New South Wales Auditor-General's Report
Financial Audit

Volume Three 2012
Focusing on New South Wales State Finances

audit office
OF NEW SOUTH WALES

The role of the Auditor-General

The roles and responsibilities of the Auditor-General, and hence the Audit Office, are set out in the *Public Finance and Audit Act 1983*.

Our major responsibility is to conduct financial or 'attest' audits of State public sector agencies' financial statements. We also audit the Total State Sector Accounts, a consolidation of all agencies' accounts.

Financial audits are designed to add credibility to financial statements, enhancing their value to end-users. Also, the existence of such audits provides a constant stimulus to agencies to ensure sound financial management.

Following a financial audit the Office issues a variety of reports to agencies and reports periodically to parliament. In combination these reports give opinions on the truth and fairness of financial statements, and comment on agency compliance with certain laws, regulations and Government directives. They may comment on financial prudence, probity and waste, and recommend operational improvements.

We also conduct performance audits. These examine whether an agency is carrying out its activities effectively and doing so economically and efficiently and in compliance with relevant laws. Audits may cover all or parts of an agency's operations, or consider particular issues across a number of agencies.

Performance audits are reported separately, with all other audits included in one of the regular volumes of the Auditor-General's Reports to Parliament – Financial Audits.

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auditoffice OF NEW SOUTH WALES

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Pursuant to the *Public Finance and Audit Act 1983*,
I present Volume Three of my 2012 report.

Peter Achterstraat.

Peter Achterstraat
Auditor-General
31 October 2012

Contents

Executive Summary

Audit Result

I issued a qualified audit opinion on the Total State Sector Accounts for the year ended 30 June 2012. I have issued a qualified opinion every year for the past decade.

Qualification

The key issue contributing to past qualifications has been partially resolved, but new issues have arisen that impact my ability to confirm property, plant and equipment balances in 2011-12.

Budget Result

Budget Result

The Budget Result was a surplus of $680 million for the year ended 30 June 2012, $1.4 billion better than originally budgeted in September 2011. Revenues were generally in line with budget and expenses were 2.3 per cent below budget mainly in the areas of employee costs grant expenses.

The Budget Result was $1.0 billion better than predicted in the 2012-13 Budget Papers published in June 2012.

Financial Analysis

Impact of Economic Conditions

The State's finances have been significantly impacted by global economic conditions. The biggest impact is on liabilities, which have increased significantly in 2011-12.

Record low interest rates have influenced government bond rates, which impact the measurement of liabilities. Decreases in bond rates have lead to increases in liabilities.

Significant Transactions

The State received $2.3 billion from the lease of the Sydney Desalination Plant. It used $1.8 billion to repay associated borrowing. The State recorded a profit of $261 million on the transaction.

Revenues and Expenses

Total revenues and expenses for the whole-of-government were $71.3 billion and $69.6 billion respectively, resulting in a Net Operating Balance of $1.7 billion surplus. The State's revenues and expenses per capita are traditionally lower than other states and territories.

After fair value adjustments to liabilities and other losses, the State recorded an Operating Result of $4.8 billion deficit.

Taxation revenues increased by 2.8 per cent overall, with all sources of revenue increasing, with the exception of stamp duty. Commonwealth grants totalled $26.1 billion, $1.1 billion more than in 2010-11, but less than expected.

Employee costs were 47 per cent of total expenditure, which is relatively consistent with previous years. The State employs approximately 11 per cent of all people employed in New South Wales. Over the past five years, the public sector has generally increased in line with the overall increase in people employed in New South Wales.

Assets and Liabilities

The value of the State's assets is over $300 billion. The assets mostly comprise property, plant and equipment to provide or support service delivery. The value reflects $68.0 billion in capital expenditure over the past five years. Capital expenditure was $13.1 billion in 2011-12, which represents about 85 per cent of the budgeted amount. In addition to the infrastructure assets reflected in the Total State Sector Accounts, the State has over forty public private partnerships to deliver infrastructure and services.

The State's total liabilities have increased to almost $160 billion. Much of the $28.8 billion increase occurring in 2011-12 is attributable to the impact of current economic conditions. The State incurred actuarial losses of $21.6 billion on superannuation obligations during the year, which directly contributes to the growth in liabilities. New borrowings represent about $5.5 billion.

Fiscal Responsibility

New Fiscal Responsibility Act

The *Fiscal Responsibility Act 2012* was passed in August 2012. The objective of the new Act is to maintain the State's AAA credit rating.

Credit Rating

Despite high levels of liabilities at 30 June 2012 and the State exceeding thresholds set by Standard & Poor's for a credit rating review, the ratings agency has maintained the AAA rating. However, Standard & Poor's has lowered the State's outlook to negative.

Quality and Timeliness of Financial Reporting

Financial reporting in New South Wales can still improve.

Public Accounts Committee Recommendations

Progress has occurred to address the Committee's recommendations to improve the quality and timing of financial reporting. However, there are still opportunities for further improvements.

Agency Financial Statements in 2011-12

The timeliness of agencies' financial reporting still needs to improve. Several agencies did not meet Treasury's timetable for collecting financial reporting data. The volume of errors has increased from last year. Improvements in agency review processes and application of accounting standards are required to reduce errors.

Other Governance Matters

Follow up of my previous recommendations

Most of the 118 recommendations I made last year have been or are being actioned.

Compliance with Internal Audit and Risk Management Policy

I reviewed a sample of 24 agencies' compliance with certain aspects of TPP 09-05 'Internal Audit and Risk Management Policy for the New South Wales Public Sector' for the year ended 30 June 2011. I found a reasonable level of compliance with the core requirements of the Policy. Ten of the 24 agencies materially satisfied the core requirements I reviewed.

I identified various opportunities for improvement and have made related recommendations to agencies.

Significant Items

This summary shows the most significant issues identified during my audit.

Fiscal Responsibility

Quality and Timeliness of Financial Reporting

Other Governance Matters

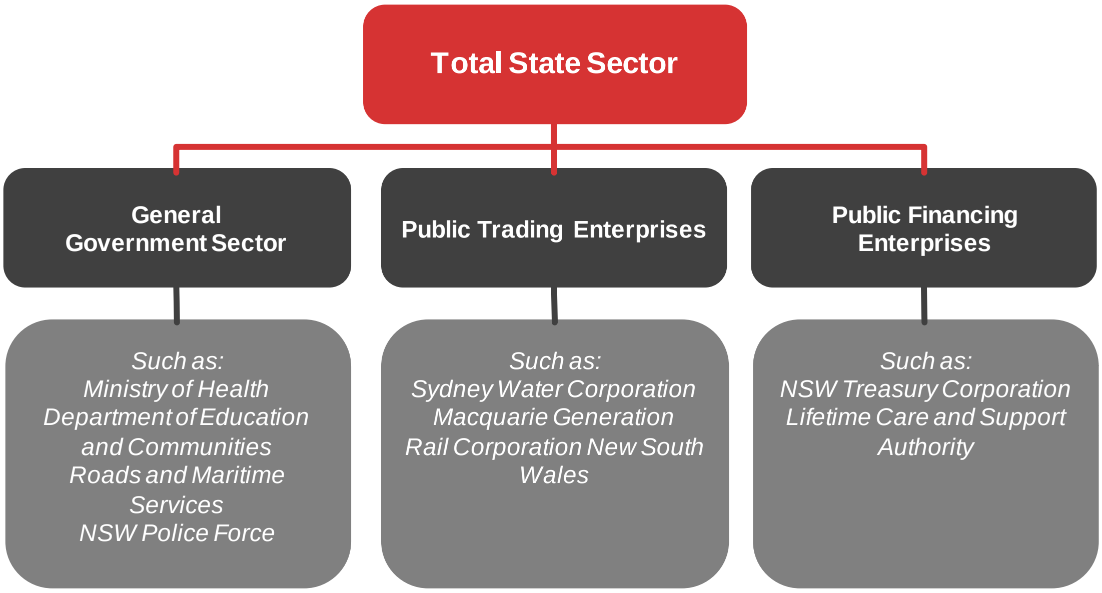
Compliance Review Report – Internal Audit and Risk Management Policy for the New South Wales Public Sector

Audit Result

The *Public Finance and Audit Act 1983* requires the Treasurer to prepare and submit consolidated financial statements for the New South Wales General Government and Total State Sectors to the Auditor-General. After the financial statements have been audited, the Treasurer presents them to Parliament and the Auditor-General reports the results of his audit to Parliament.

The General Government Sector and Total State Sector

The General Government and Total State Sectors are structured as shown below:



The Total State Sector comprises all entities and activities under the control of the NSW Government. The General Government Sector comprises those entities that provide goods and services not directly paid for by consumers (i.e. largely financed from tax revenues and Commonwealth grants). The Non General Government Sector comprises Public Enterprises that have a market orientation, and provide goods and services such as transport, water and electricity, or participate in financial or other markets.

Qualified Auditor's Opinion

There has not been a single year in the past decade when the State has received an unqualified auditor's opinion

I could not give an unqualified auditor's opinion on the General Government and Total State Sector Accounts. Notwithstanding general improvements in public sector reporting, there has not been a single year in the past decade when the State has received an unqualified auditor's opinion. This year I could not obtain all the information I required to form an opinion in three areas. Two of these items are new limitations.

Building Valuations

The State could not provide all the information I needed to form an opinion on the value of certain buildings owned by the Department of Education and Communities (the Department). As a result, I could not form an opinion whether buildings totalling $18.6 billion are correctly valued. This has meant I also could not form an opinion whether revaluation increments of $4.9 billion and depreciation expense of $380 million are correct. As a result, I could not form an opinion on the State's Net Operating Balance/Budget Result, Operating Result and Comprehensive Result.

During the year, the Department performed a revaluation of its buildings. The revaluation methodology was largely the same as that used in 2007, the last time the buildings were revalued. Whilst in 2007 I was satisfied with the evidence provided to support the valuations, there is now too much new evidence that calls into question the methods used. More work will be required to support the values recorded. This work may result in demonstrating the value of these buildings is correct or it may highlight shortcomings in the revaluation process. Further information will appear in Volume Nine of my 2012 Report to Parliament.

Land and Infrastructure Holdings

The State could not provide all the information I needed to form an opinion on the value of land assets and any related infrastructure that should be recognised in the financial statements. The value of land and infrastructure that potentially should be recognised is estimated to be between $500 million and $1.5 billion but may be outside this range.

Recommendation

The government needs to resolve the remaining issues in identifying, valuing and recording land and related assets it may control as a matter of priority.

This is the ninth year the General Government and Total State Sector Accounts have been qualified because of this issue. Whilst progress was made to resolve the matter during the year, more work is still required to bring it to a complete resolution.

I reported in 2011 that more than one New South Wales public sector agency could not provide all the information I needed to form an opinion on the value of land and infrastructure assets that should be recognised in the financial statements. The main issue was Crown reserves. There are approximately 39,000 Crown reserves in New South Wales.

Progress has occurred in identifying the full extent of the government's land and infrastructure holdings

The government has made progress with identifying and valuing Crown reserves ‘controlled’ and that should be recognised as assets in the General Government Sector and Total State Sector Accounts. A significant volume of reserves have been identified as not being controlled, reducing the extent of the potential unrecognised land from between $3.0 billion to $4.0 billion to the estimates reported above.

Recognition of Archives

I couldn’t obtain all the information I needed to form an opinion on the existence and value of archives recognised for the first time.

These archives are managed by the State Records Authority, which provided new information about their fair value in October 2012. Previously, the State archives have not been recognised because management concluded they could not be reliably measured.

Further information is expected to appear in a later Volume of my 2012 Report to Parliament.

Other Matters

Other matters noted during the course of the audit that were not significant enough to impact my Independent Auditor’s Report, include the following.

Water Filtration Plants

The Total State Sector Accounts do not include a liability of $336 million ($345 million at 30 June 2011) relating to water filtration plants.

Sydney Water Corporation has agreements with the owners/operators of water filtration plants for the filtration of bulk water. The agreements are for 25 years and require the Corporation to pay the owners a fee for the service provided. At the end of the agreement, the Corporation has the option to extend the arrangements or to acquire the filtration plants at market value. The agreements are expected to run for approximately a further nine years.

In my opinion, these arrangements effectively transfer to the Corporation substantially all the risks and benefits incidental to ownership of the plants. The Corporation considers these agreements to be service agreements for the filtration of water. It considers the agreements do not meet the definition of a finance lease as the agreements do not convey the right for the Corporation to use the assets.

Lifetime Care and Support Scheme

There is uncertainty in the estimate of the State's provision for scheme participants' care and support services, which was $1.8 billion at 30 June 2012 ($1.4 billion). This liability is included in the Total State Sector Accounts but is not part of the General Government Sector.

The scheme provides treatment, rehabilitation and attendant care services to people severely injured in motor accidents in New South Wales, regardless of who was at fault in the accident. This scheme is funded by a levy on compulsory third party insurance policies.

