State's share of Commonwealth grant payments and below average population growth.

5.2.2 The State's increasing reliance on GST revenue

The significance of GST and taxation revenue is demonstrated in figure 5.3, which shows the actual ratio of GST and taxation revenue to total general government sector revenue up to 2016-17 and the estimated ratio from 2017-18 to 2021-22.

Figure 5.3: GST revenue and taxation revenue as a percentage of total revenue

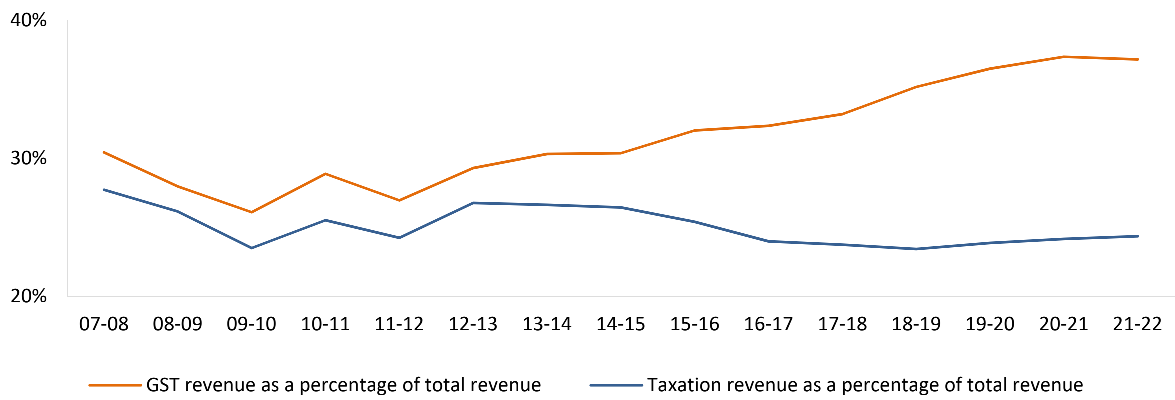


Figure 5.3 shows the widening gap between the GST and taxation revenue ratios from 2014-15 to 2020-21, as a greater proportion of total revenue is expected from GST revenue grants and a diminishing proportion from taxation revenue. The GST revenue ratio grows from 33% of total revenue in 2017-18 to 37% in 2020-21 and is consistently 35% or more across the four years of the Budget. This trend reflects expected growth in the GST pool and South Australia's share of the pool. Meanwhile there is low growth in taxation revenue due to the factors explained in section 5.4.

GST revenue is primarily dependent on the level of national economic activity, while taxation revenue is mainly driven by State economic activity. The increased proportional reliance on GST revenues heightens exposure to national economic activity.

The Budget notes that South Australia's reliance on GST revenue grants increases its risk exposure to lower than expected growth in the GST pool. Further, changes to the methodology and data underlying the HFE process for GST grant distribution have the potential to significantly impact (both positively and negatively) the State's revenue base and budget position.

Risk analysis in the Budget Papers highlights the importance of GST revenue to the Budget projections:

- A 1% change in GST pool growth has a revenue impact for South Australia of about $69 million p.a.
- A 0.01 change in South Australia's relativity would result in a change in GST revenue grants of about $42 million.

5.2.3 Revisions to GST revenue grants by the Commonwealth Government present a risk to achieving a net operating surplus in 2018-19

The Commonwealth Government's 2018-19 MYEFO, released on 17 December 2018, revised South Australia's GST revenue grants for 2018-19 down by $72 million, mainly due to a decrease in GST receipts collected. The downward revision is not reflected in the SA Government's 2018-19 MYBR, which was released before the 2018-19 MYEFO.

As the estimated net operating surplus for the general government sector in the 2018-19 MYBR is small ($40 million), the downward revision to GST revenue grants presents a risk to achieving the projected net operating surplus in 2018-19. This highlights the State's susceptibility to small variations in this revenue stream and high degree of reliance on GST revenue.

5.2.4 New GST distribution model effective from 2021-22

In May 2018 the Productivity Commission released its final report on its inquiry into Australia's system of HFE.

Legislation was passed by the Federal Parliament in November 2018 to give effect to key elements of the Commonwealth Government's interim response to the Productivity Commission's report. The legislative changes introduce a new GST distribution system and transitional arrangements.[7]

The new GST distribution model will come into effect from 2021-22 and as such will have no impact on South Australia's GST revenue until this time. This legislation will provide South Australia with a degree of revenue certainty, but only for the transition period.

At the time of preparing the 2018-19 Budget, no aspects of the Commonwealth Government's response to the Productivity Commission had been finalised and therefore no adjustments were made to estimates in the 2018-19 Budget for the new GST distribution system.

GST revenue for 2021-22 was revised upwards by $41 million in the 2018-19 MYBR to reflect the estimated impact of the new GST distribution system.

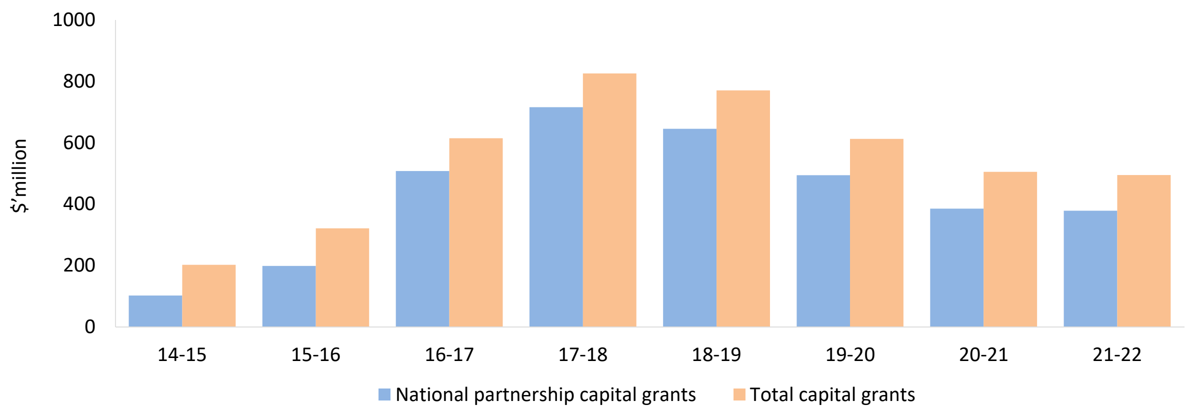
DTF advised us that the actual impacts of the new model are difficult to estimate as they are sensitive to forecasts of States' GST relativities, the GST pool and population. Projections by the Commonwealth indicate that South Australia will be $257 million better off from 2021-22 to 2026-27 under the new GST distribution system.

5.3 Other Commonwealth grants

5.3.1 Re-profiling of Commonwealth capital grant revenue significantly impacts budgeted operating surpluses

Figure 5.4 shows the recent trend in actual Commonwealth capital grant funding over recent years and the expected trend over the four years of the 2018-19 Budget.

Figure 5.4: Commonwealth capital grant funding



7 Refer to the Treasury Laws Amendment (Making Sure Every State and Territory Gets Their Fair Share of GST) Bill 2018, *Explanatory Memorandum* <https://parlinfo.aph.gov.au/parlInfo/download/legislation/ems/r6203_ems_b4177aab-9050-4e38-8881-649c45bcb2ed/upload_pdf/687636.pdf;fileType=application/pdf>, viewed January 2019, for further details about the legislative amendments.

Most of this funding reflects national partnership grants for road and rail transport infrastructure projects.

Commonwealth capital grants peak in 2017-18, before trending downwards and levelling off over the forward estimates.

The increase in Commonwealth capital grants between 2016-17 and 2017-18 largely reflected changes to the profile and timing of funding for major projects, including funding for the Darlington upgrade, the Goodwood/Torrens rail junction project and the Tonsley rail extension project.

Capital grant funding in 2018-19 remains high due to the revised funding profile for three major infrastructure projects[8] resulting in $144 million being brought forward to 2018-19. In total $395 million has been brought forward in the Budget from out years for these projects due to changes in the timing of project milestones. The change in funding profile has a significant positive impact on the net operating balance given the relatively small projected operating surpluses over the four years of the Budget.

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

5.4 Taxation revenue

5.4.1 Growth in payroll tax between years is relatively consistent while conveyance duty is more volatile

The two largest items of State taxation are payroll tax and conveyance duty. Historically, growth in payroll tax has been relatively consistent between years while conveyance duty has been more variable.

The difference in the volatility of these two taxation revenue sources is represented in figure 5.5, which shows actual annual nominal percentage changes from 2006-07 to 2016-17 and the estimated changes from 2017-18 to 2021-22.

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8 The North–South Corridor Regency Road to Pym Street upgrade, the Gawler Rail Electrification project and the duplication of the Joy Baluch AM Bridge.

Figure 5.5: Annual percentage change in payroll tax and conveyance duty

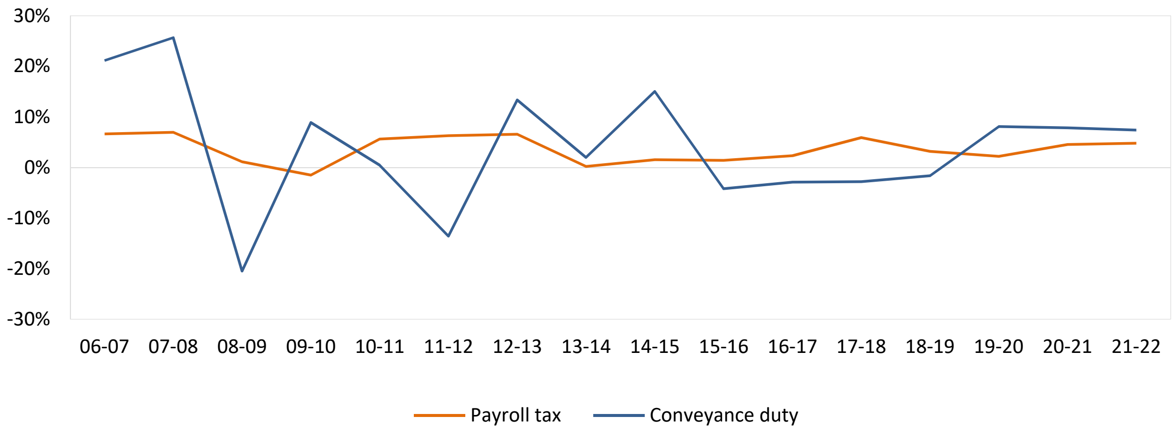


Figure 5.5 shows the relative stability of payroll tax growth over the period in comparison to the significant fluctuations in conveyance duty. It also demonstrates that over the forward estimates, while payroll tax is expected to grow modestly, conveyance duty is expected to grow by around 8% in 2019-20 and 2020-21.

5.4.2 Low growth in taxation revenue largely due to SA Government policy measures

Taxation revenue is projected to grow by around 3% p.a. (0.6% p.a. real) on average from 2017-18 to 2021-22. The Budget attributes this low growth rate to:

- the full abolition of stamp duty on non-residential property (excluding primary production) transfers from 1 July 2018
- the impact of the SA Government's taxation measures, which reduce payroll tax, land tax and the Emergency Services levy.

Payroll tax threshold changes, reinstating the Emergency Services levy general remission and land tax reductions are estimated to reduce taxation revenue by $613 million over the four years of the Budget.

5.4.3 Payroll tax estimates primarily driven by State employment trends and economic factors

Payroll tax estimates are based on the outlook for employment and wages growth and payroll compositional factors (eg employment mix across smaller and larger businesses). The Budget identifies a risk that employment or wages growth will be lower than forecast, which would reduce payroll tax revenue. Risk analysis in the Budget Papers notes that a 1% change in taxable payrolls equates to about $14 million in payroll tax revenue.

5.4.4 Conveyance duty largely depends on residential property market activity

Conveyance duties are sensitive to both transaction levels and property prices. The Budget assumes that underlying residential property market transactions are expected to grow moderately over the forward estimates and return to long-term trend levels over the medium term. Property prices are expected to grow moderately over the forward estimates.