The uncertainty arises because of the long term nature of the provision and the limited participants' experience to date. This uncertainty will remain until sufficient participants' experience is available.

Home Warranty Insurance Liabilities

There is uncertainty in the estimates of the State's liabilities in respect of home warranty insurance. These liabilities total $249 million at 30 June 2012 ($213 million). The uncertainty arises mainly due to variability in claims costs.

The State has various liabilities related to home warranty insurance arrangements. Since 1 July 2010, the State has recognised liabilities under home warranty insurance policies issued through the Home Warranty Insurance Fund. Between 2002 and 2010, such policies were offered by private sector insurers. However, the State has a liability in respect of reinsurance arrangements provided to those insurers. The State also recognises provisions arising from its assumption of liabilities for policies issued by the HIH insurance group, which collapsed in March 2001.

Resolution of Matters

Some matters reported by me in 2011 have been resolved in 2012.

Significant Uncertainty about Taxation Assessment

In 2007, the State recognised as revenue a one-off taxation assessment of $424 million ($259 million of duty and $165 million of interest). The taxpayer objected to the assessment and the matter was subject to protracted legal proceedings. By 30 June 2011, the State had recognised further interest bringing the total amount receivable to $557 million, of which $143 million had been impaired. I reported there was significant uncertainty as to whether the assessment would be collected in full or part.

In 2011-12, the matter was settled and the State received $287 million. The balance of the receivable was expensed, reducing the Net Operating Balance by $270 million. Impairment expense of $143 million recognised in Other Economic Flows in 2010-11 was reversed in 2011-12. The net impact on the 2011-12 Operating Result of the settlement was a reduction of $144 million.

Electricity Generation Assets

I reported there was uncertainty in the estimates used to value the State's electricity generation assets. The uncertainty stemmed from the potential impact of the Australian Government's carbon pricing mechanism. At the time of reporting, the final form of the legislation and its impact on the estimates used to value assets was not known.

At 30 June 2011, electricity generation assets included in the Total State Sector Accounts were valued at approximately $4.0 billion. During 2011-12, these assets were impaired by $1.3 billion as a result of carbon pricing. This amount was written off the State's asset revaluation surplus.

Accounting for the State's Investment in Snowy Hydro

The State measures its property, plant and equipment at fair value. When accounting for its interest in Snowy Hydro Limited in 2011, it measured that company's assets at cost instead of fair value.

In last year's Report on State Finances, the carrying value of the State's 58 per cent interest in Snowy Hydro was recorded as $1.1 billion. In 2011-12, the State obtained information to enable application of consistent accounting policies to Snowy Hydro's assets. In the current year's Report, the 2011 carrying value has been restated to $2.8 billion. The carrying value at 30 June 2012 is $3.3 billion.

Snowy Hydro Limited owns and operates the Snowy Mountains Hydro Electric Scheme. The company is owned by the New South Wales, Victorian and Australian Governments.

Sydney Ferries

I reported there was uncertainty as to whether the State would realise the value of its assets and extinguish the liabilities of Sydney Ferries in the normal course of business and at the amounts stated in the financial statements. The uncertainty arose due to an announcement by the Minister for Transport in May 2011 of the franchising of Sydney Ferries to a non-government operator to lease, maintain and operate the fleet.

In 2011-12, the franchising arrangements were finalised, and the non-government operator took over from 28 July 2012. The impact of the franchising arrangements was incorporated into the Total State Sector financial statements at 30 June 2012.

Applicable Accounting Framework

The General Government and Total State Sector financial statements are prepared in accordance with Australian Accounting Standards. This includes compliance with AASB 1049 Whole of Government and General Government Sector Financial Reporting.

AASB 1049 is designed to provide users with information:

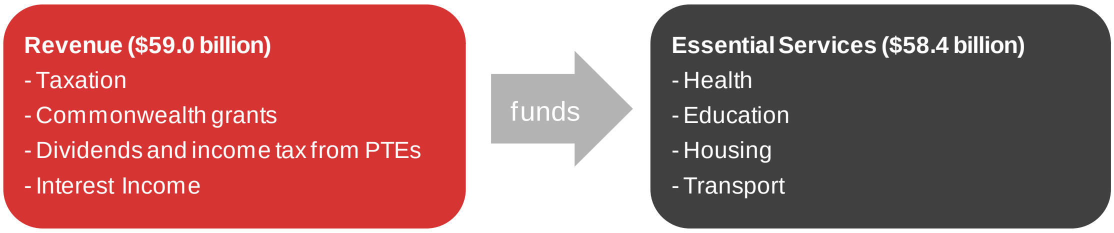
- about the government's stewardship and accountability for the resources entrusted to it
- about the financial position, performance and cash flows of the government and its sectors
- that facilitates assessments of the macro-economic impact of the government and its sectors.

AASB 1049 generally requires compliance with Australian Accounting Standards but limits the selection of certain accounting policy options within those standards. It also requires presentation of key fiscal aggregates and disclosures about sectors of government as defined by the Australian Bureau of Statistics publication Government Finance Statistics: Concepts, Sources and Methods.

The presentation of the General Government and Total State Sector Accounts prepared in accordance with AASB 1049 is not generally comparable with that of individual government agencies.

Budget Result

A government's Budget Papers focus on the financial and service delivery performance of the General Government Sector. A principal measure of a government's financial performance is its Net Operating Balance, or Budget Result. The Net Operating Balance reports the difference between the cost of General Government service delivery and the revenues earned to fund those services.



Net Operating Balance – Variance to Original Budget

The table below compares the actual result for 2011-12 with those amounts budgeted in the 2011-12 Budget Papers published in September 2011.

The 2011-12 Budget Result was a $680 million surplus, $1.4 billion better than expected

Financial Information

Year ended 30 June 2012	Actual $m	Budget $m	Difference $m	Difference % of Budget
Revenues				
Taxation	20,660	20,558	102	0.5
Commonwealth grants	26,043	26,463	(420)	(1.6)
Other grants and subsidies	700	585	115	19.7
Sale of goods and services	4,961	4,857	104	2.1
Interest	530	533	(3)	(0.6)
Dividend and income tax	2,138	1,815	323	17.8
Other dividends and distributions	410	529	(119)	(22.5)
Fines, regulatory fees and other	3,590	3,686	(96)	(2.6)
Total revenues	**59,032**	**59,026**	**6**	**--**
Expenses				
Employee related	25,425	26,034	(609)	(2.3)
Superannuation	3,115	3,116	(1)	--
Depreciation and amortisation	2,978	3,056	(78)	(2.6)
Interest	2,061	2,087	(26)	(1.2)
Other property	1	--	1	--
Other operating	13,409	13,291	118	0.9
Current grants and transfers	9,220	9,639	(419)	(4.3)
Capital grants and transfers	2,143	2,521	(378)	(15.0)
Total expenses	**58,352**	**59,744**	**(1,392)**	**(2.3)**
Net operating balance - surplus	**680**	**(718)**	**1,398**	**(194.7)**
Net borrowing	**2,024**	**3,986**	**(1,962)**	**(49.2)**

In accordance with normal budget practice, the 2011-12 Budget does not include the impact of business asset transactions. These are excluded on the basis the transactions are not complete at the time of preparing the Budget.

In one respect, the 2011-12 results are relatively consistent with the 2011-12 Budget. Total revenues were almost exactly as budgeted and total expenses were two per cent less than budgeted. However, these small variances translate into large amounts when applied to the State's significant revenues and expenses and the Budget Result was $1.4 billion better than budgeted.

Revenue

Total revenue was $6.0 million over budget, a minimal difference from the original budget.

Overall, taxation revenue was in line with budgeted figures. At a more detailed level, land tax was slightly less than expected, but this was more than offset by higher receipts for payroll tax and stamp duties.

Commonwealth grants were less than budgeted, mainly due to GST grants being $936 million less than expected. This reflects weaker economic activity and a shift in spending to GST exempt goods and services. Offsetting this were higher receipts under National Partnerships, which included capital grants for transport originally expected in 2012-13.

The higher than expected sales revenue relates mainly to higher than expected goods and services sales in the health sector.

Dividends and taxes received from public trading enterprises exceeded budget due to higher than forecast profits in the State's electricity businesses. Dividends from the electricity sector were $199 million higher than budgeted, partly due to timing adjustments of around $63 million.

Expenses

Most of the improvement in the Budget Result is due to lower expenditures

Employee related expenses were $609 million less than expected mainly due to changes made during 2011-12 to the State's workers' compensation scheme and NSW Police death and disability scheme. The changes meant the schemes' liabilities reduced – having a favourable impact on expenses.

Grants and transfers were $797 million less than budget due to a number of smaller programs being underspent for 2011-12. These include lower than expected payments from the Climate Change Fund and delays in planned program payments. Planned grants of $100 million relating to light rail did not go ahead after the network was acquired by the State. Instead, these monies went towards capital works.

Changes to the Expected Budget Result during 2011-12

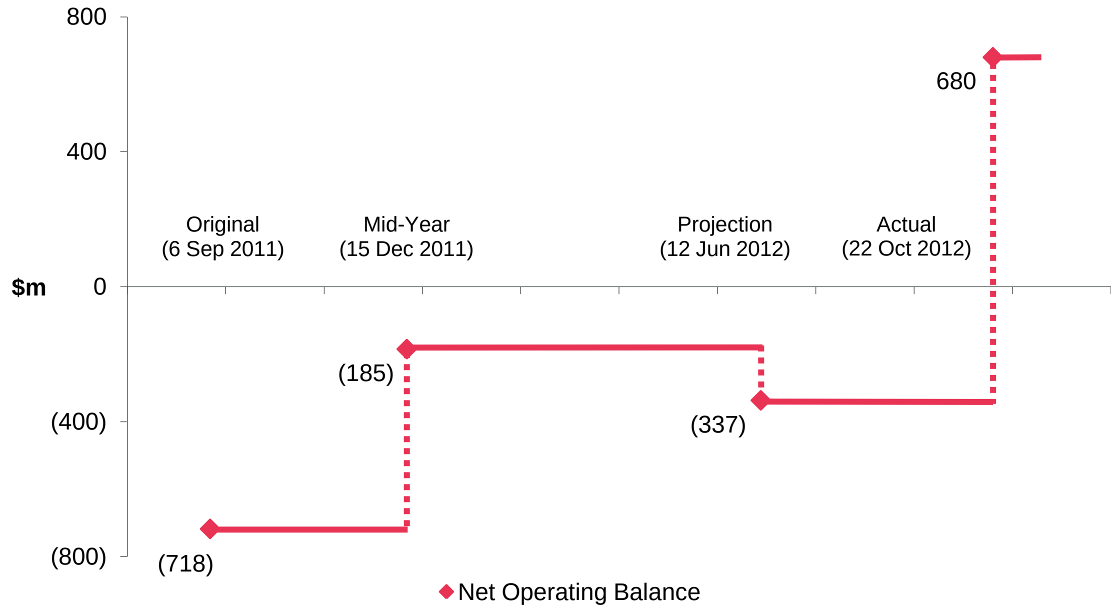
The availability of accurate up-to-date information is widely accepted as crucial to effective decision making.

Recommendation

Treasury should take further steps to improve the accuracy of information it uses to prepare whole-of-government reports.

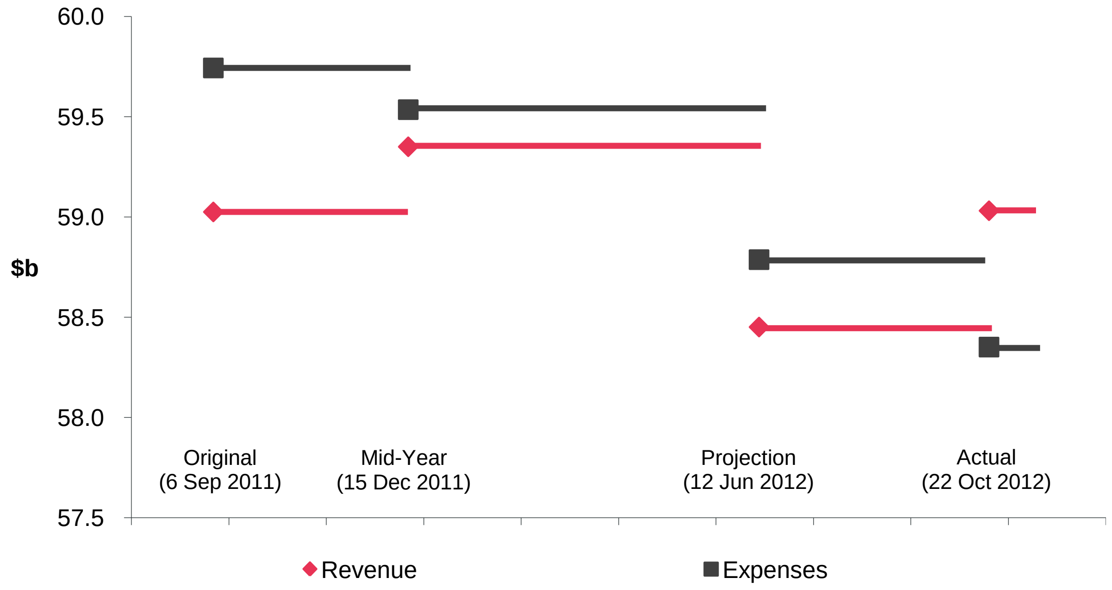
The Budget was announced in September 2011. All budgets are publicly revised twice each year. The first revision occurs in December as part of the mid-year review. The second occurs when handing down the following year's Budget, which this year occurred in June. The graph below demonstrates how the State's expectations about its net operating balance changed for each of the revisions during 2011-12.

Changes to Net Operating Balance during 2011-12



The changes to the expectations about the Net Operating Balance occurred due to revisions of budgeted revenues and expenses. The original budgeted revenues and expenses, revised expectations and the actual amounts for 2011-12 are reflected below.

Changes to Budgeted Revenues and Expenses during 2011-12



The change in the expected Budget Result published in June 2012 and the final audited Budget Result in the 2011-12 Report on State Finances was in excess of $1.0 billion. The expected Budget Result is formulated using actual year to date information for the first nine months of the financial year and a projection for the final quarter. In any year, a variance between expectations published in June and the final result can be attributed to a combination of the following:

- inaccurate year to date information
- inaccurate projections for the final months of the year
- policy changes that occur after the Budget Papers are completed.

It is appropriate that future policy changes are not considered when formulating the Budget Result expectations. But variances from inaccurate year to date data or projections should be minimised. Items contributing to the over $1.0 billion variance are set out in the following table.

Date information released	**31 October 2012**	**12 June 2012**		
Year ended 30 June 2012	**Actual $m**	**Projection $m**	**Difference $m**	**Difference % of Projection**
Revenues				
Taxation	20,660	20,659	1	--
Commonwealth grants	26,043	25,896	147	0.6
Other grants and subsidies	700	564	136	24.1
Sale of goods and services	4,961	4,832	129	2.7
Interest	530	556	(26)	(4.7)
Dividend and income tax	2,138	2,115	23	1.1
Other dividends and distributions	410	387	23	5.9
Fines, regulatory fees and other	3,590	3,444	146	4.2
Total revenues	**59,032**	**58,453**	**579**	**1.0**
Expenses				
Employee related	25,425	25,858	(433)	(1.7)
Superannuation	3,115	3,154	(39)	(1.2)
Depreciation and amortisation	2,978	3,060	(82)	(2.7)
Interest	2,061	2,059	2	0.1
Other property	1	1	--	--
Other operating	13,409	13,237	172	1.3
Current grants and transfers	9,220	9,194	26	0.3
Capital grants and transfers	2,143	2,224	(81)	(3.6)
Total expenses	**58,352**	**58,787**	**(435)**	**(0.7)**
Net operating balance - surplus	**680**	*** (334)**	**1,014**	**(303.6)**
Net borrowing	**2,024**	**(2,833)**	**809**	**(28.6)**

* $3.0 million difference exists in the published projected budget result due to rounding.

The additional Commonwealth grant monies received include unexpected amounts provided in late June 2012.

Approximately $200 million of the reduction in employee related expenses relates to the workers' compensation reforms noted earlier. These legislative reforms occurred in the last few days of June 2012, making this variance attributable to a policy change subsequent to the Budget Papers. The police death and disability reforms occurred in November 2011 and the extent of their impact appears underestimated in the Budget Papers by about $100 million.

A significant component of the increase in other operating expenses relates to the outcome of a legal settlement that occurred in late June 2012. The amount ultimately received was less than expected at Budget time, when the outcome of the settlement was unknown.

Many other items contributing to the variances appear related to the quality of data and the ability to make accurate projections. I understand Treasury has identified a number of potential actions aimed at improving the accuracy of information used in budgeting.

The General Government Sector subsidised other public enterprises by a net $1.4 billion in 2011-12

Impact of other Sectors on the Budget Result

The Budget Result is essentially the net of revenues and expenses of the General Government Sector. The General Government Sector's revenues and expenses are impacted by the operations of the public trading enterprises and public financial enterprises (the other sectors). For example, General Government Sector payroll tax revenues include amounts from the other sectors.

The General Government Sector can be thought of as holding an 'investment' in the other sectors. This investment generates returns in the form of dividends. The General Government Sector also receives income tax equivalent payments, and payments for use of the State's credit rating when borrowing money. Over 90 per cent of the distributions made by the other sectors come from the State's electricity and water businesses.

The Budget Result is impacted by grants made to the State's transport and social housing entities. These grants, or contributions to the other sectors, are for investment in infrastructure and payments to subsidise the delivery of public services.

Year ended 30 June	**2012 $m**	**2011 $m**
Distributions from the other sectors	2,637	* 2,427
Contributions to the other sectors	4,055	4,291
Net expense	**(1,418)**	**(1,864)**

* Excludes $3.4 billion special dividend from the electricity sale transaction (not included in the Budget Result).

Further information on the State's public trading enterprises appears in Appendix B.

Financial Analysis of the General Government and Total State Sectors

This section analyses key financial data in the General Government and Total State Sector Accounts (Total State Sector Accounts) to inform Parliament and the community of trends in the State's financial position and its performance.

Snapshot of the Total State Sector Accounts

The General Government and Total State Sectors comprise hundreds of separate agencies with distinct functions.

The Total State Sector Accounts consolidate the financial position and performance of all functions of the New South Wales Government. The Total State Sector's annual revenue and expenditure exceeds all other states and territories.

Significant Events

Impact of Global Economic Conditions on the State's Finances

The State's finances have been significantly impacted by global economic conditions, which are beyond control of the Government

The State's finances have been significantly impacted by global economic conditions. This has resulted in lower revenue available for spending. It has also impacted the State's net worth.

Lower GST collections by the Australian Government have a flow on impact to the State's revenues. Consumer confidence and economic growth levels indirectly impact on the volume of State taxation collected.

Interest rates are at record low levels, which impacts measurement of the State's liabilities. While the impact is not isolated to New South Wales or to the public sector, the nature of many public sector liabilities means the impact for governments is pronounced.

Impacts from general economic conditions cannot be controlled by the Government.

Significant Transactions

Long-Term Lease of the Sydney Desalination Plant

Proceeds from the desalination plant transaction were $2.3 billion, of which $1.8 billion was used to repay debt

On 1 June 2012, the government entered into a long-term lease of the Sydney Desalination Plant at Kurnell. The State received gross proceeds of $2.3 billion from the transaction. It used $1.8 billion of the proceeds to repay borrowings associated with the construction of the plant.

The State recorded an accounting gain of $261 million from the transaction. This includes $20.0 million in costs paid to complete the transaction.

The long-term lease requires the State to purchase water from the operators of the plant for the next 50 years. The State is required to pay the operators an annual fixed charge and variable charge depending on the amount of water sourced. I understand that based on pricing mechanisms for water, whether the Plant was owned by the State or leased to the private sector, there is no impact on water prices to retail customers.

Analysis of Operating Results

The General Government Sector Operating Result was a $1.9 billion deficit

The Total State Sector Operating Result was a $4.8 billion deficit

Financial Information

Abridged Statement of Comprehensive Income

Year ended 30 June	General Government		Total State Sector	
	2012 $m	2011* $m	2012 $m	2011* $m
Revenues				
Taxation, fees, fines and other	24,250	23,989	24,504	23,995
Grants and subsidies	26,743	25,617	26,554	25,414
Sales of goods and services	4,961	4,658	18,625	17,809
Interest, dividends, income tax equivalents and other distributions	3,078	2,880	1,649	1,923
Total revenues	**59,032**	**57,144**	**71,332**	**69,141**
Expenses				
Employee costs	28,540	27,322	32,671	30,989
Depreciation and amortisation	2,978	2,818	6,078	5,928
Interest	2,061	1,826	4,188	4,149
Grants and subsidies	11,363	11,399	7,277	8,250
Other	13,410	12,439	19,419	18,576
Total expenses	**58,352**	**55,804**	**69,633**	**67,892**
Net operating balance – surplus	**680**	**1,340**	**1,699**	**1,249**
Asset sale gains	12	3,395	281	3,311
Fair value adjustments to financial instruments	(534)	258	(5,074)	235
Other net losses	(2,017)	(414)	(1,723)	(62)
Operating result – surplus/(deficit)	**(1,859)**	**4,579**	**(4,817)**	**4,733**
Revaluations	6,384	976	6,193	4,989
Actuarial gain/(loss) from superannuation	(19,407)	447	(21,574)	425
Net gain/(loss) on equity investments	(5,479)	4,347	--	--
Other net gains/(losses)	(38)	46	(201)	248
Comprehensive result - total change in net worth before transactions with owners as owners	**(20,399)**	**10,395**	**(20,399)**	**10,395**

* 2011 amounts have been restated for changes made in accordance with Australian Accounting Standards.

Unless otherwise stated, the following commentary relates to the Total State Sector.

Comparison with other Australian States and Territories

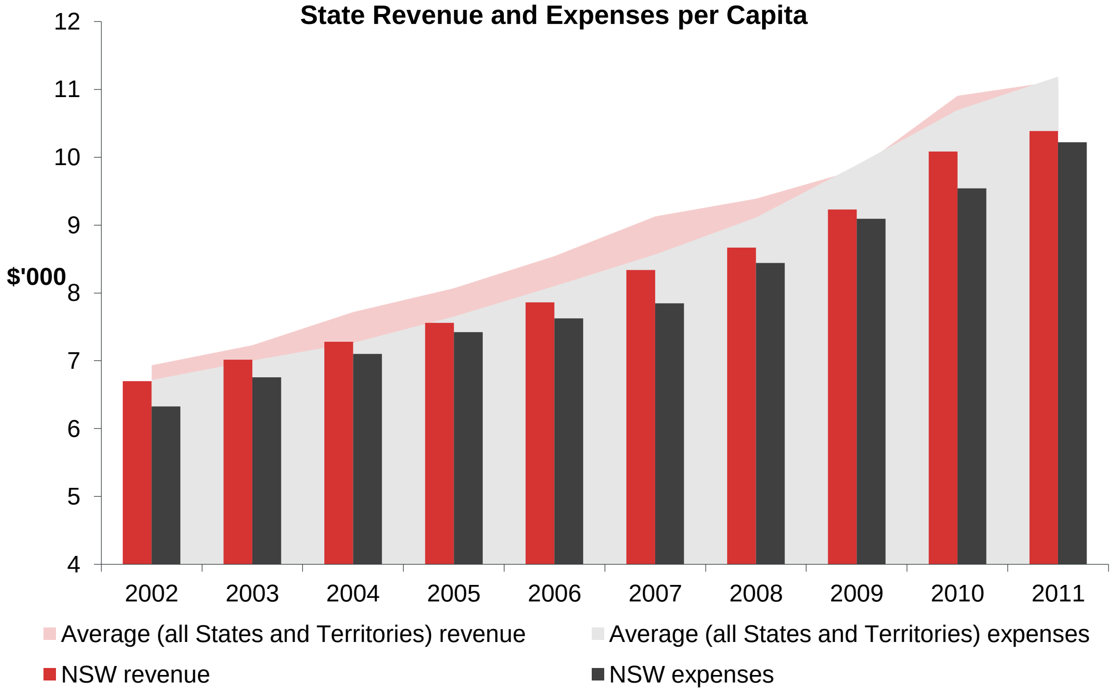
The State does not collect as much revenue per capita as the average of other states and territories. In turn, expenditure per capita is also less than the average.

	New South Wales	Average (all States and Territories)
Total revenue per capita ($)	10,387	11,122
Total expenses per capita ($)	10,222	11,186

Source: Australian Bureau of Statistics; amounts based on 2010-11 Total Public Sector Government Finance Statistics data.

Note: My analysis relies on publicly available information for all states and territories. The most current data available is for 2010-11.