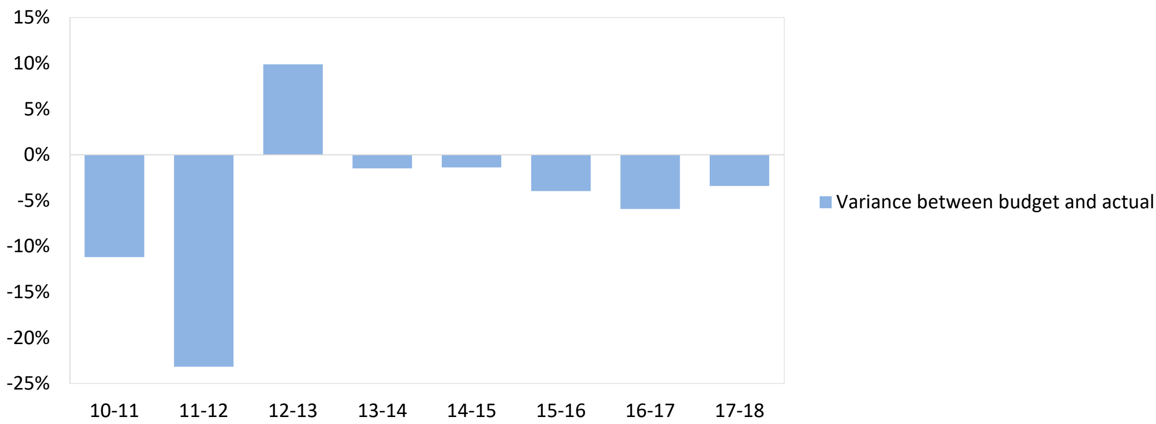
The Budget comments on the difficulty in predicting trends in property market values and activity levels, particularly transaction numbers which can change significantly from year to year. This makes forecasting conveyance duties difficult. Since 1999-2000 the annual growth in conveyance duty revenue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

The Budget notes that the removal of conveyance duty on transfers of non-residential property (excluding primary production) from 1 July 2018 will reduce the forecasting error associated with irregular large commercial transactions.

5.4.5 Conveyance duty historically revised downwards from estimates in the original Budget

Figure 5.6 compares budget to actual outcomes for conveyance duty since 2010-11. It illustrates that conveyance duty estimates have been generally optimistic and consistently revised downwards, with the exception of 2012-13 when actuals were higher than budgeted mainly due to large one-off transactions.

Figure 5.6: Conveyance duty variance between budget and actual results



The difficulties with predicting trends in property market values and transaction levels is further illustrated by the revision to conveyance duty in the 2018-19 MYBR, only three months after the release of the 2018-19 Budget. The 2018-19 MYBR reduces conveyance duty by $22 million in 2018-19 and $106 million in total over the four years of the Budget. The 2018-19 MYBR attributes the downward revision mainly to softer year-to-date growth in residential property values and transaction numbers, as well as lower transaction growth estimates from 2019-20.

5.5 Dividend and income tax equivalent income

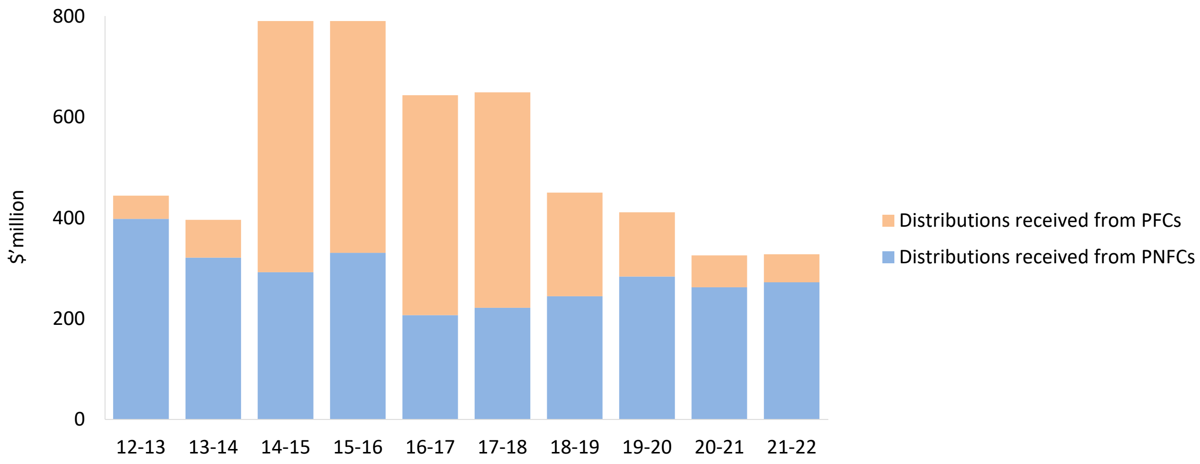
5.5.1 Dividend and income tax equivalent income trends significantly downwards over the forward estimates

Dividend and income tax equivalent income in the general government sector reflects distributions received from public non-financial corporations (PNFCs) and public financial corporations (PFCs).

In 2017-18 total distribution income is estimated to be $650 million, predominantly comprising the dividend payment from MAC to the Highways Fund of $342 million and SA Water dividend and ITE payments totalling $198 million.

Figure 5.7 shows the trend in total distributions received from PNFCs and PFCs for the 10 years to 2021-22.

Figure 5.7: Distributions received by the general government sector



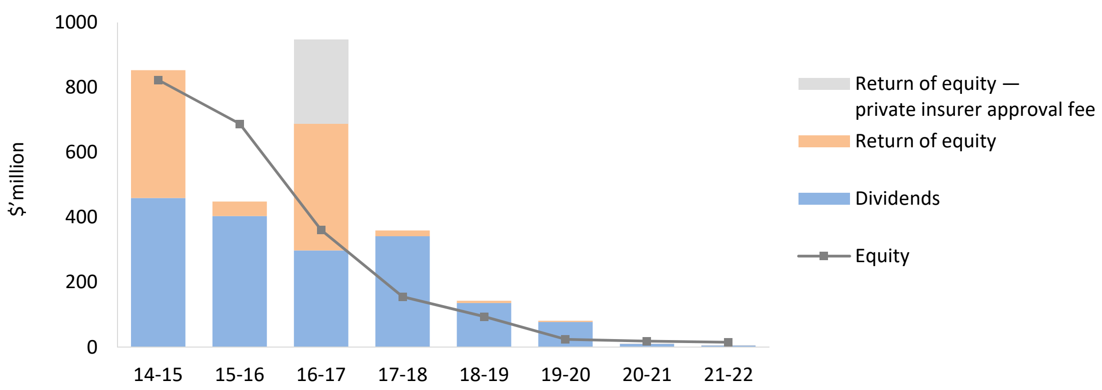
Total distributions peaked in 2014-15 and 2015-16 and are expected to trend significantly downwards over the forward estimates.

Distributions from government owned corporations are expected to decline from $650 million in 2017-18 to $329 million in 2021-22.

Distributions since 2014-15 have been driven in large part by the privatisation of MAC. Table 1.5 of 2018-19 Budget Paper 3 *Budget Statement* details the actual and estimated MAC dividends for the period 2014-15 to 2021-22.

MAC dividends are expected to significantly decrease from $342 million in 2017-18 to less than $6 million in 2021-22, as the amount of equity available for distribution diminishes. Figure 5.8 shows the decline in MAC's available capital and corresponding distributions from 2014-15 to 2021-22.

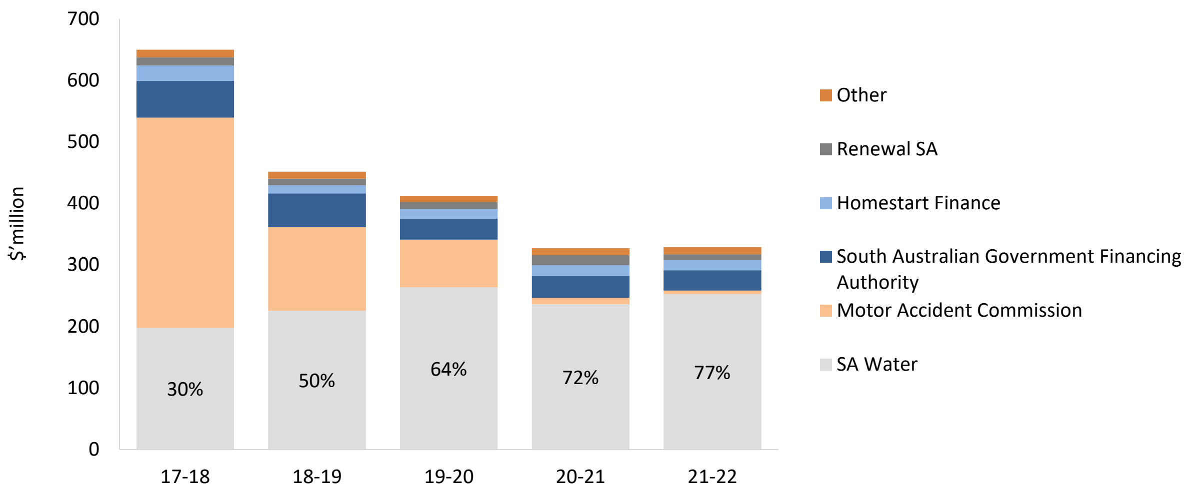
Figure 5.8: MAC distributions and equity



5.5.2 SA Water is becoming the main source of distributions income over the forward estimates

Figure 5.9 show that the SA Government's distributions revenue is becoming less diversified over the four years of the Budget as the distributions from MAC diminish.

Figure 5.9: Sources of distributions



SA Water is expected to become the main source of distributions, with its dividends and ITE income increasing from 30% of total distributions in 2017-18 to 77% in 2021-22.

5.5.3 SA Water's debt to asset ratio will impact its ability to make special dividends

The 2017-18 Budget included a decision to maintain SA Water's debt to asset ratio at 45%. This means that at the end of each financial year, if SA Water's gearing is below 45% it will increase its borrowings to return the gearing level to 45%. This involves SA Water returning a capital contribution to the Treasurer for the same amount as its borrowings increase for credit to the Consolidated Account (special dividend).

In the 2017-18 MYBR, SA Water was forecast to make a $64 million return of capital contribution in 2017-18. In the 2018-19 Budget, however, SA Water's debt to asset ratio exceeded 45% and therefore it did not make this payment.

Additional borrowings by SA Water to fund the Zero Net Electricity Cost 2020 project are also forecast to result in a debt to asset ratio above 45% in 2018-19 and 2019-20, reducing its ability to make special dividends to the SA Government. The Budget Papers note that initiative will reduce special dividends to the SA Government by around $186 million by the end of the forward estimates.

6 Operating expenses

Key points

- Restraint in expenditure growth in the 2018-19 Budget is underpinned by a substantial annual savings task of $864 million by 2021-22, comprising $715 million of savings from prior budgets and $149 million in new savings measures.
- Previous health savings strategies have not been effective. The 2018-19 Budget provides $730 million of additional funding to Health and Wellbeing[9] from 2018-19 to 2021-22, on top of $70 million in 2017-18.
- The savings task for Health and Wellbeing has also been revised downwards from $516 million to $381 million by the end of the forward estimates. These initiatives are to make Health and Wellbeing's savings task more achievable while moving towards the NEP for hospital services by end of the forward estimates.
- General government sector employees are expected to fall by 4013 FTEs by 2021-22, reflecting the impact of savings measures and transition of staff to the non-government sector as part of the National Disability Insurance Scheme (NDIS). The Budget includes $170 million in 2018-19 to help agencies meet TVSP and separation costs associated with workforce reductions.