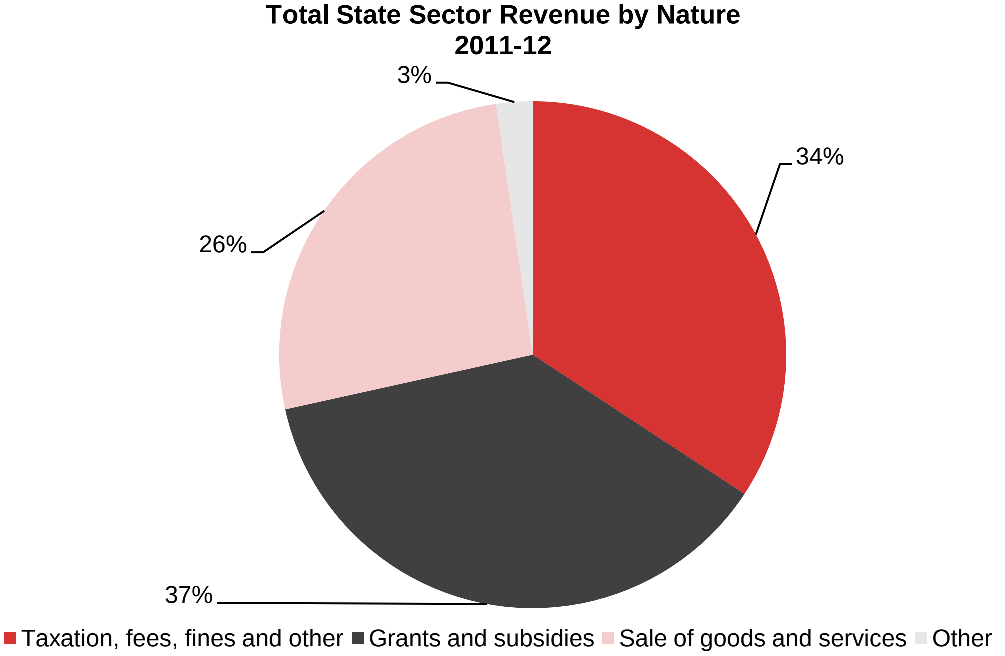
This variation from the average is consistent over time, as the graph below demonstrates.



The revenue and expenses per capita varies between states and territories because of the different models used to deliver services. For example, one state may operate its own electricity generation businesses whereas another state may rely on the private sector to generate electricity.

Revenues

Total State Sector Revenue by Nature



Taxation revenues grew by 2.8 per cent

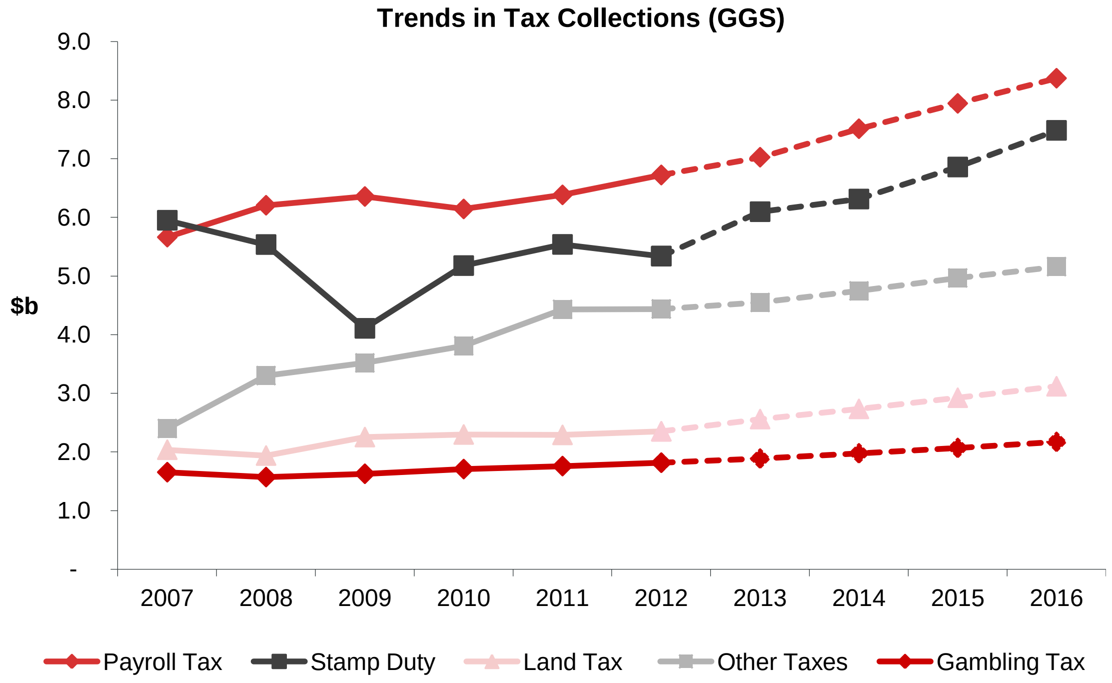
Taxation, fees, fines and other

Taxation, fees, fines and other revenue comprises $19.9 billion of taxation ($19.3 billion in 2010-11) and $4.6 billion of fees, fines and other ($4.2 billion).

Tax revenue for the Total State Sector increased by $540 million (2.8 per cent) compared to 2010–11. All sources of tax revenue increased except for stamp duty, which fell slightly. The increases largely reflect stabilisation of growth in the New South Wales economy after the global financial crisis.

Over the last five years, total tax revenue increased from $17.8 billion to $19.9 billion, which represents average annual growth of 2.8 per cent.

The following chart shows tax collected between 2007 and 2012 and the Treasury's forecasts for General Government Sector tax collections over the next four years to 2016.

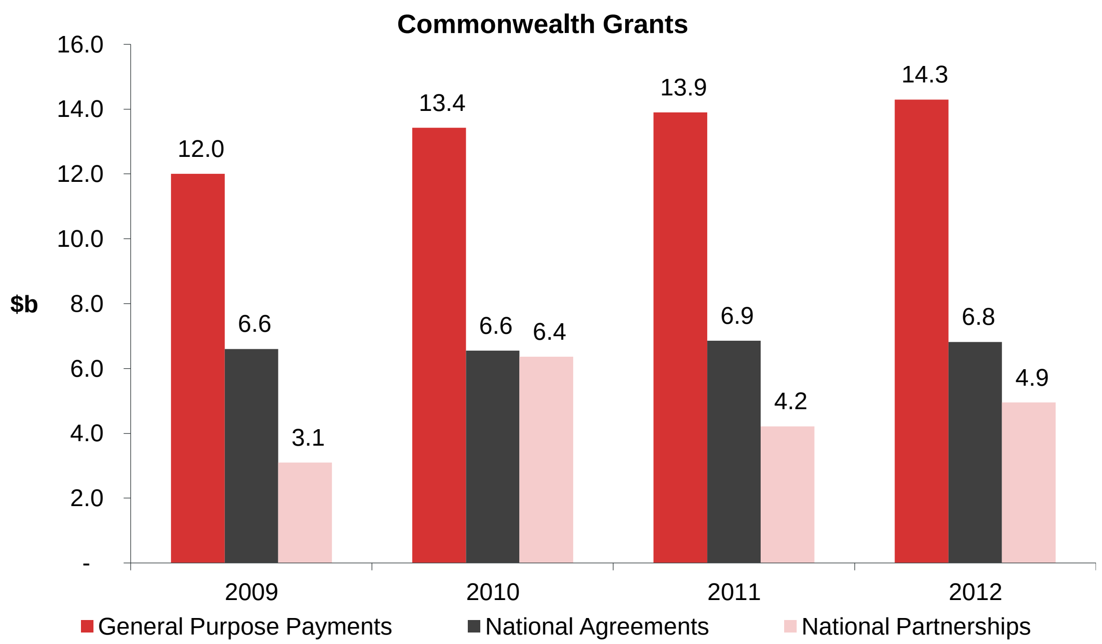


Fees, fines and other revenue include mining royalties of $1.5 billion ($1.2 billion).

Grants and Subsidies

The State received $26.1 billion in Commonwealth grants, more than last year, but less than expected

The State received $26.1 billion from the Australian Government in 2011–12, which was more than last year, but less than expected. The money is provided to the State under various arrangements. These arrangements fall into three broad categories – general purpose payments, national agreements and national partnerships.



GST grants increased by $389 million from last year, but was $936 million less than budget

General Purpose Payments

Commonwealth General Purpose GST grants increased by $389 million from 2010–11. The increase reflects the State's marginal increase in its share of the total GST pool available for distribution to the states and territories and general economic growth. Despite the increase, GST revenue was $936 million less than budgeted by the State, reflecting weaker than expected consumption growth by Australian consumers and changing spending habits. The Treasury advises this reduction is indicative of a longer-term shift in the way households spend their income.

All states and territories have a level of reliance upon GST receipts.

	New South Wales	Average (all States and Territories)
GST revenue as a percentage of total revenue (%)	18.3	18.0
GST revenue per capita ($)	1,901	1,997

Source: Australian Bureau of Statistics; amounts based on 2010-11 Total Public Sector Government Finance Statistics data.

Note: My analysis relies on publicly available information for all states and territories. The most current data available is for 2010-11.

The State is slightly more dependent on GST receipts from the Australian Government than other states and territories. The difference is not significant, with all states and territories moderately reliant on GST revenue. The State receives less GST per capita than other states and territories. Whilst the difference is small, it was around $700 million less in total in 2010-11 than the average. The current GST distribution model is not solely based on a state's or territory's population.

National Agreements

National Agreements set out the policy objectives in six key service delivery areas, covering healthcare, education, skills and workforce development, disabilities, affordable housing and Indigenous reform. Each agreement establishes the roles and responsibilities between levels of government and sets out the high level objectives, outcomes and performance indicators, as agreed by all jurisdictions (source: 2011–12 Budget Statement).

In 2011–12, the State received $6.8 billion in National Agreement payments ($6.9 billion), including the following significant items:

National Agreements	Amount $m
Healthcare	4,138
Education	1,245
Skills and workforce development	448
Disability	397
Affordable housing	396

National Partnerships

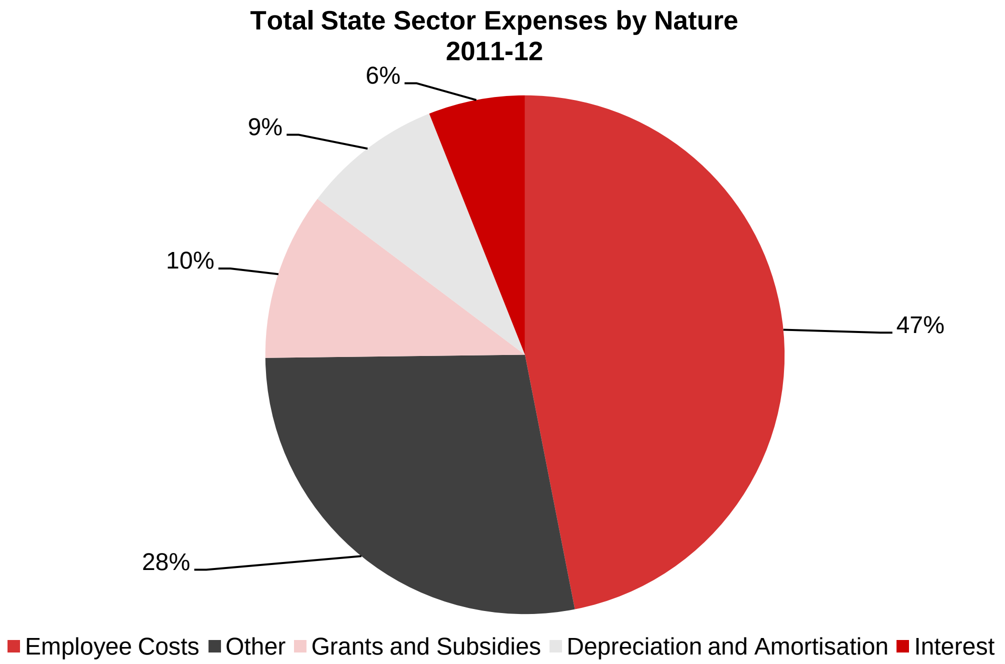
National Partnerships are time limited arrangements that focus on delivering specific outputs or projects in areas of nationally significant reform or on achieving service delivery improvements. The Australian Government funds National Partnerships to help progress the reforms and/or reward jurisdictions for achieving agreed performance benchmarks (source: 2011–12 Budget Statement).

In 2011–12, the State received $4.9 billion in National Partnership Payments ($4.2 billion), including the following significant items:

National Partnerships	Amount $m
Transport	1,312
Nation building plan for the future	1,220
Education	710
Health and national health reform	551

Expenses

Total State Sector Expenses by Nature



The State employs around 11 per cent of people employed in New South Wales

Employee Costs

The State employs approximately 395,000 people, around 11 per cent of all people employed in New South Wales. The size of the New South Wales public sector has increased 1.5 per cent annually over the five-year period to 2011, slightly less than the 1.8 per cent annual increase in people employed in New South Wales.

Most employees are within the General Government Sector, with the health and education sectors employing about 60 per cent of all full time equivalents.

Employee costs increased by approximately 5.8 per cent compared to the prior year. Increases mainly reflect the increased number of people employed in the public sector and increases in wages.

The State spent $251 million on employee redundancies in 2011-12 ($53 million in 2010-11). A large portion of redundancies were from rail, correctional and central government agencies.

Employee costs do not include increases and decreases in superannuation obligations resulting from changes to assumptions used to calculate these obligations (e.g. movements in discount rates and other economic assumptions). These costs are reported in Other Economic Flows – Other Comprehensive Income.

Expected Changes in Expenses over the Long-Term

Last year, I reported on the NSW Long-Term Fiscal Pressures Report released as part of the 2011-12 Budget. The report identified the expected change in expenses over the long-term as a result of changing demographics and pressures placed on government services. The long term modelling predicts proportionally increased spending on health and welfare, in line with an aging population.

Due to the long-term nature of the expected changes, it is unlikely a shift in government spending will be noticable in the short-term. Nothing has come to my attention in the current year to indicate any changes in long term expectations.

Analysis of the Financial Position

Abridged Statement of Financial Position

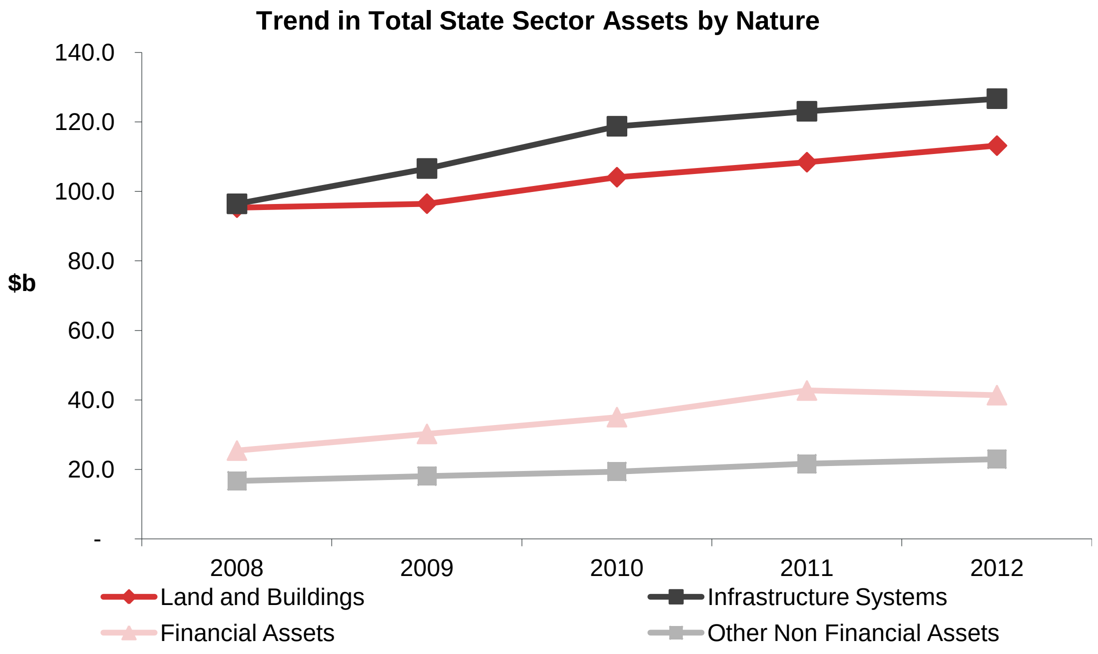
Year ended 30 June	General Government		Total State Sector	
	2012 $m	2011* $m	2012 $m	2011* $m
Assets				
Cash and cash equivalents	6,576	8,258	9,975	11,758
Receivables	12,151	12,447	6,356	7,210
Financial assets at fair value	7,235	7,577	20,777	19,987
Other investments	82,542	87,963	4,240	3,738
Property, plant and equipment	135,731	128,076	254,309	245,528
Other	4,098	3,296	8,479	7,534
Total assets	**248,333**	**247,617**	**304,136**	**295,755**
Liabilities				
Payables and deposits held	5,674	5,362	7,900	8,568
Borrowings	27,641	23,300	73,098	62,762
Employee provisions	12,802	11,627	15,289	13,737
Superannuation provision	47,181	32,333	50,922	34,054
Other provisions	7,032	6,538	8,571	7,939
Other	2,492	2,547	2,845	2,785
Total liabilities	**102,822**	**81,707**	**158,625**	**129,845**
Total net worth	**145,511**	**165,910**	**145,511**	**165,910**

* 2011 amounts have been restated for changes made in accordance with Australian Accounting Standards.

The State has over $300 billion in assets, mostly property, plant and equipment

Assets

Total assets increased from $234 billion in 2008 to $304 billion in 2012 (30.1 per cent over five years) which equates to an average annual growth rate of 6.8 per cent. Almost 70 per cent of this growth has occurred within property, plant and equipment, around two-thirds of which occurred in infrastructure systems.

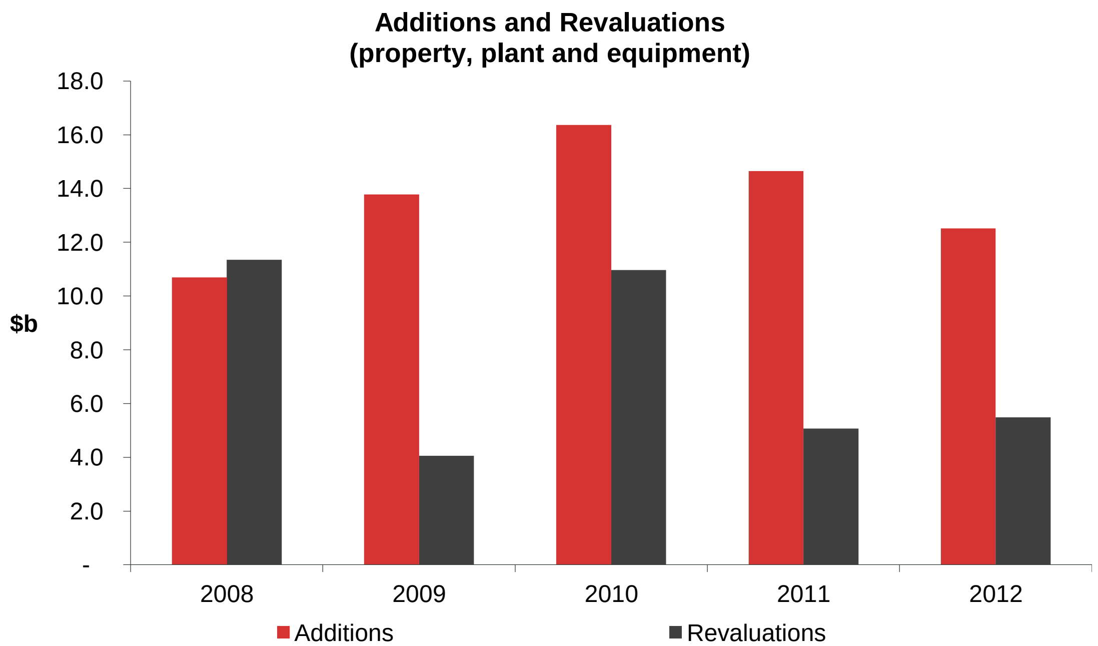


Property, Plant and Equipment

Property, plant and equipment assets represent 84 per cent of the State's total assets (83 per cent at 30 June 2011). Physical assets of land and buildings, infrastructure systems and plant and equipment are used to provide or support service delivery.

The State measures these assets at fair value, usually represented by the cost to replace the remaining service potential of the asset. This is considered more useful information for government decision-making and is allowable under Australian Accounting Standards. Measuring at fair value means movements in carrying values year on year may be caused by the purchase or disposal of assets or revaluations of existing assets.

The impact of additions and revaluations on the fair value of property, plant and equipment over the last five years are shown in the graph below.



The State has spent around $68 billion on capital works over the past five years

Over the last five years, the State has spent $68.0 billion on capital expenditure (an average of $13.6 billion per year). In 2011–12, additions to property, plant and equipment totalled $12.5 billion, funded, in part, by capital grants of $3.0 billion from the Australian Government.

Major revaluations recorded in 2011–12 included:

- schools and TAFE land upwards by $1.1 billion and buildings by $4.9 billion
- roads infrastructure and earthworks upwards by $2.1 billion
- residential property portfolio upwards by $1.1 billion
- land under roads and land acquired for future roads works downwards by $2.6 billion
- electricity generation assets downwards by $1.3 billion.

As discussed in the Audit Result section, I was not able to determine if the value of the State's schools and TAFE buildings are materially correct. As a result, I was also unable to determine if the 2011-12 revaluation of schools and TAFE buildings was materially correct.

Maintenance Spending and Depreciation

The State spent $4.5 billion in 2011–12 ($4.4 billion in 2010-11) maintaining its property, plant and equipment including relevant employee costs. Expenditure on asset maintenance is equivalent to 2.2 per cent (2.3 per cent) of the State's property, plant and equipment (excluding land) and represents 6.4 per cent (6.4 per cent) of total expenses. In comparison, depreciation on the State's property, plant and equipment represents 8.7 per cent (8.7 per cent) of total expenses.

The State recorded depreciation and amortisation expenses of $6.1 billion in 2011-12 ($5.9 billion). Additions to property, plant and equipment and intangible assets were $12.5 billion ($14.6 billion). The expenses as a proportion of additions were 45.6 per cent in 2011-12 (38.4 per cent).This is higher than the five year average of 39.1 per cent.

Major Capital Projects

The government publishes its capital infrastructure plans for current and forward estimates periods in Budget Paper 4: Infrastructure Statement. In the 2011–12 Infrastructure Statement the Treasurer announced:

'Over the four years to 2014–15, New South Wales will undertake a record infrastructure investment program worth $62.6 billion. This includes $15.3 billion in 2011-12 and an average of $15.8 billion per annum in the following three years.'

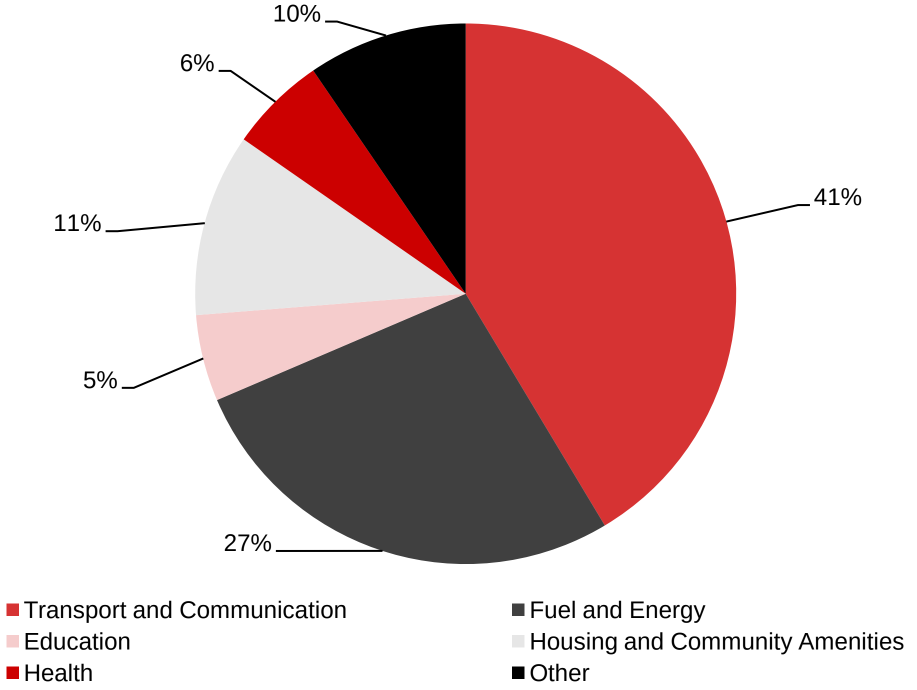
The government's 2011–12 capital infrastructure plan included over 750 major capital projects estimated to cost $15.3 billion. The State spent $13.1 billion (85.4 per cent) of the infrastructure budget in 2011-12. The State spent $14.9 billion on infrastructure in 2010-11. Treasury advises the reasons for the $2.2 billion Budget underspend include:

- $444 million for electricity transmission and distribution infrastructure mainly because of delays in property acquisitions, rescheduling of site works, revisions to the delivery strategy for some projects to improve efficiency, and some project deferrals and cancellations. Wet weather also delayed projects.
- $356 million for roads infrastructure mainly because of heavy rain delaying projects
- $298.4 million for transport infrastructure mainly because of rescheduling certain projects to match operational needs, later than expected delivery of Waratah train carriages, and deferral of property acquisition for the Wynyard Walk project.
- $201 million for ports infrastructure mainly because of delays in the Cruise Passenger Terminal relocation by the Barangaroo Review and planning issues with local Council. Other delays were caused by unexpected project issues (known as latent conditions) and the need for additional planning and design. Wet weather also delayed earthworks and related projects for the Port Botany expansion.
- $167 million for health infrastructure was mainly due to delays in negotiating agreements with the Australian government. The budget underspend was also due to weather-related delays on many projects, and delays in planning and documentation caused by project variations on a number of projects.

Further information on major capital projects will appear in later volumes of my Report to Parliament.