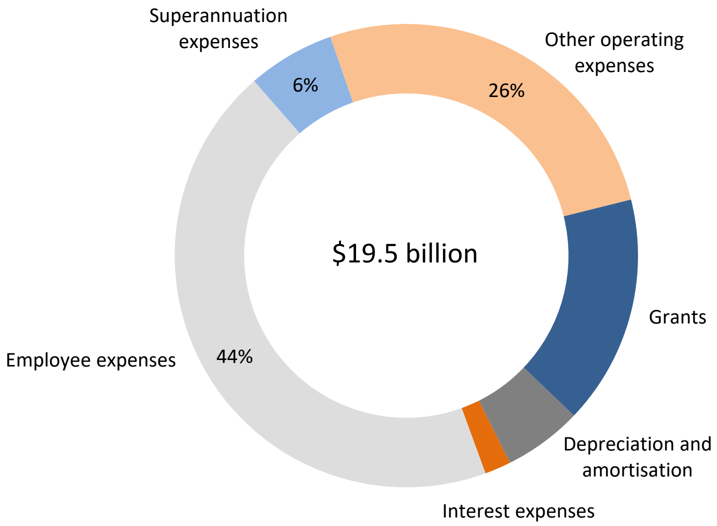
6.1 Total operating expenses – trends and issues

6.1.1 Employee and superannuation expenses account for half of total operating expenses

Figure 6.1 shows that in 2018-19, employee and superannuation expenses combined represent half of general government operating expenditure. Other operating expenses represent 26% of general government operating expenditure and include items such as supplies and services, consultancies, contractors and repairs and maintenance expenses.

[9] The Health and Wellbeing portfolio comprises the Department for Health and Wellbeing, CALHN, the Northern Adelaide Local Health Network Incorporated, the Southern Adelaide Local Health Network Incorporated, the Women's and Children's Health Network Incorporated, the Country Health SA Local Health Network Incorporated, the SA Ambulance Service Inc and the SA Mental Health Commission.

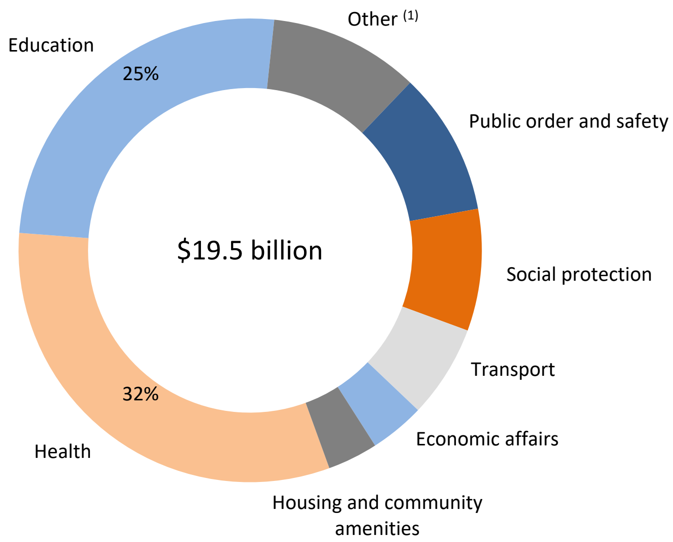
Figure 6.1: 2018-19 general government expenses by class



6.1.2 Health and education sectors represent 57% of total operating expenses

Figure 6.2 shows the split of 2018-19 Budget year expenses by sector and demonstrates the extent to which the health and education sectors dominate overall expenditure by the SA Government.

Figure 6.2: General government sector expenses by function[10],[11]



(1) Includes recreation, culture and religion, environmental protection, and other functions.

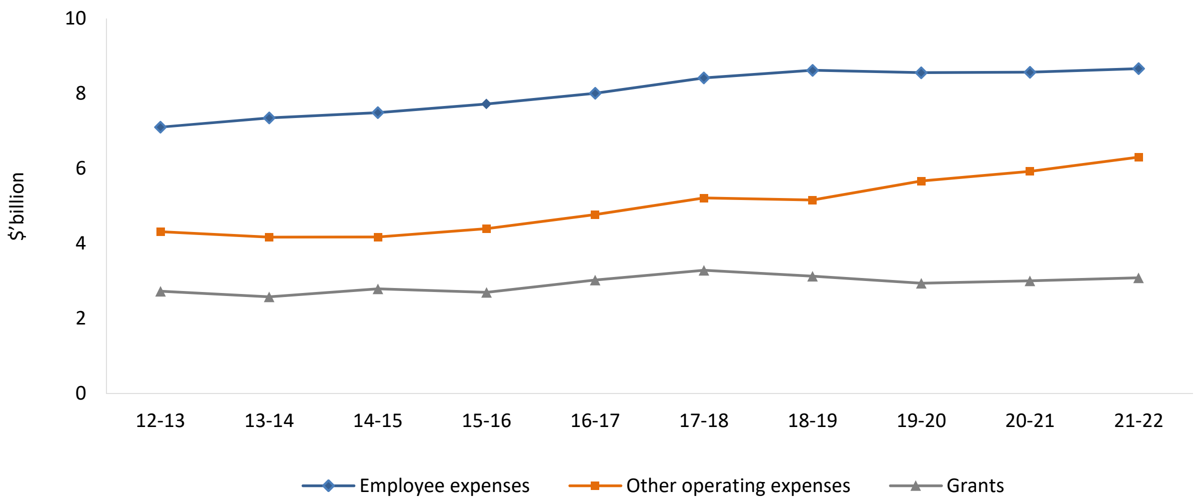
[10] 2018-19 Budget Paper 3 *Budget Statement*, table A.16.

[11] The 2018-19 Budget is the first budget presented using the *Classification of the Functions of Government* classification framework, which replaces the former *Government Purpose Classification* framework.

6.1.3 Growth in expenses limited to 1.6% p.a. on average over the four years of the Budget

Figure 6.3 shows trends expected for major expenses lines in the 2018-19 Budget, against the experience of the previous six years.

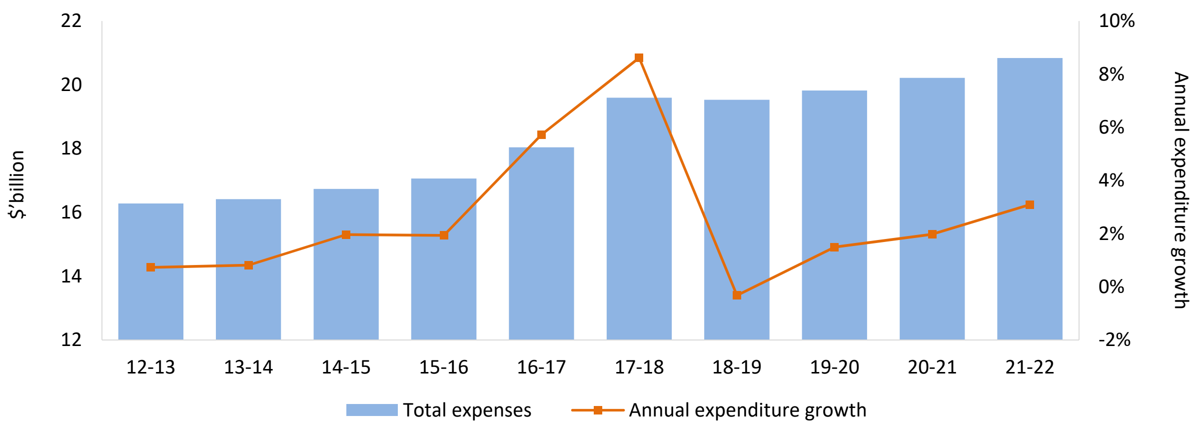
Figure 6.3: General government sector key expense types



The 2018-19 Budget expects significant restraint in spending, with growth in total operating expenses limited to 1.6% p.a. nominal (negative 0.8% p.a. real growth) on average over the four years of the Budget.

Figure 6.4 shows that growth in total expenses over the four years of the Budget is significantly lower than it was in 2016-17 and 2017-18.

Figure 6.4: General government sector total expenses



Higher levels of expenditure growth occurred in 2016-17 and 2017-18 mainly due to:

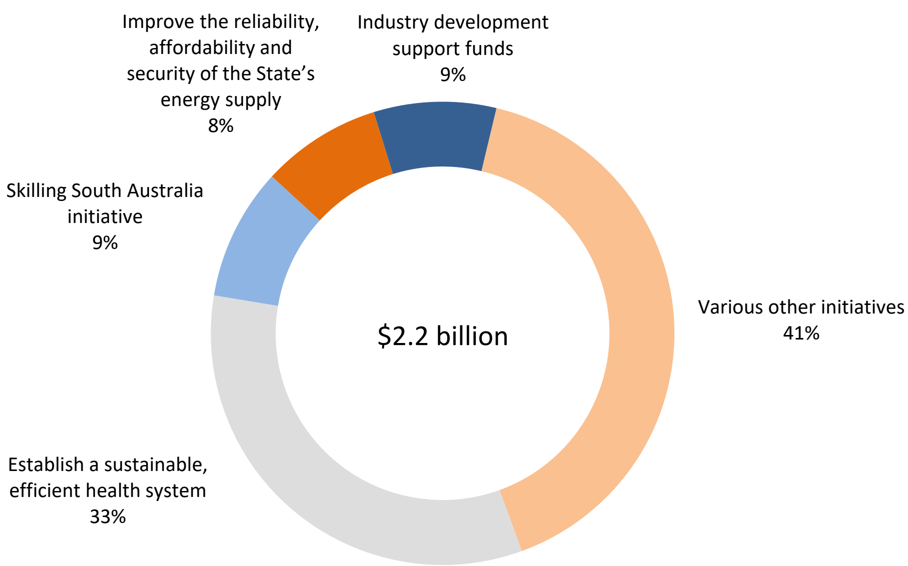
- a number of one-off factors in 2016-17 including additional lease payments for TAFE SA assets transferred to the Urban Renewal Authority (Renewal SA), the timing of onpassing Commonwealth Government funding to local government and additional resources for the State’s response to the Child Protection Systems Royal Commission
- 2017-18 including the start of full-year operating service payments associated with the new Royal Adelaide Hospital (nRAH) and the implementation of significant initiatives introduced in the 2016-17 MYBR and 2017-18 Budget (including the Our Energy Plan initiative and the full-year impact of the State’s response to the Child Protection Systems Royal Commission).

The trends in employee expenses, other operating expenses and grant expenses, are discussed further in the sections that follow.

6.1.4 $2.2 billion in new operating initiatives in the 2018-19 Budget

The 2018-19 Budget contains new operating initiatives totalling $2.2 billion over the next four years. The major initiatives focus on the areas of health, training and job creation, energy and industry support as shown in figure 6.5.

Figure 6.5: New operating initiatives

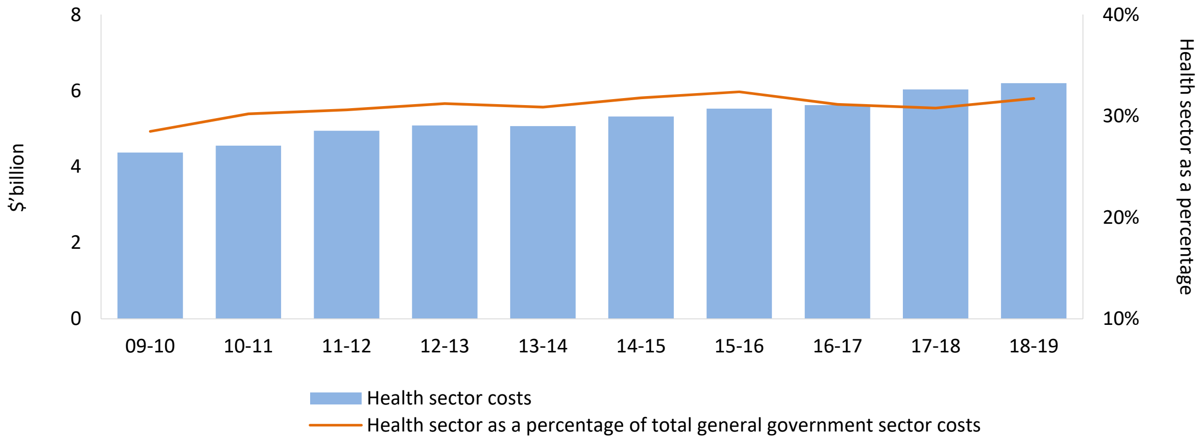


6.1.5 Hospital expenditure growth

Health sector costs are a significant component of the general government sector budget and hospital expenditure growth remains a highlighted risk in the 2018-19 Budget, as it has for many years.

Figure 6.6 shows the actual health sector costs over the past eight years, the 2017-18 estimated cost and the 2018-19 budgeted cost, compared to total general government sector costs.

Figure 6.6: Health sector costs



The Budget notes that a 1% increase in hospital expenditure above the level in the 2018-19 Budget would increase expenditure by around $56 million p.a.

6.1.6 $392 million in contingencies provides expenditure flexibility

Contingency amounts are incorporated into the Budget to provide flexibility if additional expenditure needs to be made by the SA Government. Figure 6.7 shows the composition of contingency provisions for 2017-18 and 2018-19.

Figure 6.7: Contingency provisions

	2017-18 Budget $'million	2017-18 Estimated result $'million	2018-19 Budget $'million
Employee entitlements	69	20	220
Investing contingencies	114	9	18
Supplies and services	398	258	154
	581	287	392

While allocating sums to each of the categories for presentation purposes, contingency funds may also be transferred from other lines where available.

The 2018-19 Budget includes contingency amounts totalling $392 million, $105 million more than the estimated outcome for 2017-18.

Contingencies for employee entitlements are higher in 2018-19 mainly due to the $170 million funding for TVSP and separation payments, as discussed in section 6.2.3. This is partly offset by contingencies for supplies and services, which were higher in 2017-18 due primarily to the inclusion of Our Energy Plan implementation costs of $103 million.

6.1.7 Transition to the National Disability Insurance Scheme impacts the expenditure profile

The SA Government is targeting full transition to the NDIS by 30 June 2019. The timing of transition and changes in funding arrangements impact the expenditure profile in 2018-19 and over the forward estimates

The Budget indicates that under the transition, 1727 FTEs are expected to transfer from the public sector to non-government organisation service providers by 2021-22.

The Budget Papers note that the transition will result in a change in classification of expenditure, with expenditure previously recorded as grants and employee expenses being recognised as NDIS contributions included in other operating expenses. This accounts for the substantial growth in other operating expenses from 2019-20 onwards.

DTF advised us that the Budget assumes that there will not be an increase in costs or savings to the SA Government under the NDIS when compared to the previous disability services arrangements, excluding transition costs and some disability support services retained by the SA Government.

6.2 Employee expenses

6.2.1 Minimal growth in employee expenses from 2018-19 to 2021-22

Employee expenses are estimated to grow by less than 1% from 2018-19 to 2021-22, reflecting expected reductions in employment levels and constraint in wage growth. DTF advised us that from 2018-19, estimated public sector wage growth over the forward estimates is expected to be largely offset by the cumulative impact of savings measures, and the decline in employee expenses in real terms by 6.4% from 2018-19 to 2021-22 supports this.

6.2.2 Future wage negotiations critical to expenditure control

Salaries and wages are the main public sector operating cost and wage negotiations will occur for major employee groups in 2018-19.

The Budget Papers highlight that the outcomes of future wage negotiations will be crucial in determining whether expenditure forward estimates in this Budget can be achieved and the planned level of government services can be delivered.

The 2018-19 Budget provides for anticipated public sector wage increases from enterprise agreement outcomes over the forward estimates period, both in individual agency budgets and in the total of the contingency items in the administered items for DTF.

The Budget indicates that if public sector-wide wage outcomes for new enterprise agreements vary by 1% p.a. from allowances in the forward estimates, the budget impact will be around $210 million in 2021-22 and will flow through directly to the net operating balance. Figure 6.8 summarises the approximate expenditure impact of a 1% p.a. variation by year as advised by DTF.

Figure 6.8: Expenditure risk – wage outcomes for new enterprise agreements

	2018-19 $'million	2019-20 $'million	2020-21 $'million	2021-22 $'million
Expenditure impact if wage outcomes vary by 1% p.a. from allowances in the forward estimates	10	45	120	210

The value increases across the forward estimates as active enterprise agreements expire. The 2018-19 Budget notes that enterprise bargaining negotiations will occur for major employee groups including school and pre-school staff, South Australia Police, nurses and midwifes, and ambulance officers. The wage outcomes for these employee groups will be critical to expenditure control as they collectively represent about 46% of total general government sector employees.

The previous SA Government's 1.5% wages policy has not been adopted by the new SA Government. DTF advised us the new SA government has, as a matter of policy, adopted a set of objectives and principles for enterprise bargaining within the State public sector, noting a limit on salary increases has not been specified. The objectives and principles consider negotiating affordable and reasonable salaries, and for wage and salary increases to demonstrate improvements in efficient and effective service delivery.

6.2.3 Targeted voluntary separation program

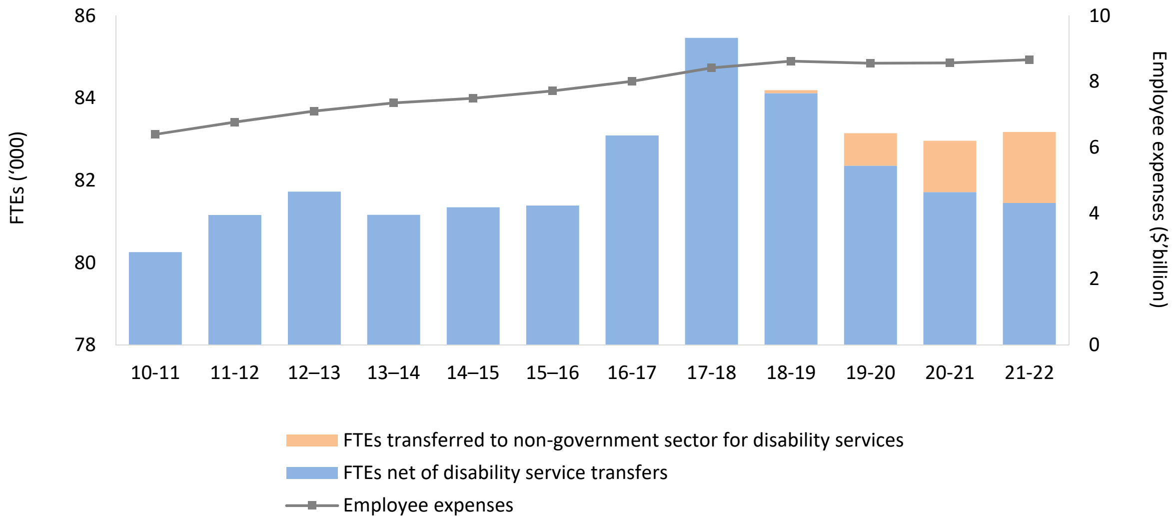
The TVSP scheme introduced by the SA Government in November 2010 to help agencies achieve savings targets is still open.

The 2018-19 Budget includes $170 million in 2018-19 to help agencies meet TVSP and separation costs associated with workforce reductions. Agencies will be responsible for meeting these costs from 1 July 2019.

6.2.4 2018-19 Budget estimated a 4013 net FTE reduction by 2021-22 mainly due to savings measures and new National Disability Insurance Scheme employment arrangements

Figure 6.9 shows FTE and employee expense trends expected in the 2018-19 Budget against the experience of recent years.

Figure 6.9: General government sector employee expenses and FTEs



DTF advised us that growth in FTE levels between 2016-17 and 2017-18 reflects additional resources in Health and Wellbeing provided in the 2017-18 and 2018-19 Budgets, as well as increased resources in Education reflecting higher enrolments and Gonski funding.

FTE levels are expected to peak at 85 461 FTEs as at 30 June 2018, the highest level in eight years.

The 2018-19 Budget Papers indicate that FTE levels are expected to fall by 4013 net FTEs by 2021-22, reflecting the impact of savings measures and transition of 1727 FTEs from State disability services to the non-government sector as part of the State's full, phased transition to the NDIS.

The 2018-19 Budget Paper 5 *Budget Measures Statement* earmarks significant FTE reductions in agencies such as the Department for Environment and Water and DTF, however chief executives have the flexibility to deliver savings however they consider most appropriate.

6.2.5 Estimated FTE reductions revised downwards in 2018-19 MYBR

Total estimated FTE reductions to be achieved by 2021-22 were reduced from 4013 FTEs in the 2018-19 Budget to 3243 FTEs in the 2018-19 MYBR, reflecting:

- actual FTEs at 30 June 2018 being 510 FTEs lower than estimated in the 2018-19 Budget
- new initiatives announced in the 2018-19 MYBR, including additional resources for Health and Wellbeing to address further inefficiencies identified and additional FTEs for Education associated with the National School Reform Agreement
- additional FTEs in Health and Wellbeing at 30 June 2019 and 30 June 2020 to operate aged care assessment teams associated with the Commonwealth Government funded Aged Care Assessment Program.

6.3 Other operating expenses

6.3.1 Other operating expenses grow over the forward estimates

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

Other operating expenses in 2017-18 are estimated to experience significant growth of 9.3% due to various factors explained in section 6.1.3.

Other operating expenses are expected to grow over the forward estimates at rates above CPI. This is mainly due to:

- the full, phased transition to the NDIS (the 2018-19 Budget Papers indicate that these costs were reallocated from grants and employee expenses to other supplies and services)
- growth in children in care and costs associated with providing care services
- growth in student school enrolment numbers and the cost of providing core services
- additional resources in Health and Wellbeing provided in the 2017-18 MYBR and 2018-19 Budget.

2018-19 Budget Paper 3 *Budget Statement* identifies growth in hospital expenditure, student enrolment numbers and children in care, and the management of NDIS transition costs as major financial risks that could negatively affect the fiscal outlook set out in the 2018-19 Budget. My Annual Report for the year ended 30 June 2018 notes that the State has experienced delays in transitioning to the NDIS and further discusses the financial implications for the Department of Human Services and the State if these delays continue.[12]

6.4 Grant expenses

6.4.1 Grants forecast to decline in real terms

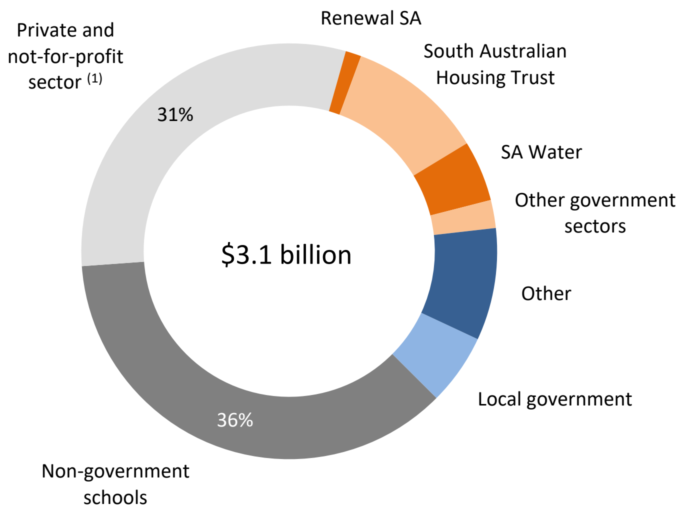
Grants are forecast to gradually decrease over the forward estimates in real terms. The Budget Papers note this is primarily due to lower grant payments during the NDIS transition as contributions to the scheme are recorded as other operating expenses. This is offset in later years by the growth in payments to non-government schools under the National Education Reform Agreement.

6.4.2 Non-government schools and other parts of the private and not-for-profit sector are key grant recipients

Figure 6.10 shows grant expenditure budgeted in 2018-19 by key recipients. Most grants are provided to non-government schools and other parts of the private and not-for-profit sector.

[12] Auditor-General's Report 5 of 2018 *Annual Report for the year ended 30 June 2018, Part A: Executive Summary,* section 4.2.

Figure 6.10 Key grant recipients for 2018-19



(1) Excluding grants to non-government schools which are shown separately.

Approximately one-third of grants are related to onpassing arrangements which the State only administers and has no discretion over.

6.4.3 Change of approach to grants and industry support

Numerous grant programs and industry financial assistance programs from previous budgets will not continue, including the Future Jobs Fund, Unlocking Capital for Jobs program and Fund My Neighbourhood program.