The State has over forty public private partnerships to provide facilities and services

Total State Sector Infrastructure Investment by Policy Area 2011-12



Summary of Public Private Partnerships

The State controlled $253 billion of property, plant and equipment assets at 30 June 2012 ($245 billion). Of this, $127 billion ($123 billion) relates to infrastructure systems. Infrastructure can be provided via mechanisms other than State owned, financed and operated.

Public Private Partnerships (PPPs) are long-term contracts between the public and private sectors where government generally pays the private sector to deliver infrastructure and related services to meet government’s service responsibilities. PPPs rely on borrowing or equity funding from private sources.

The Treasury recently released NSW Public Private Partnerships Guidelines. This publication requires all agencies to assess PPPs as a potential procurement method for any public infrastructure project with an estimated capital value exceeding $100 million. PPPs have varying impacts on State finances. The Guidelines require agencies to assess the impact on revenues, expenses, assets and liabilities, and identify the State Budget impacts.

The State currently has over 40 active PPPs that cover a wide range of government services:

PPP	PPP commencement [a]	PPP term (years)
Purchase arrangements with deferred payments		
Royal North Shore Hospital (RNSH) Redevelopment – Stage 2	2011	26
Bathurst, Orange & Associated Health Services	2011	24
Bonnyrigg Living Communities Project	2010	25
Newcastle Mater Hospital Redevelopment	2009	25
Colongra Gas Pipeline and Storage Facility	2009	18
Long Bay Prison and Forensic Hospitals	2008	26
Ten new schools (New Schools Project 2)	2007–2009	29
Nine new schools (New Schools Project 1)	2004–2005	29
Finance lease arrangements		
Rollingstock Maintenance Facility	2012	32
Electric Passenger Rollingstock Replacement	2011	33
Metropolitan Buses	2005	7
Parramatta Police Headquarters	2004	20
Hawkesbury Hospital	1996	18
Blue Mountains Sewage Transfer Tunnel	1996	32
Macarthur Water Treatment Plant	1995	35
Sydney Harbour Tunnel	1992	30
Build (Own) Operate Transfer (BOT or BOOT) arrangements		
M5 Motorway Widening	(b)	(b)
M2 Motorway Widening	(c)	(c)
Lane Cove Tunnel	2007	30
Westlink M7 (Western Sydney Orbital) Motorway	2005	32
Cross City Tunnel	2005	30
Airport Line Stations	2000	30
St George Hospital Car Park	1999	25
Eastern Distributor Motorway	1999	49
Stadium Australia	1999	32
Sydney SuperDome	1999	31
Randwick Hospital Car Park	1998	25
Light Rail System	1997	31
M2 Motorway	1997	49
Sydney Hospital Car Park	1995	25
Opera House Car Park	1993	50
M4 Motorway Service Centres	1993	25
M5 Motorway	1992	31

PPP	PPP commencement [(a)]	PPP term (years)
Build Own Operate (BOO) arrangements		
Rosehill Camellia Recycled Water Project	2011	20
Pindari Mini Hydro Power Station	2001	(d) 30
Woronora Water Treatment Plant	1997	23
Prospect Water Treatment Plant	1996	31
Illawarra Water Treatment Plant	1996	23
Burrendong Mini Hydro Power Station	1996	(d) 30
Copeton Mini Hydro Power Station	1995	(d) 30
Liverpool Hospital Car Park	1994	19
Glenbawn Mini Hydro Power Station	1994	(d) 30
Wyangala Mini Hydro Power Station	1991	(d) 30
Other		
Chatswood Transport Interchange	2008	(d) 47
Parramatta Transport Interchange	2006	23

Source: The Treasury (unaudited).

a PPP commencement is the year the project was ready for operation.

b The M5 Motorway widening is in its construction phase. Construction will extend the original M5 Motor term by around three years (ending in 2026).

c The M2 Motorway widening is in its construction phase. Construction is split into four stages with planned completion dates ranging from 2012–2013. Completion of the construction phase will extend the original M2 Motorway term by four years (ending in 2046).

d Excludes options to extend PPP term.

During 2011-12, the State restructured the ‘Electric Passenger Rollingstock replacement’ PPP. The financial restructure requires the State to make a $175 million investment in Reliance Rail in 2018. The investment is conditional on Reliance Rail delivering 78 Waratah trains and their ability to refinance existing debt at that time. The State would own Reliance Rail once the investment is made. The State has the option to sell its requirement to invest in Reliance Rail to a third party before 2018.

As a result of the restructuring, the State recognised an $8.3 million financial instrument at 30 June 2012. The financial instrument is essentially calculated as the difference between the value of Reliance Rail and the State’s future investment amount. The State has also recognised $28.5 million receivable from Reliance Rail at 30 June 2012 for fees it is entitled to under the financial restructure. Offsetting this receivable is a $10.3 million liability for unearned fees.

Legal claims between various PPP participants (including the State) were settled or withdrawn as part of the financial restructure.

The Treasury advised of the following proposed PPPs:

Proposed PPP	Nature of proposed PPP
Sydney International Convention and Entertainment Centre	Expansion and enhancement of the convention, exhibition and entertainment complex, including the refurbishment of existing facilities and the development of new facilities.
Airds-Bradbury Social Housing PPP	Increase total dwellings in Airds-Bradbury (near Campbelltown) to 2,100 of which 30 per cent will be social housing and 70 per cent private dwellings.
North West Rail Link-Operations, Trains and Systems component	Manage the Operations, Trains and Systems component of the heavy rail project between Rouse Hill and Epping (North West Rail Link).

The State currently uses four broad types of PPP arrangements:

- purchase arrangements with deferred payments, which include infrastructure that is State owned and controlled, and which has been financed by the private sector
- finance lease arrangements, which include infrastructure owned and financed by the private sector, but which is controlled by the State
- Build (Own) Operate Transfer arrangements, which include infrastructure that is financed, built, and operated for a certain period of time by the private sector, after which ownership and control of the infrastructure is transferred to the State. The private sector recovers its investment through charges paid by the infrastructure users
- Build Own Operate arrangements, which include infrastructure that is financed, built, and operated by the private sector generally for the life of the infrastructure. The private sector recovers its investment through charges paid by the State.

Other Assets

Cash and Cash Equivalents

The State had around $10.0 billion of cash and cash equivalents at 30 June 2012 ($11.8 billion). Most of the decrease was due to the transfer of $3.8 billion cash to the State’s superannuation investments. This cash was the proceeds from last year’s electricity transactions.

Financial Assets at Fair Value

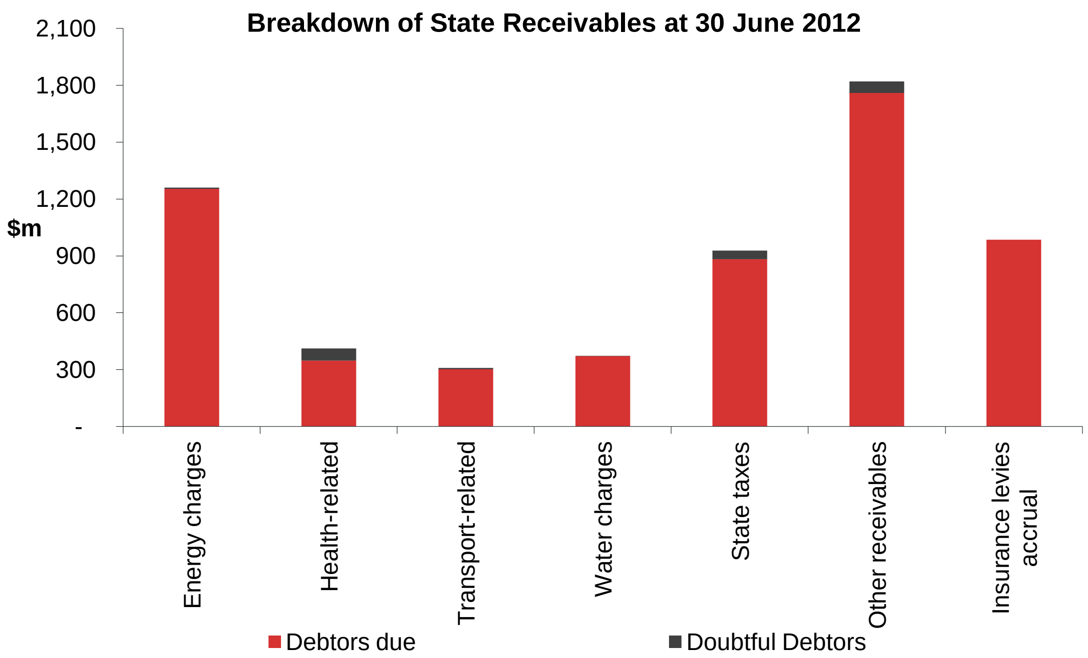
Financial assets held at fair value increased by $790 million to $20.8 billion during 2011-12. This asset category mainly comprises financial investments held by the State, such as listed equities and bonds. These investments are made by New South Wales Treasury Corporation (TCorp) on behalf of agencies.

Other Investments

The State has around $4.2 billion invested directly in entities outside the New South Wales public sector. Ownership of these entities is generally shared with other Australian jurisdictions. Entities include Snowy Hydro Limited ($3.3 billion) and joint ventures operated through the Murray-Darling Basin Authority ($700 million).

Receivables

The State had receivables of around $6.1 billion at 30 June 2012 ($7.1 billion). During 2011-12, the State received over $76.0 billion cash from the collection of receivables. The following shows the breakdown of State receivables at 30 June 2012 according to their nature:



Other receivables represent the total of various relatively small amounts across many individual agencies.

The State generally collects most of what it is owed. The statutory nature of charges such as dust diseases insurance levies generally result in high recoverability, for example. The table below shows details of doubtful debts at year end and debt write offs during the year.

Year ended 30 June	2012	2011	2010
Total receivables at 30 June ($m)	6,086	7,076	6,975
Doubtful debts at 30 June ($m)	184	313	200
Doubtful debts (% of total receivables) at 30 June	3.0	4.4	2.9
Debtors written off ($m) *	126	82	48
Debtors written off (% of total receivables)	2.1	1.2	0.7

* Excludes a one-off $311 million debt write off in 2011-12, which is discussed in the Audit Result section of this Volume.

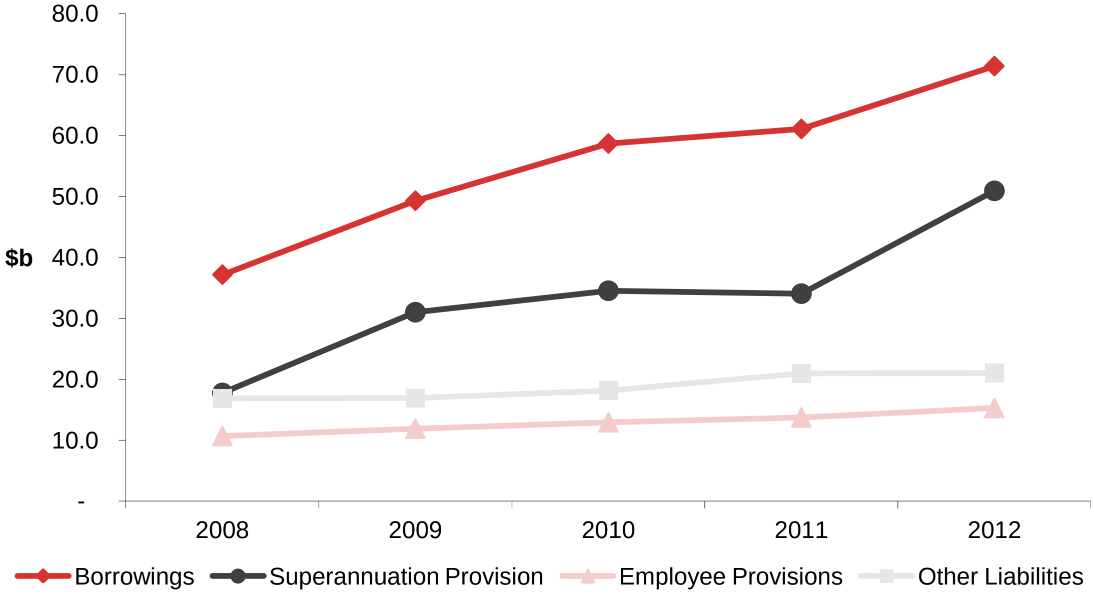
The results indicate the State collects most of its debtors with only a low percentage of doubtful debts and debt write offs. The bulk of bad and doubtful debts can generally be isolated to a few areas:

- The Office of State Revenue wrote off $46.9 million of tax debts in 2011-12. Whilst this is a large amount of money, it represents just 0.3 per cent of the $17.3 billion taxes it collected in 2011-12.
- The Ministry of Health wrote off $56.6 million in 2011-12 ($25.5 million). While health-related receivables are relatively low, a large portion (15.6 per cent) is considered doubtful. Further information on the Ministry's collectability of its debtors will appear in Volume Ten of my 2012 Report to Parliament.