The 2018-19 Budget shows the SA Government intends to focus on industry financial assistance through three key funds:

- Economic and Business Growth Fund – $100 million over four years
- Regional Growth Fund – $60 million over four years ($150 million over 10 years)
- Research, Commercialisation and Start-Up Fund – $28 million across the forward estimates.

The Budget Papers note that this approach is targeted towards opportunities that provide broader strategic economic development benefit to the State.

I reported on the risks associated with providing government financial assistance to industry in my Annual Report for the year ended 30 June 2017.[13]

[13] Auditor-General's Report 9 of 2017 *Annual Report for the year ended 30 June 2017, Part A: Executive Summary,* section 4.8.

6.5 Savings initiatives

6.5.1 The savings task in the Budget is substantial involving annual savings of $864 million by 2021-22

The 2018-19 Budget introduces a substantial savings task, on top of the previous SA Government's savings targets, to fund budget overruns in the areas of health and child protection and contain expenditure growth.

The Budget plans to deliver annual operating savings of $864 million by 2021-22, comprising $715 million from prior budgets and $149 million in new savings measures (net of Health and Wellbeing savings relief) as shown in figure 6.11.

Figure 6.11: Savings initiatives

	2018-19 $'million	2019-20 $'million	2020-21 $'million	2021-22 $'million
Previous savings targets	166.7	319.0	470.1	594.9
2017-18 MYBR efficiency measures	81.1	122.4	118.4	120.1
Savings introduced by the previous government	**247.7**	**441.4**	**588.5**	**715.0**
2018-19 Budget operating savings measures	212.5	248.0	244.4	259.9
Health and Wellbeing savings relief	(105.0)	(113.0)	(121.0)	(111.0)
2018-19 Budget net operating savings measures	107.5	135.0	123.4	148.9
2018-19 Budget total savings	**355.3**	**576.3**	**711.9**	**863.9**

Note: Totals may not add due to rounding.

44% of the 2021-22 savings target relates to the Health and Wellbeing portfolio, which has historically experienced challenges meeting its savings targets.

Major new specific savings measures identified in the 2018-19 Budget include:

- establishing a sustainable, efficient health system ($182 million)
- public transport services review ($47 million)
- prison services high performance benchmarking review ($28 million)
- ceasing 34 projects and programs including the Economic Development Board ($11 million), Riverbank Authority ($3 million), South Australian Early Commercialisation Fund and TechInSA ($25 million).

The Budget also identifies plans to outsource certain services to the private sector to achieve savings. They include:

- transferring the Adelaide Remand Centre's operations to a private sector provider as the SA Government expects this will deliver prison services at a lower cost
- potentially outsourcing radiology and pathology services if these units cannot deliver services at an efficient price comparable to other jurisdictions and private sector operators.

The 2018-19 Budget continues the previous SA Government's efficiency dividend policy[14] and the 2017-18 MYBR efficiency measure, which form a substantial proportion of the overall savings task. It also introduces new savings initiatives requiring significant operating efficiencies to be achieved across various agencies, including:

- DTF ($84 million)
- the Department of Planning, Transport and Infrastructure ($45 million)
- South Australia Police ($39 million)
- TAFE SA ($34 million)
- the Department for Environment and Water ($27 million).

6.5.2 Detailed monitoring of savings measures will resume in 2018-19

DTF advised us that, given the significant savings measures included in the 2018-19 Budget, it will monitor all saving measures in the 2018-19 *Budget Measures Statement* individually in 2018-19.

DTF also advised that it will periodically monitor efficiency dividends in 2018-19, with focused attention on issues affecting the budget position of agencies.

6.6 Health and Wellbeing portfolio savings task

6.6.1 Savings targets reset as they have not been achievable

My previous Reports detail the history of savings initiatives for the Health and Wellbeing portfolio since 2010-11. This portfolio has repeatedly failed to achieve its savings targets or has experienced service demands requiring additional funding. Previous savings strategies, including Transforming Health, have not worked. Until there is a demonstrated history of achieving savings goals, we expect these savings strategies to remain a challenge.

The Health and Wellbeing savings task was reduced in the 2017-18 Budget by $321 million across the four years of the Budget to reflect the revised timing of expected efficiencies, and further reduced by $78.9 million in the 2017-18 MYBR.

Despite these large revisions, the Health and Wellbeing portfolio did not achieve its savings target in 2017-18 and was the only portfolio to receive funding in 2017-18 due to the non-achievement of savings targets. Auditor-General's Report 8 of 2018 *Health Budget Performance 2017-18* highlights control deficiencies and shortcomings associated with Health and Wellbeing's budget shortfall.

The 2018-19 Budget concedes that previous targets were not realistic or achievable and aims to reset Health and Wellbeing's savings targets to more sustainable levels. This change is consistent with past budget approaches.

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[14] 1% of the agency employee expenses budget per annum and a 1% reduction in agency net cost of services per annum. The efficiency dividend on net cost of services continues to exclude the judicial area of courts, police officers (with only 0.5% applied to the remainder of Police) and frontline emergency services staff, prison operations, disabilities and schools.

The revised savings task for Health and Wellbeing is $82 million in 2018-19, growing to $381 million in 2021-22. This amount is net of $800 million additional funding to Health and Wellbeing from 2017-18 to 2021-22.

Figure 6.12 summarises the changes in Health and Wellbeing's savings task between the 2017-18 and 2018-19 Budgets.

Figure 6.12: Summary of Health and Wellbeing's revised savings measures and initiatives

	2017-18 $'million	2018-19 $'million	2019-20 $'million	2020-21 $'million	2021-22 $'million
2017-18 Budget savings measures	(70)	(212)	(325)	(425)	(516)
2018-19 Budget reduction in savings measures	70	175	183	191	181
2018-19 Budget new savings measures	-	(45)	(46)	(46)	(46)
2018-19 Budget revised savings measures	**-**	**(82)**	**(187)**	**(280)**	**(381)**
Annual growth in savings task	-	(82)	(105)	(93)	(101)

	2018-19 $'million	2019-20 $'million	2020-21 $'million	2021-22 $'million
Department for Health and Wellbeing savings initiatives				
Efficiencies in the Department for Health and Wellbeing (central office)	5.6	14.5	14.6	14.7
SA Health grant and service contracting arrangements	2.5	2.5	2.5	2.5
Recover the public system costs of providing clinicians right of private practice	-	13.0	13.0	13.0
An efficient public pathology service	-	25.0	35.0	45.0
Reform of hotel services at SA hospital sites	-	1.1	4.5	4.5
An efficient public imaging and diagnostic service	1.1	4.9	6.2	6.2
Achieving national efficiency benchmarks by 2021-22	73.0	126.0	204.0	295.0
	82.0	187.0	280.0	381.0

Note: Totals may not add due to rounding.
Source: 2018-19 Budget Measures Statement, page 77.

Achieving Health and Wellbeing's savings task of $82 million in 2018-19 will be a difficult challenge given the complex nature of the health system, the portfolio's poor savings history and the current projected financial result for the State's largest health network, CALHN. Section 6.6.4 provides further detail about CALHN's projected financial result for 2018-19.

6.6.2 Development of 2018-19 savings task

As part of the 2018-19 Budget, the new SA Government set a time frame for Health and Wellbeing to reach efficiency targets, considering the current differential to the NEP.[15] This then formed the basis for a savings profile, with additional funding provided to align with the revised savings targets.

DTF advised us that the savings task required to achieve the NEP was broadly based on data provided by the Department for Health and Wellbeing, which compared the cost of delivering services by local health networks (LHNs) – based on 2014-15 cost data – to other

[15] The NEP is determined by the Independent Hospital Pricing Authority based on the average cost of an admitted acute episode of care provided in public hospitals during a financial year. It provides a benchmark for comparing the costs of delivering the services provided by Australian public hospitals across jurisdictions.

jurisdictions and the 2014-15 NEP.[16] The analysis performed by the Department for Health and Wellbeing indicated that:

- South Australia's average cost per National Weighted Activity Unit[17] (NWAU) was $5202, compared to the best performing State, Victoria, at $4192. This ranks South Australia in fifth place across all jurisdictions
- South Australia's average cost per NWAU was 12% above the national average cost per NWAU of $4626
- CALHN's average cost per NWAU was $5704, substantially higher than other major metropolitan LHNs and 14% higher than the NEP of $5007
- South Australia's average length of stay of 3.3 days was ranked seventh (second worse) across all jurisdictions and was 11% above the national average length of stay of 2.96 days.

6.6.3 Savings strategies

The Health and Wellbeing savings task is underpinned by the goal to deliver services at the NEP by the end of the forward estimates period. DTF advised us that, aside from savings in the Department for Health and Wellbeing (central office), all savings initiatives identified in figure 6.12 are aimed at achieving the NEP by the end of the forward estimates. Detailed information about the nature of some of these initiatives is contained in the Budget Measures Statement under the Department for Health and Wellbeing.

The SA Government is reforming the governance of Health and Wellbeing including re-establishing governing boards for each LHN. The LHN boards will start full responsibility for overseeing clinical and financial outcomes for their respective networks from 2019-20. The SA Government also announced its intention to establish a new governance and accountability framework for the public health system. Auditor-General's Report 8 of 2018 *Health Budget Performance 2017-18* discusses some of the challenges to successfully implementing the new governance and accountability framework.

The Department for Health and Wellbeing has also engaged external advisors, KordaMentha, to review, assess and identify challenges and opportunities within CALHN to improve its financial position.

6.6.4 KordaMentha estimates CALHN expenditure will exceed budget by $315 million in 2018-19 if urgent corrective action does not occur

Table 2.4 in Budget Paper 3 *Budget Statement* highlights a history of consistent overspending in CALHN. More recent data suggests that this trend is likely to continue in 2018-19 if significant and immediate intervention does not occur. KordaMentha, in its diagnostic review report dated September 2018,[18] forecast expenditure for CALHN

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16 The NEP is calculated based on cost data from three years prior (ie the 2014-15 NEP is based on cost data from 2011-12).

17 Cost per NWAU, developed by the Independent Hospital Pricing Authority, measures the costs of acute admitted patients against a common unit of activity (a measure of output).

18 KordaMentha, *Central Adelaide Local Health Network Diagnostic Review September 2018,* <https://www.sahealth.sa.gov.au/wps/wcm/connect/public+content/sa+health+internet/resources/calhn+diagnostic+review>, viewed January 2019.

(excluding Statewide Clinical Support Services) to exceed budget by $315 million in 2018-19.

KordaMentha's report identifies various strategic, operational and financial drivers contributing to CALHN's history of unsatisfactory financial outcomes, with the main factor being CALHN's cost of activity being materially higher than the NEP. The report notes:

- for the six months to 31 December 2017, CALHN's cost of delivery per NWAU was 29% higher than the NEP, which equates to a total unfavourable cost efficiency variance of $105.6 million, with the nRAH contributing 82% of the total NEP overspend
- sub-optimal design factors at the nRAH facility have resulted in workarounds being put in place since the move to the nRAH, leading to poor work practices and additional operational costs for business as usual activity.

KordaMentha has developed a three-year recovery plan[19] to address the key issues identified in its diagnostic review report. Planned initiatives include:

- improved patient flow and discharge processes
- minimising unnecessary hospital admissions
- redesigning the organisational structure and accountabilities
- ensuring relevant leadership and capability development occurs
- establishing an effective data and reporting function
- developing an activity-based budget
- optimising public and private patient revenue
- improving cost management controls.

KordaMentha states that with adequate support from Health and Wellbeing and a disciplined approach, CALHN can be transformed into a high performing LHN operating at an equivalent level of performance to its national peers within three years.

6.6.5 Savings target further reduced and additional funding provided in 2018-19 MYBR

The 2018-19 MYBR provides a further $83 million from 2018-19 to 2019-20 for the expenditure initiative to establish a sustainable and efficient health system. This comprises:

- $23 million to reduce Health and Wellbeing's savings target in 2018-19 (reducing the savings target for 2018-19 from $82 million to $59 million due to Health and Wellbeing's final 2017-18 result being worse than expected and performance over the first part of 2018-19)
- $60 million to meet the costs of additional inefficiencies identified since the 2018-19 Budget.

[19] KordaMentha, *Central Adelaide Local Health Network Organisational and Financial Recovery Plan November 2018,* <https://www.sahealth.sa.gov.au/wps/wcm/connect/public+content/sa+health+internet/resources/calhn+organisational+and+financial+recovery+plan>, viewed January 2019.

7 Purchases and sales of non-financial assets

Key points

2017-18 result:

- Purchases of non-financial assets for 2017-18 were $186 million below budget due mainly to revised timing of projects, adjustments to Commonwealth funded projects and project underspends.
- Sales of non-financial assets were $1 billion lower than budget due mainly to the change in the treatment of the land services commercialisation transaction in the 2017-18 FBO.
- Commercialisations and sales of government assets since 2012-13 have resulted in significant proceeds flowing through to net debt, while also resulting in a less diversified revenue base for the State.

2018-19 Budget:

- Capital expenditure over the forward estimates is expected to be relatively high compared to historical levels, at around or above $2 billion p.a.
- Proceeds from sales of non-financial assets are expected to be minimal after 2017-18.

7.1 Purchases of non-financial assets

7.1.1 Purchases of non-financial assets for 2017-18 were $186 million below budget

The 2017-18 FBO for purchases of non-financial assets in the general government sector ($1.999 billion) was $186 million below the 2017-18 Budget ($2.185 billion). This is mainly due to the revised timing of projects including project delays, adjustments to Commonwealth funded projects and project underspends.

7.1.2 Capital expenditure projected to increase compared to prior year Budget

Figure 7.1 shows the purchase of non-financial assets over the 10 years to 2021-22.

Figure 7.1: General government sector purchases of non-financial assets

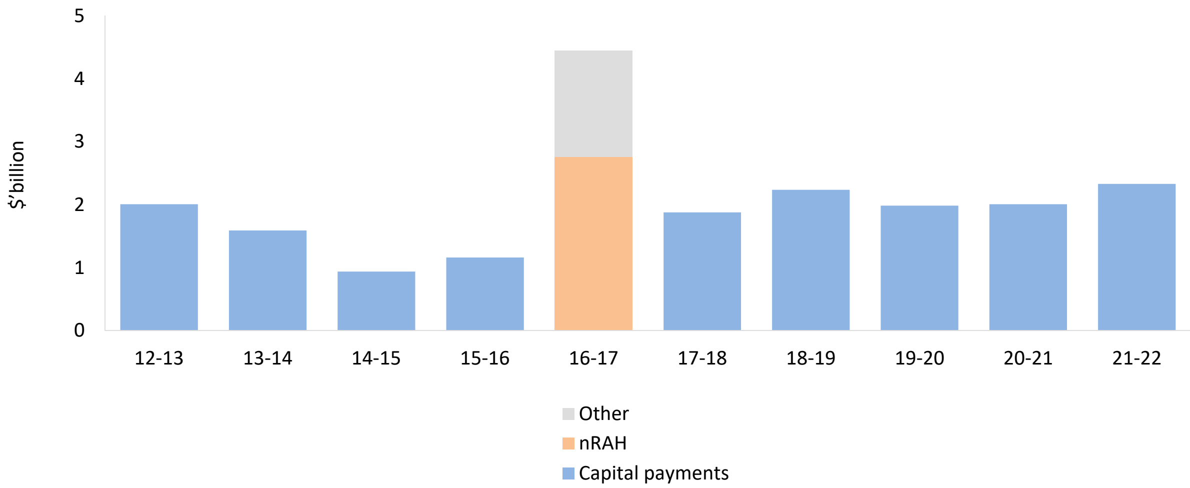


Figure 7.1 highlights that capital payments peaked in 2016-17. This was mainly due to the recognition of the nRAH finance lease ($2.8 billion), representing 62% of total capital payments in that year.

Estimated capital expenditure from 2018-19 onwards is relatively high compared to historical levels, at around or above $2 billion p.a. Purchases of non-financial assets are projected to total $8.6 billion over the four years of the 2018-19 Budget, compared to $7.1 billion over the four years of the 2017-18 Budget.

A large proportion of the capital program over the four budget years is attributable to four agencies:

- Department of Planning, Transport and Infrastructure – total capital investment of $3.4 billion including projects for the North-South Corridor ($992 million), Gawler Line Modernisation ($533 million) and Main South Road duplication from Seaford to Aldinga ($264 million).
- Department for Education – total capital investment of $1.3 billion including Building Better Schools capital works program ($688 million), STEM facilities in Schools ($104 million) and Whyalla Secondary School ($100 million).
- Department for Health and Wellbeing – total capital investment of $853 million including Queen Elizabeth Hospital Redevelopment Stage 3 ($272 million).
- Department for Energy and Mining – total capital investment of $312 million including construction of gas generator ($300 million).

7.1.3 New Adelaide Women's and Children's Hospital

In the 2018-19 Budget, the SA Government announced a commitment of $750 000 in 2018-19 and $1.5 million p.a. to 2021-22 for the required planning and design of a new Women's and Children's Hospital.

A taskforce with representation from clinicians and health professionals has been established. It will develop a fully costed project plan for the SA Government's consideration. This will identify the costs of the project, the state-wide model of care that the hospital will support, and the size and configuration of health services at the site.

The capital funding held in DTF contingency provides for the start of the construction project. This funding provision assumes a traditional build of the hospital rather than a public private partnership. A total cost estimate for the project, budget profile and the final form of procurement for the new hospital will be determined in project planning.

7.1.4 Former RAH site items included in the 2018-19 Budget

Various projects are budgeted for the former RAH site. These include:

- project management for the redevelopment of Lot Fourteen and the innovation and commercialisation precinct
- SA Pathology separation capital works
- National Aboriginal Art and Cultures Gallery
- International School of Culinary Excellence
- Australian Space and Innovation Precinct.

Project management for the redevelopment of Lot Fourteen and the innovation and commercialisation precinct will be performed by Renewal SA. The budgeted capital expenditure cash flow for Lot Fourteen over 2017-18 and the four years of the Budget is $277 million.

The SA Pathology separation capital works will be managed by the Department for Health and Wellbeing. The budgeted capital expenditure cash flow for these works over 2017-18 and the four years of the Budget is $20 million.

The remaining projects are budgeted for in contingencies.

7.1.5 Contingency provisions for capital investing program

The general government sector budget holds a contingency provision over the forward estimates to maintain the overall size of the SA Government's investing budget. While agency budgets typically decline over the forward estimates as projects are scheduled to finish, the contingency provision will rise as the unallocated component of the overall general government sector budget increases.

7.1.6 Proper management of major capital projects is needed to manage risks to the Budget from increased capital outlays

As the capital program expands, proper management and control of major capital projects becomes more critical to achieving budgeted outcomes.

Major capital projects carry high inherent risks associated with estimating costs, complex contract arrangements, cost escalations and timeliness of completion. Appropriate procurement, contract and project management expertise, as well as sound information systems and financial controls, are required to effectively manage these risks and meet budget targets.

My previous Reports have highlighted significant scope for improvement in the planning, procurement, project management and contract management of major capital projects.[20] It is important that due consideration be given to the findings and recommendations in these Reports when planning and managing the State's capital program.

7.2 Sales of non-financial assets

7.2.1 Sales of non-financial assets were $1 billion lower than budget due mainly to the change in the treatment of the land services commercialisation transaction in the 2017-18 final budget outcome

The 2017-18 FBO for the sale of non-financial assets was $320 million. These proceeds were $1.018 billion lower than the 2017-18 Budget ($1.338 billion). This is mainly due to the land services commercialisation transaction. The estimated proceeds from the transaction were originally reflected as the sale of a non-financial asset (intangible asset) in the 2017-18 Budget. The treatment of the transaction was revised in the 2017-18 FBO to reflect the final GAAP treatment in line with AASB 1059. As a result, the proceeds of the transaction were no longer reflected as the sale of a non-financial asset in the FBO. Section 4.2.2 provides further detail on the treatment and impacts of the transaction.

The actual proceeds from the transaction were $1.605 billion and exceeded those estimated in the 2017-18 Budget by $855 million.

The remaining variation to budget is mainly due to delays in the sale of government owned buildings and terminating the sale of the Repatriation General Hospital site.

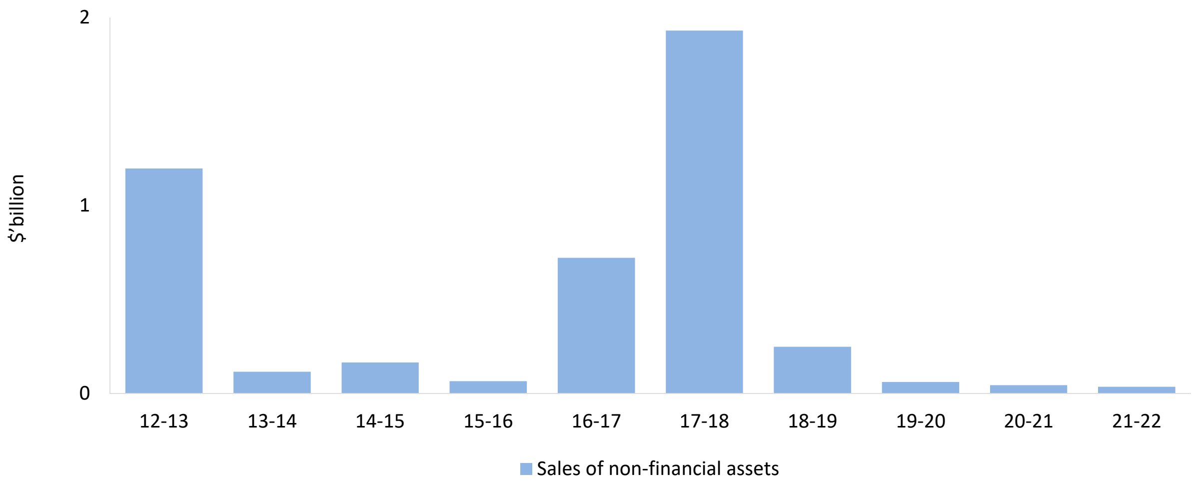
7.2.2 Proceeds from sales of non-financial assets expected to be minimal after 2017-18

Total asset sales for the general government sector over the four years to 2021-22 are estimated to be $393 million.

[20] Refer to Auditor-General's Report 11 of 2018 *New Royal Adelaide Hospital operating term arrangements*, Auditor-General's Report 13 of 2017 *Adelaide Riverbank (Festival Plaza) Development* and Auditor-General's Report 5 of 2017 *The Torrens Road to River Torrens South Road Upgrade Project* for examples where significant scope for improvement in planning, procurement, project management and contract management of major capital projects was identified.

Figure 7.2 shows that after peaks in 2012-13 and 2017-18, sales of non-financial assets are expected to be relatively minimal over the forward estimates.

Figure 7.2: General government sector sales of non-financial assets



Sales of non-financial assets are not expected to exceed $250 million in any year over the four years of the Budget.

7.2.3 Net debt significantly impacted by commercialisations and sales of government assets since 2012-13

The previous SA Government initiated the commercialisation and sale of several government assets from 2012-13, which impacted net debt as follows:

- proceeds from the forward sale of the State's Green Triangle forest plantations ($635 million in 2012-13)
- appointment of Tatts Lotteries SA Pty Ltd as exclusive Master Agent to operate the Lotteries Commission of South Australia's brands and products ($403 million in 2012-13)
- contributions from the MAC privatisation ($1.5 billion between 2014-15 and 2017-18)
- fees received from four private insurers for initial market shares under the compulsory third party insurance market reforms ($259 million in 2016-17)
- the land services commercialisation transaction ($1.6 billion in 2017-18).

The total cumulative impact on net debt of these commercialisations and sales from 2012-13 to 2017-18 was $4.4 billion.

These commercialisations and sales of assets resulted in a less diversified State revenue base over the period of the Budget, in particular revenue from dividends and ITEs. This is discussed in section 5.5.

The commercialisation of assets also impacts the SA Government's risk profile in moving from an internal service delivery model to an outsourced service delivery model. Effective ongoing contract management is required to ensure an appropriate standard of service is delivered under the outsourced contract arrangements.