Total liabilities have nearly doubled from $82.5 billion in 2008 to $159 billion in 2012, an average annual growth rate of 17.8 per cent

Liabilities

Trend in Total State Sector Liabilities by Nature



Borrowings increased by $10.3 billion during 2011-12

Borrowings

The State had $73.1 billion of borrowings at 30 June 2012. Borrowings increased $10.3 billion (16.5 per cent) during 2011-12. The increase includes around $5.5 billion of new borrowings, used to fund capital projects, operating cash flows and additional superannuation contributions.

The increase in borrowings also includes movements in the value of existing borrowings. Most of the State's borrowings are in the form of bonds, which are measured at fair value. The fair value of bonds is influenced by the cash rate set by the Reserve Bank of Australia and supply and demand of bonds. Generally when the cash rate falls, bond rates also fall, which causes the value of bonds to go up. The fall in bond rates in 2011-12 increased the fair value of existing borrowings by around $5.0 billion.

Interest on borrowings for the 2011-12 year was $3.5 billion ($3.6 billion), which represents 4.9 per cent (5.7 per cent) of the year end borrowings balance and 5 per cent of total annual revenue (5.2 per cent).

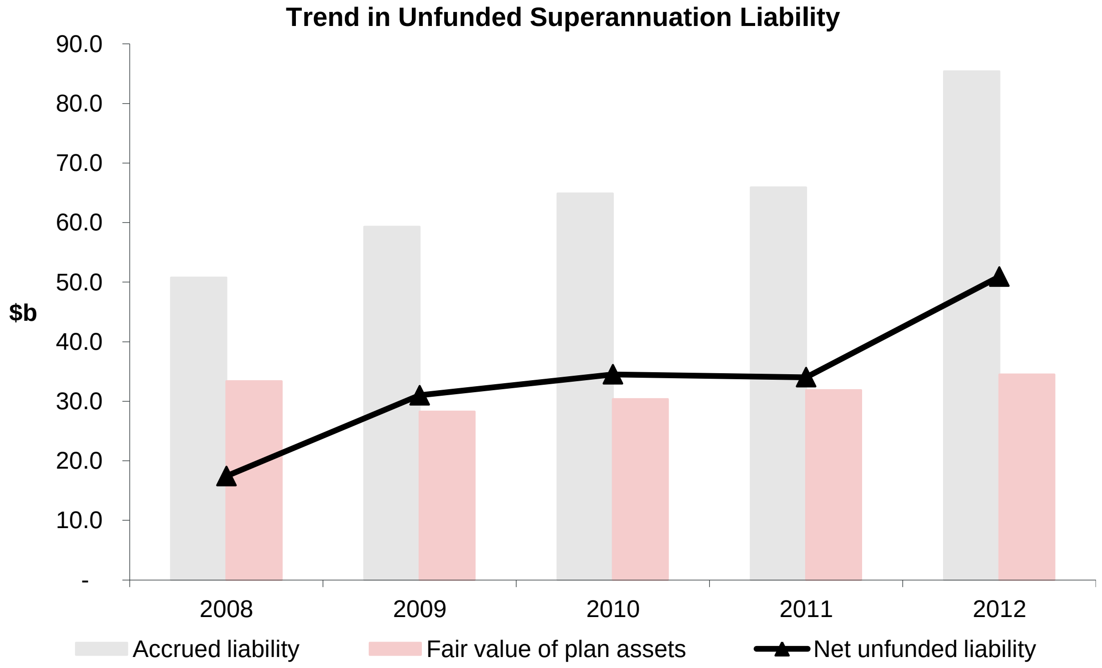
During the year, the State has issued $19.2 million in Waratah Bonds, which is included in borrowings.

Superannuation Provisions

Superannuation liabilities increased by $16.9 billion during 2011-12, a 49.5 per cent increase from 2010-11

The State's superannuation liability of $50.9 billion represents obligations for past and present employees, less the value of assets set aside to meet those obligations. Superannuation liabilities increased $16.9 billion (49.5 per cent during 2011-12).

This increase has arisen largely from the impact of global economic conditions. Returns on the assets offsetting liabilities (plan assets) have been lower than expected and liabilities have increased as a result of lower bond rates.



Lower than Expected Investment Returns

Superannuation investments that offset the liabilities did not perform as well as expected during 2011-12. The investments earned 0.4 per cent in 2011-12 compared to the return expected by the Government of between 7.0 – 8.6 per cent. The lower investment returns meant there were $2.5 billion fewer investments available to reduce superannuation liabilities.

Offsetting the impact from global economic conditions was the transfer of $4.6 billion into superannuation investments in 2011-12. Of this, $3.8 billion was from the proceeds from last year's electricity sale transaction and $800 million was from additional borrowings. The State borrowed money for this purpose because it is expects investment returns will be higher than the interest payable on the borrowings.

Lower Bond Rates

Superannuation liabilities are discounted using government bond rates. These bond rates fell dramatically during 2011-12 from 5.3 per cent to 3.1 per cent. The drop caused superannuation liabilities to increase by around $19.0 billion. This increase does not impact the Budget Result but it does reduce the State's net worth.

Superannuation liabilities are very sensitive to changes in the government bond rate. A one per cent change in the bond rate affects the liability by around $10 billion.

Additional Contributions

The State makes annual contributions to the plan assets with a view to eliminating unfunded liabilities by 2030. Annual contributions in 2011-12 were $1.5 billion ($1.6 billion). In 2011-12, the State made additional contributions of $4.6 billion. These contributions were funded from the proceeds of last year’s electricity transactions including interest of $3.8 billion and $800 million of borrowings. The State borrowed extra money because the interest payable on the borrowings is expected to be less than the superannuation investment returns.

Further information on superannuation obligations will appear in Volume Five of my 2012 Report to Parliament.

Employee Provisions

The State’s employee-related liability of $15.3 billion includes annual leave and long service leave owed to public sector employees. It also includes $3.3 billion ($3.1 billion) outstanding workers’ compensation claims from public sector employees.

Employee provisions increased $1.6 billion during 2011-12 mainly due to the way the liabilities are calculated. The fall in government bond rates causes liabilities to increase, even if the amount of leave owed to employees has not changed.

Offsetting the increase was a $223 million decrease in NSW Police death and disability liability. The decrease is mainly due to legislative changes to the death and disability scheme during 2011-12. Also offsetting the increase was a $247 million decrease in the expected cost of outstanding workers’ compensation claims. The decrease is due to legislative changes to the State’s workers’ compensation scheme during 2011-12.

Other Liabilities

Other liabilities and provisions remained largely stable during 2011–12.

Fiscal Responsibility

Governments across Australia have legislation aimed at promoting sound financial management, or fiscal responsibility in budgeting. It is generally accepted that balancing immediate community needs with longer term needs is necessary for intergenerational equity. The next generation should not pay for the excesses of the previous, for example.

New Fiscal Responsibility Legislation

In August 2012, the *Fiscal Responsibility Act 2005* (2005 Act) was replaced by the *Fiscal Responsibility Act 2012* (2012 Act). Whilst the stated objects of the two Acts are different, in my view, the two Acts have many similarities. The table below sets out my summary of the Acts' contents.

Act	2005	2012
Objective	Provide the framework for fiscal policy with a view to maintaining financial results that are fiscally sustainable in the medium and long term.	Maintain the AAA credit rating with a view to limiting borrowing costs and accessing broad sources of borrowings, and maintaining business and consumer confidence to sustain economic activity and employment.
Targets	Specific limitations on General Government sector net financial liabilities and net debt in the medium and long terms. Eliminate unfunded superannuation liability by 2030.	Annual growth in General Government expenses is less than long term average General Government revenue growth. Eliminate unfunded superannuation liability by 2030.
Principles	10 principles	3 principles
Reported in Annual Budget Papers	Departures from principles and indicate when the principles will be reinstated. Long term fiscal pressures and long term fiscal gap addressed every five years.	Departures from principles and indicate how and when the principles will be reinstated. Long term fiscal pressures and long term fiscal gap addressed every five years.

The target in the 2012 Act of limiting expenses will result in surpluses. Surpluses contribute to limiting net financial liabilities and net debt, which are the subject of targets in the 2005 Act. This is why there is some similarity in the targets.

The fiscal principles in both Acts cover various aspects of financial management and there is a fair degree of similarity in their scope. Both Acts contemplate such matters as capital expenditure, taxation policy, risk management and intergenerational equity, for example.

I had previously recommended the Government seek amendments to the 2005 Act to improve its effectiveness. I had concerns the measures within that Act were significantly impacted by factors outside the control of Government. This meant it was difficult to attribute accountability when the targets were not met. Whether expenditure growth is constrained per the target in the 2012 Act will be readily assessable on an annual basis. Whether unfunded superannuation liabilities will be eliminated by 2030 cannot be predicted with certainty. However, regular consideration of progress, as was the case under the 2005 Act, can occur.

What may be more difficult to assess is the Government's adherence to the principles in the 2012 Act. The principles are high level and the Act does not include standards of performance in all instances. This may present challenges for me in future years in assessing compliance with the Budget reporting provisions of the 2012 Act.

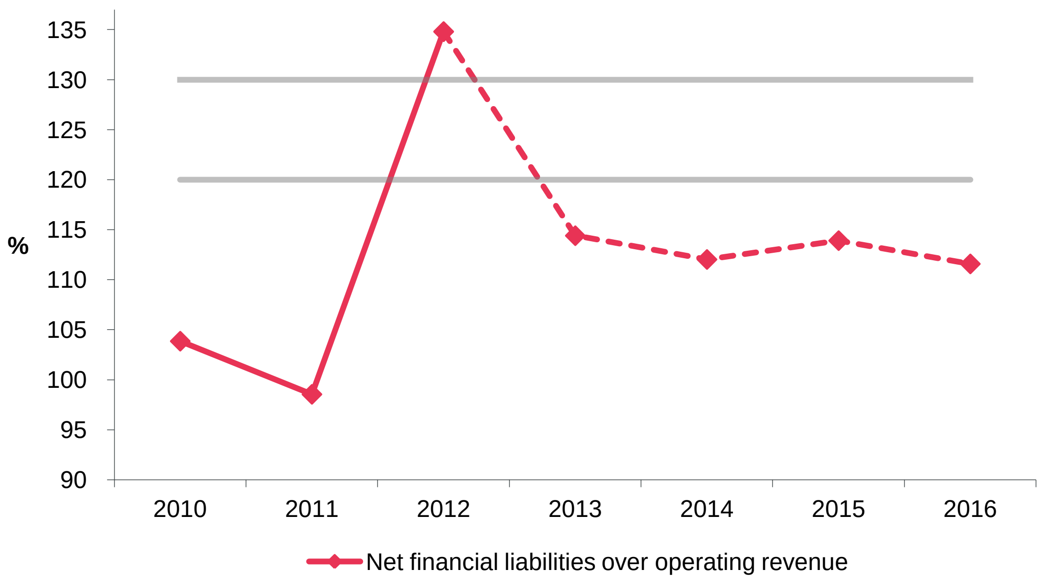
The State of New South Wales maintained its AAA credit rating during 2011-12

AAA Credit Rating

Given the objective of the 2012 Act, it is worthwhile considering the State's current credit rating. New South Wales has credit ratings of AAA from Standard & Poor's, Aaa/Stable from Moody's Investors Service and AAA from Fitch Ratings. In October 2012, Standard &Poor's reaffirmed the State's AAA credit rating but lowered the outlook to negative. Their view is that there is a one in three chance of a downgrade in the next two years. Moody's and Fitch Ratings last assessed the State's credit rating outlook as being stable and are expected to issue formal credit opinions in coming months.

Ratings agencies use a variety of quantitative factors and apply judgment when determining the State's rating. Agencies frequently identify a key metric for triggering a review of a rating. The following graph shows the State exceeded Standard & Poor's credit rating review trigger at 30 June 2012.

Standard & Poor's Credit Rating Review Trigger



Source: 2012–13 budget papers (unaudited), Audit Office calculations.

Note: Standard & Poor's definition of net financial liabilities is net debt plus unfunded superannuation liabilities.

The State exceeded Standard & Poor's credit rating review trigger at 30 June 2012

As discussed earlier in my Report, the State's liabilities significantly increased in 2011-12, largely because of the fall in government bond rates. This led to a spike in the ratio of net financial liabilities to operating revenue at 30 June 2012. The graph above displays forecast positions published in the 2012-13 Budget Papers. These forecasts are based on an assumption bond rates will return to higher levels in the longer term.

The Net Financial Liabilities ratio is only one indicator of the State's credit-worthiness. Standard & Poor's has already identified that the State can tolerate higher levels of net financial liabilities than most jurisdictions. With the exception of Victoria, trigger ranges for other states and territories are lower than for New South Wales.