My previous Reports have highlighted significant scope for improvement in the ongoing management of major commercialisation and outsourcing contracts.[21] It is important that due consideration be given to the findings and recommendations in these Reports when managing such arrangements in the future.

[21] Refer to Auditor-General's Report 12 of 2018 *Land Services Commercialisation Project* and Auditor-General's Report 11 of 2018 *New Royal Adelaide Hospital operating term arrangements* for examples where significant scope for improvement in managing commercialisation and outsourcing contracts was identified.

8 Balance sheet

> Key points
>
> - NFPS net debt is projected to trend significantly upwards between 2018-19 and 2021-22, rising by $4.1 billion to $17 billion.
> - The estimated ratio of NFPS net debt to revenue is expected to increase from 64% in 2017-18 to 76% in 2021-22. This is largely due to a 62% increase in net debt over the four years of the Budget in the general government sector arising from successive net lending deficits.
> - Total assets are expected to increase by $6.4 billion over the four years of the Budget, mainly due to a rise in the value of land and fixed assets resulting from the SA Government's significant capital program and revaluation impacts.
> - Total liabilities are expected to increase by $3.2 billion over the four years of the Budget, mainly due to higher borrowings required to partially fund the SA Government's capital program.
> - The SA Government remains committed to fully funding the unfunded superannuation liability by 2034.

8.1 Net worth

8.1.1 Net worth expected to grow over the four years of the Budget mainly due to rises in the value of land and other fixed assets

The State's NFPS net worth is expected to grow by $3.3 billion (7.5%) over the four years of the 2018-19 Budget [22].This is mainly due to a rise in the value of land and other fixed assets ($6.5 billion) and a decrease in superannuation liabilities ($1.7 billion), offset partly by increases in borrowings ($4.2 billion) and other employee benefits ($510 million).

The capital program driving the rise in value of land and other fixed assets is only funded in part by borrowings, with the rest funded by the net operating surpluses over the forward estimates.

8.1.2 Net financial worth expected to deteriorate by $3.2 billion over the forward estimates mainly due to increased borrowings

NFPS net financial worth is expected to deteriorate over the forward estimates by $3.2 billion (12%), due primarily to increases in borrowings of $4.2 billion and other employee benefits of $510 million, offset by a reduction in the unfunded superannuation liability of $1.7 billion.

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[22] Balance sheet data is for the NFPS as detailed in 2018-19 Budget Paper 3 *Budget Statement*, table B.10, unless otherwise stated. The NFPS consolidates the general government and PNFC sectors.

This reflects an accelerating downward trend in net financial worth compared to the previous Budget. Net financial worth was estimated to deteriorate by $632 million over the four years of the 2017-18 Budget.

As outlined in section 4.2.3, the increase in borrowings is mainly due to the State's significant capital program. Section 8.5 provides further detail on the main drivers of unfunded superannuation liability movements.

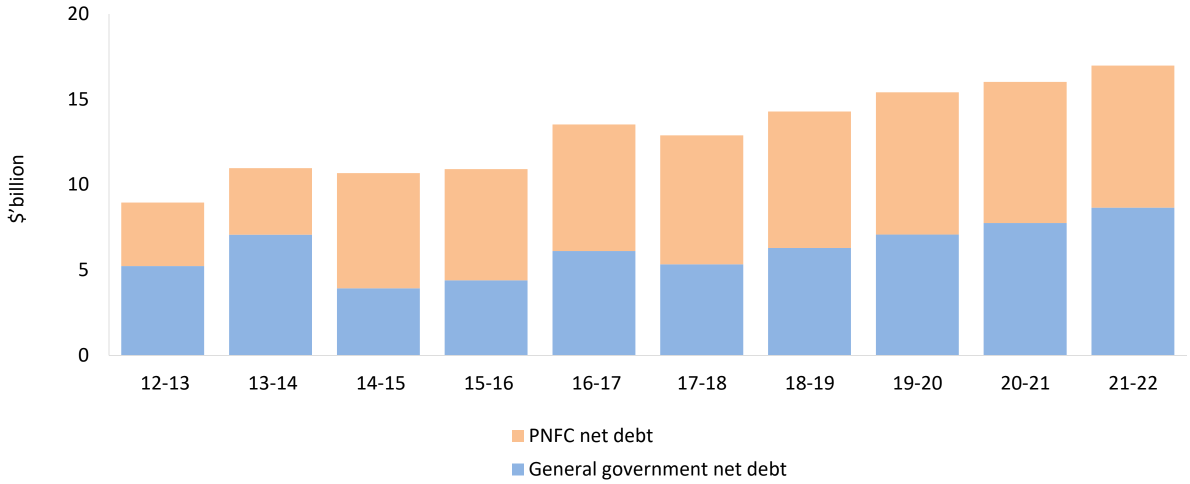
8.2 Net debt

8.2.1 Non-financial public sector net debt expected to rise to $17 billion by 2021-22

NFPS net debt reflects the combined debt of the general government and PNFC sectors.

Figure 8.1 shows that NFPS net debt is projected to trend upwards from 2018-19, rising to $17 billion by 30 June 2022.

Figure 8.1: South Australian NFPS net indebtedness 2012-13 to 2021-22



The estimated ratio of net debt to revenue for the NFPS is expected to increase from 64% as at 30 June 2018 to 76% at 30 June 2022, largely due to the increase in net debt in the general government sector.

The increase in general government sector net debt over the forward estimates is primarily attributable to the SA Government's larger investing program in the 2018-19 Budget compared to the previous year's Budget. The capital program in the 2018-19 Budget is discussed in section 7.1.2.

The significant movements in PNFC and general government net debt prior to 2017-18 were:

- a reduction in general government net debt and converse rise in PNFC net debt in 2014-15 due to the SA Government's decision to vary SA Water's debt to asset gearing ratio

- an increase in general government net debt in 2016-17 mainly reflecting the recognition of the financial obligations for the nRAH, offset partly by contributions from the MAC privatisation
- an increase in PNFC net debt in 2016-17 mainly due to borrowings incurred by Renewal SA to purchase TAFE SA properties.

8.2.2 General government sector net debt is forecast to increase by 62% between 2017-18 and 2021-22

General government sector net debt is forecast to increase by $3.3 billion (62%) from $5.3 billion in 2017-18 to $8.7 billion in 2021-22. As a percentage of revenue, net debt is expected to increase from 28% at 30 June 2018 to 41% at 30 June 2022.

The increase in general government net debt across the forward estimates is primarily attributable to projected net lending deficits, totalling $3.2 billion from 2018-19 to 2021-22. The net lending deficits are driven in large part by the SA Government's significant capital program.

Figure 8.2 explains the expected movements in net debt for the general government sector at the time of the 2018-19 Budget.

Figure 8.2: Reconciliation of movements in general government net debt as at the 2018-19 Budget

	2017-18 Estimated result $'million	2018-19 Budget $'million	2019-20 Budget $'million	2020-21 Budget $'million	2021-22 Budget $'million
Opening general government net debt	6 110	5 331	6 288	7 076	7 749
General government cash surplus (deficit)	796	(902)	(741)	(700)	(772)
Add: Net cash flows from equity transactions	(20)	(51)	(17)	30	141
Less: Assets acquisition under finance leases and similar arrangements	-	(1)	-	-	(261)
Other movements	3	(3)	(30)	(3)	(10)
Improvements (Deterioration) in general government net debt	778	(956)	(788)	(673)	(902)
Closing general government net debt	5 331	6 288	7 076	7 749	8 651

Note: Totals may not add due to rounding.

In figure 8.2:

- the general government cash surplus/deficit represents the sum of net cash flows from operating activities and net cash flows from investments in non-financial assets
- net cash flows from equity transactions impact on net debt but do not pass through the operating statement. This includes distributions from MAC treated as a return of equity.

The cash surplus in 2017-18 is mainly due to the proceeds of the land services commercialisation transaction ($1.6 billion).

As net debt as a percentage of revenue increases over the forward estimates, the SA Government will have less capacity and flexibility to service borrowing costs on its debt.

8.2.3 Small forecast increases in public non-financial corporation net debt over the forward estimates

The PNFC net debt is forecast to increase by $763 million from $7.557 billion at 30 June 2018 to $8.32 billion at 30 June 2022. The expected increase in net debt mainly reflects SA Water increasing borrowings by $739 million to deliver continued capital investment, including the Zero Net Electricity Cost 2020 project and the Northern Adelaide Irrigation Scheme project, and to maintain its debt to asset ratio at 45%.

The estimated 2017-18 net debt for SA Water is $6.519 billion. This comprises most (86%) of total PNFC net debt.

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

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

At 30 June 2018, SAFA's liabilities were $27.8 billion. It had loans to the Treasurer totalling $11.2 billion. The Treasurer also had funds on deposit with SAFA totalling $7 billion at 30 June 2018.

SAFA manages its treasury function through a portfolio structure. This structure and associated procedures contribute to enhanced treasury risk identification and management. This includes the daily management of liquidity, interest rate, currency and credit risk. Further details on SAFA's functions are included in the section of my 2017-18 Annual Report titled *South Australian Government Financing Authority*.[23]

8.3 Assets

8.3.1 Total assets expected to increase by $6.4 billion over the four years of the Budget

Total assets are expected to increase by $6.4 billion over the forward estimates from $75.6 billion at 30 June 2018 to $82 billion at 30 June 2022. This is mainly due to increases in

[23] Auditor-General's Report 5 of 2018 *Annual Report for the year ended 30 June 2018: Part B Agency audit reports,* page 345.

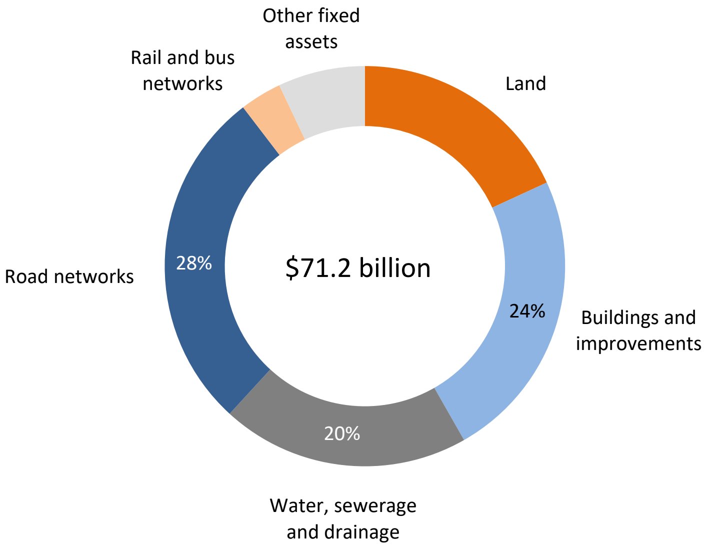
land and fixed assets, which are projected to rise from $71.2 billion to $77.7 billion. This primarily reflects investment and revaluations in water, sewerage and drainage assets and road networks.

Total financial assets are expected to be $4.4 billion in 2017-18 and remain steady across the forward estimates. Total financial assets include investments in other public sector entities. This represents the value of the SA Government's interest in PFCs including the Return to Work Corporation of South Australia, MAC and HomeStart Finance.

8.3.2 Assets primarily comprise land and fixed assets

The vast majority of estimated total assets at 30 June 2018 is land and fixed assets (94%). Figure 8.3 shows the composition of land and fixed assets estimated at 30 June 2018.

Figure 8.3: Composition of land and fixed assets estimated at 30 June 2018



Road networks represent the largest component (28%), with the other major components including buildings and improvements (24%), water, sewerage and drainage assets (20%) and land (18%).

8.4 Liabilities

8.4.1 Total liabilities expected to increase by $3.2 billion over the four years of the Budget mainly due to higher borrowings

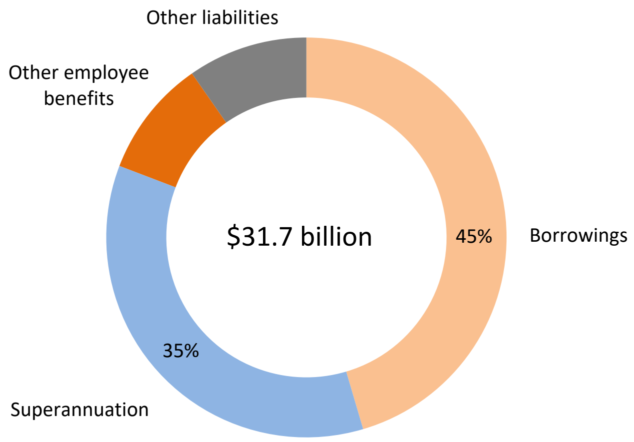
Total liabilities are expected to increase by $3.2 billion over the forward estimates from $31.7 billion at 30 June 2018 to $34.8 billion at 30 June 2022.

This is mainly due to an expected $4.2 billion increase in borrowings from $14.4 billion to $18.6 billion, offset partly by an estimated $1.7 billion reduction in the unfunded superannuation liability from $11.2 billion to $9.5 billion.

8.4.2 Liabilities primarily comprise borrowings and the unfunded superannuation liability

Figure 8.4 shows the composition of total liabilities estimated at 30 June 2018.

Figure 8.4: Composition of total liabilities estimated at 30 June 2018



The major components of total liabilities are borrowings (45%) and the unfunded superannuation liability (35%).

8.5 Unfunded superannuation

8.5.1 The SA Government remains committed to fully funding the unfunded superannuation liability by 2034

The unfunded superannuation liability is a long-term liability to current and past members of closed defined benefit superannuation schemes.

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

The unfunded superannuation liability is calculated in line with AASs as the net difference between the estimated value of accrued defined benefit superannuation obligations and the value of assets set aside to meet these obligations. Superannuation liabilities are determined on long-term estimates of total liabilities. They are not liabilities that will be called on in total in the immediate future, meaning they can be funded over many years. The State has a long-term funding strategy in place.

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

SA Government. The superannuation liability may change periodically as assumptions and earnings experience change and, because of discounting, as the Government bond rate changes and the period of settlement approaches.

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

8.5.2 Estimated unfunded superannuation liability at 30 June 2018

The unfunded superannuation liability is estimated to decrease by $10 million from the estimated 30 June 2017 figure recorded in the 2017-18 Budget. Figure 8.5 sets out the major elements comprising the movement in the estimated unfunded superannuation liability from 30 June 2017 to 30 June 2018.

Figure 8.5: Estimated unfunded superannuation liability at 30 June 2018

	$'million	$'million
Estimated unfunded liability at 30 June 2017 (2017-18 Budget)		11 217
Add: Movement in discount rate	447	
Lower than expected returns on investments	6	
2016 SA Superannuation Scheme triennial review	(178)	
Adjustments to align with AASB 119 Employee Benefits	(44)	
Total changes		231
Actual at 30 June 2017		11 448
Add: Movement in discount rate	465	
Higher than expected returns on investments	(323)	
Other movements	(383)	
Total changes		(241)
Estimated closing balance at 30 June 2018 (2018-19 Budget)		11 207

Note: Totals may not add due to rounding.

8.5.3 Unfunded superannuation liability significantly impacted by changes in discount rate

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

A discount rate of 2.9% (effective annual rate) was used for the 2018-19 Budget, compared with 3.3% used in the 2017-18 Budget and 3.3% used in the 2017-18 MYBR. Figure 8.6 shows the impact of varying the discount rate upwards from the current rate of 2.9%.

Figure 8.6: Sensitivity analysis of unfunded superannuation liabilities to discount rate movements at 30 June 2018

Discount rate	Unfunded superannuation liability $'million	Increase (Decrease) $'million
2.9%	11 207	-
6.0%	6 249	(4 958)
7.5%	4 480	(6 727)

Figure 8.6 shows how significantly the value of the liability can change with movements in interest rates alone. For example, should the composite of long dated Commonwealth Government nominal bond rates increase to 7.5%, the value of the unfunded liability will reduce by $6.7 billion. The Budget notes the unfunded superannuation liability is a long-term liability with significant volatility evident over time, reflecting the short-term variability resulting from some key valuation assumptions, in particular the discount rate and actual investment earnings. While volatility in the past has resulted in multi-billion dollar revisions to the value of the liability recorded on the balance sheet, there has been no material change in the actual expected payments to beneficiaries underlying the liability.

Appendix 1 – Reporting framework

Uniform Presentation Framework

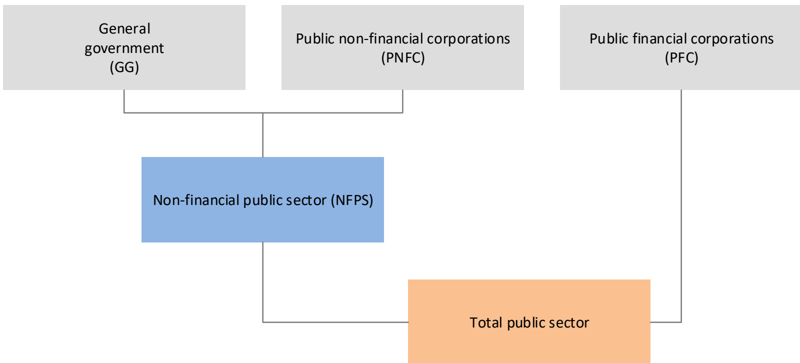
By agreement between the Commonwealth, States and Territories, each jurisdiction presents their Budget Papers and mid-year budget update on a Uniform Presentation Framework basis.

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

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

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

Figure A1: Sectors of government activity



A description of the three primary sectors is as follows:

- ***General government*** – all budget dependent departments and agencies providing services free of charge or at prices below their cost of production or service cost. These are the services that tend to be primarily financed through taxes and other charges, and for this reason this sector tends to be the focus of fiscal targets.
- ***PNFCs*** – trading enterprises mainly engaged in producing goods and services for sale in the marketplace at prices that aim to recover most or all of the costs involved. In South Australia this sector includes the South Australian Housing Trust and SA Water. The consolidation of the general government and PNFC sectors represents the NFPS.
- ***PFCs*** – bodies primarily engaged in providing financial services. This includes financial institutions such as SAFA, HomeStart Finance and the Superannuation Funds Management Corporation of South Australia.

The Budget Papers include the following GFS financial statements:

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

PFC sector data is not published in the Budget Papers.

Key Government Financial Statistics headline amounts

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

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

Australian Accounting Standards

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

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

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

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

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

Budgetary reporting in general purpose financial statements

AASB 1055 *Budgetary Reporting* requires not-for-profit entities within the general government sector, whose budgeted financial statements are presented to Parliament, to disclose:

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

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

AASB 1055 requirements also apply to the general government sector and the whole of government financial statements.

Planned adoption of GAAP framework for budget reporting

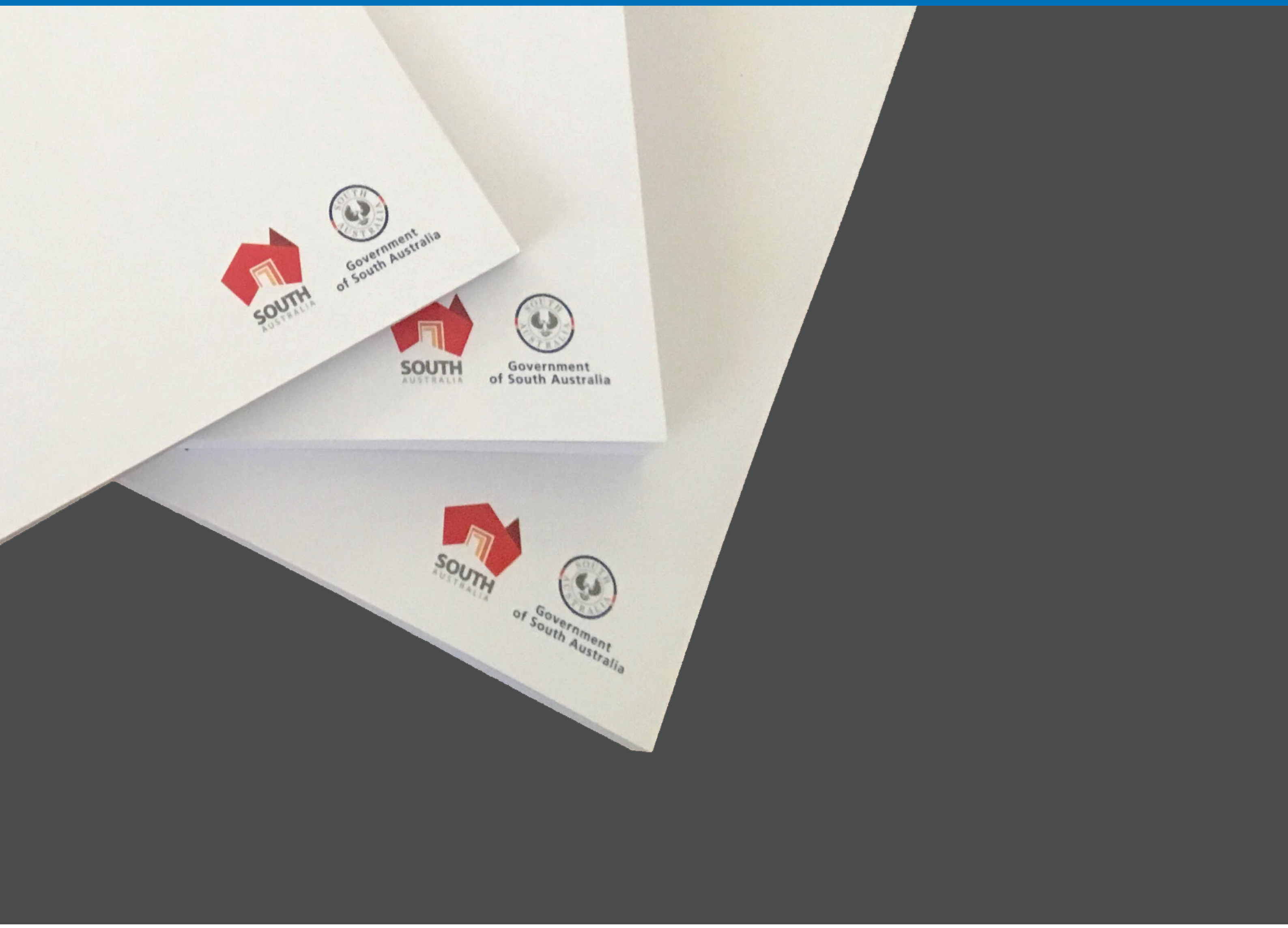
DTF advised us that it plans to adopt Generally Accepted Accounting Principles (GAAP) for budget reporting as required by the Government Finance Statistics (GFS) Framework.

DTF also advised that it is currently not possible to provide an estimate of the impacts of new accounting standards taking effect in 2018-19 and future years on key fiscal aggregates in the 2018-19 Budget. It is anticipated that the new accounting standards will be incorporated into the 2019-20 Budget.

Appendix 2 – Abbreviations used in this Report

Abbreviation	Description
AAS	Australian Accounting Standard[24]
AASB	Australian Accounting Standards Board
CALHN	Central Adelaide Local Health Network
CPI	Consumer Price Index
DTF	Department of Treasury and Finance
FBO	Final budget outcome
FTE	Full-time equivalent
GAAP	Generally Accepted Accounting Principles
GFS	Government Financial Statistics
GST	Goods and services tax
HFE	Horizontal Fiscal Equalisation
ITE	Income tax equivalent
LHN	Local health network
MAC	Motor Accident Commission
MYBR	Mid-year budget review
MYEFO	Mid-Year Economic and Fiscal Outlook
NDIS	National Disability Insurance Scheme
NEP	National Efficient Price
NFPS	Non-financial public sector
nRAH	New Royal Adelaide Hospital
NWAU	National weighted activity unit
p.a.	per annum
PFC	Public financial corporation
PNFC	Public non-financial corporation
Renewal SA	Urban Renewal Authority
SAFA	South Australian Government Financing Authority
SA Water	South Australian Water Corporation
TVSP	Targeted voluntary separation package

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


SOUTH
AUSTRALIA
Government
of South Australia