Other factors that are relevant to ratings agencies when assessing the State's credit rating include:

- prevailing economic conditions
- budgetary performance and flexibility
- the ability of the State to service borrowings
- liquidity of the State's balance sheet
- financial management processes and financial reporting.

Overriding the factors used to assess New South Wales' credit rating is the Australian credit rating. The states and territories cannot have ratings higher than the Australian government.

Credit rating agencies use these factors to build an assessment of the State's credit rating. The factors include a mix of quantitative and qualitative factors that are compared against set benchmarks and criteria. For example, a qualitative factor used by credit rating agencies is whether they believe a government has the political resolve to deliver spending cuts, increase revenues or follow through with major asset sale transactions.

Ratings agencies may update their formal opinions at any time, if they perceive material changes in credit-worthiness have occurred.

Comparison of Financial Position with other Australian States and Territories

As noted earlier in this Volume, the State's finances can be compared to other Australian states and territories using a variety of financial indicators. The following table shows how New South Wales compares on key financial management measures for 2010-11.

Measure	New South Wales	Average (all States and Territories)
Net borrowing as a percentage of GSP (%)	1.5	2.2
Net financial liabilities as a percentage of GSP (%)	20.2	18.3
Net debt as a percentage of GSP (%)	7.4	5.1
Ratio of unfunded superannuation liability and other employee entitlements to total revenue	0.62	0.58

Source: Australian Bureau of Statistics; amounts based on 2010-11 Total Public Sector Government Finance Statistics data.

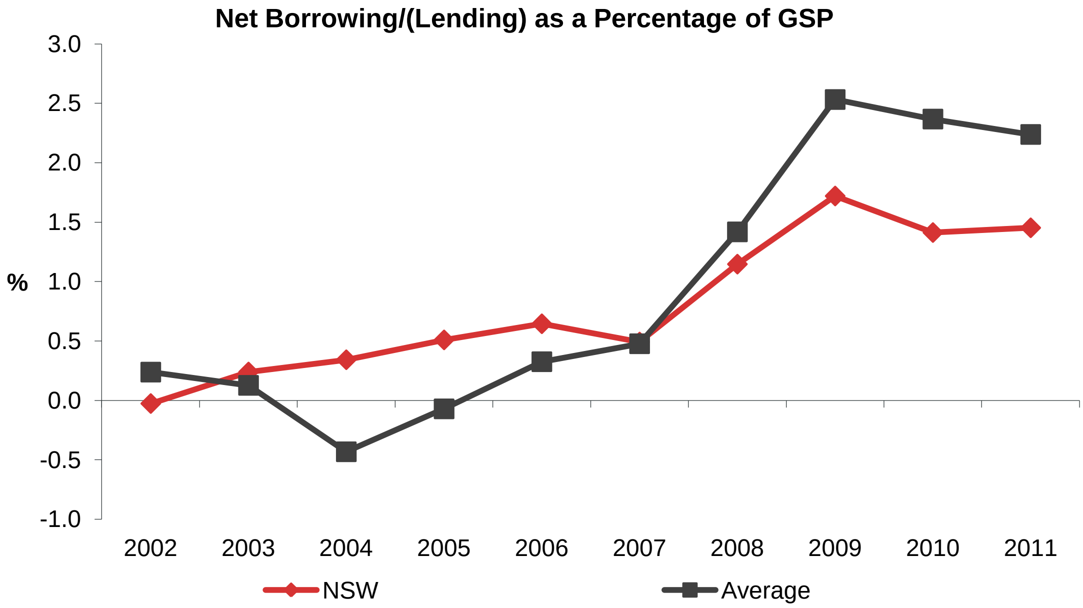
Note: My analysis relies on publicly available information for all states and territories. The most current data available is from 2010-11.

GSP: Gross State Product.

The following graphs show trends over time in these financial management measures for New South Wales compared with the average of other jurisdictions.

Net Borrowing

The net borrowing/lending result for a financial year reflects the extent to which capital spending was financed from operating surplus or from borrowings. Most jurisdictions have recorded net borrowings in recent years and the State's net borrowing as a percentage of Gross State Product (GSP) has been lower than the average of all states and territories.



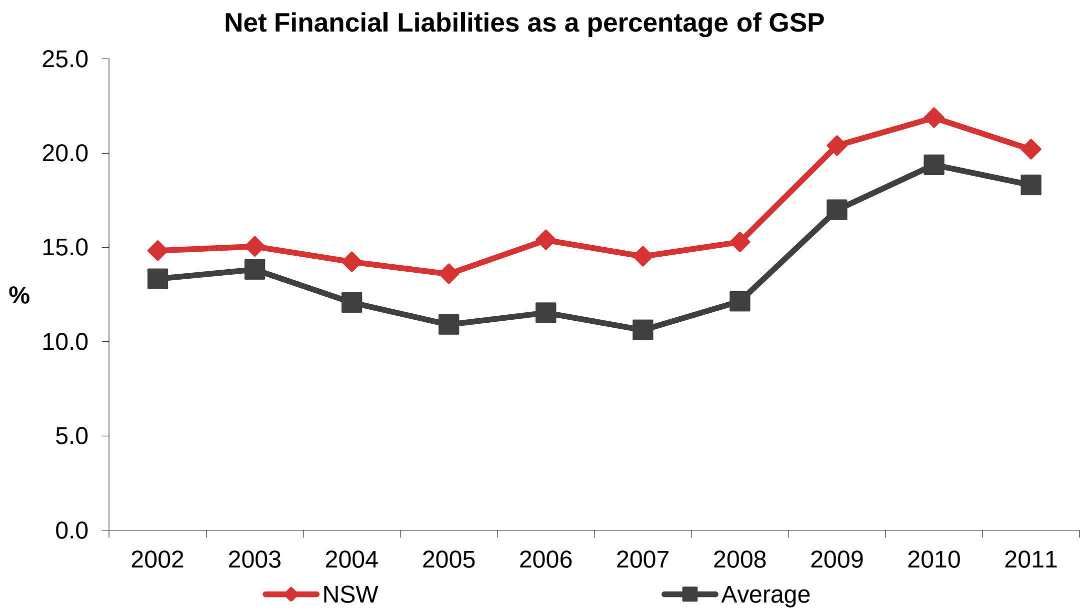
Based on data to 30 June 2011, the State has not borrowed as much money as a proportion of GSP to fund its spending compared to other states and territories. Given the State's lower net borrowing in 2011-12, it is reasonable to expect there will be no significant adverse change in the State's performance compared to average for the current year.

Net borrowing is calculated as the net operating balance (revenue from transactions minus expenses from transactions) less the net acquisition of non-financial assets. The State's net borrowing for 2011-12 was $5.2 billion ($6.4 billion for 2010-11).

Net Financial Liabilities

Net financial liabilities increased to $117 billion at 30 June 2012

Despite comparatively low net borrowing as a percentage of GSP, the State's net financial liabilities as a percentage of GSP is slightly higher compared to the average of other states and territories. Net financial liabilities are total liabilities less total financial assets.



The State's net financial liabilities have increased by about 35 per cent in 2011-12 to about $117 billion largely driven by the increase in unfunded superannuation liabilities discussed earlier in this Volume.

In 2010-11, the State's ratio of unfunded superannuation liability and other employee entitlements to total revenue was 62 cents for every one dollar of revenue, higher than the average of all states and territories.

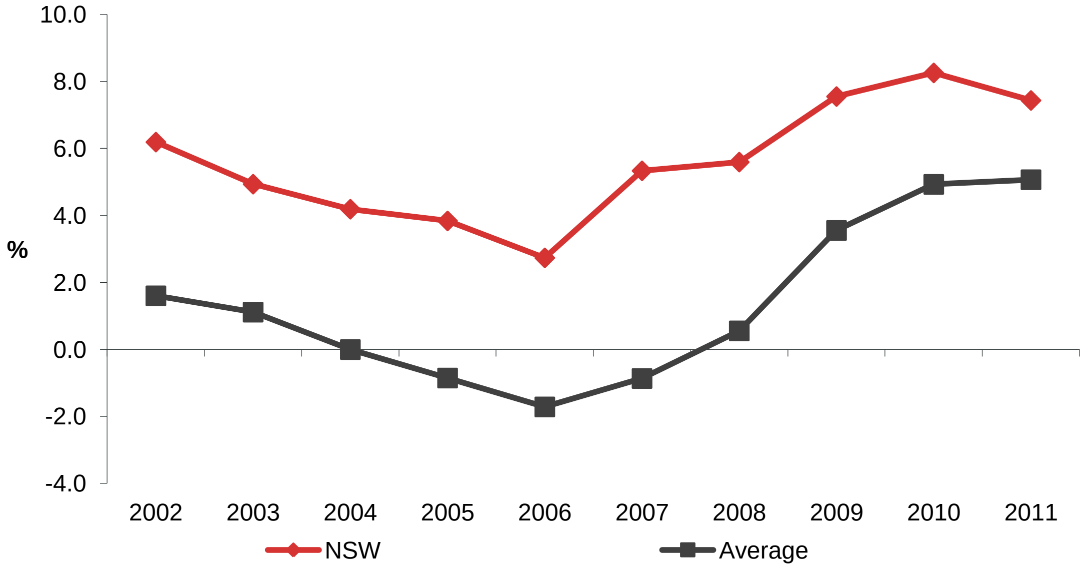
Net Debt

Net debt increased to $43.7 billion at 30 June 2012

Historically, the State's net financial liabilities have not been significantly higher than average, but despite comparatively low net borrowing as a percentage of GSP, the State's net debt as a percentage of GSP is significantly higher than the average.

Net debt, essentially borrowings less cash and liquid financial assets, was $43.7 billion at 30 June 2012 ($32.4 billion).

Net Debt as a percentage of GSP



As noted above, in 2011-12, the State reported a deterioration in net debt, which could lead to a widening in the gap between New South Wales and other states. The deterioration reflects the State's significant additional contribution to superannuation assets offsetting the gross unfunded liability.

Net debt is the sum of deposits held, borrowings and derivatives and advances received less cash and deposits, advances paid and investments, loans and placements. Net debt is narrower than net financial liabilities as it excludes liabilities such as superannuation and employee provisions, and insurance claim obligations.

Fiscal Responsibility Act 2005

I have included the following information because the 2005 Act was in force for the 2011-12 financial year.

Compliance

Budget Papers

The *Public Finance and Audit Act 1983* requires the 2012-13 Budget Papers to include:

- an assessment of progress achieved against the fiscal targets and fiscal principles of the 2005 Act
- a projection of the ability to achieve those fiscal targets in the future and to progress the achievement of those fiscal principles.

The 2012-13 Budget Papers addressed these requirements.

Progress towards the 2005 Act Targets

Progress towards the targets in the 2005 Act was relatively unsuccessful largely because of shortcomings in the targets. Performance against targets was significantly affected by variables outside the government's control.

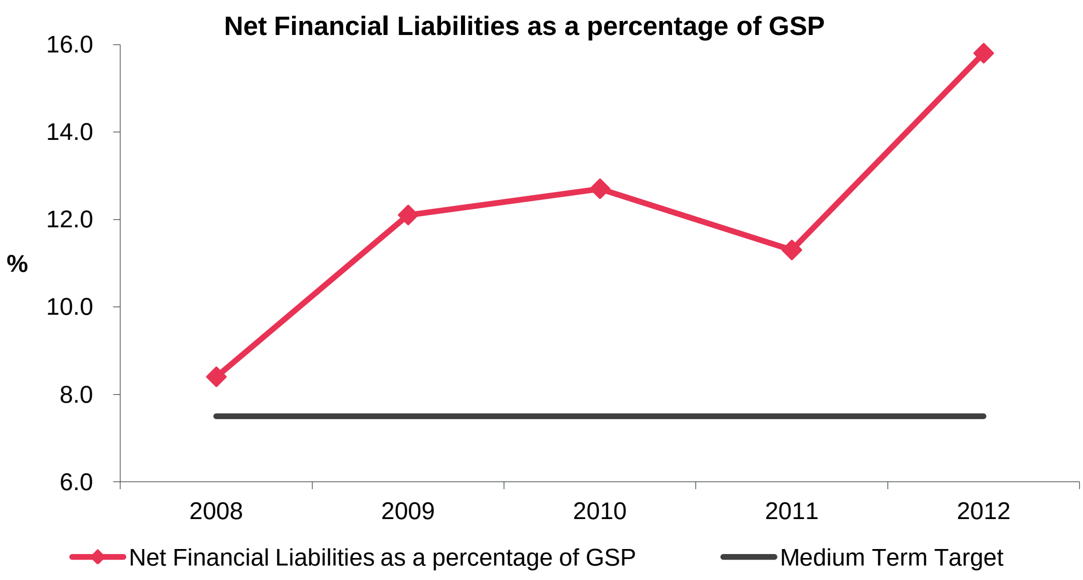
I discussed the impact of current economic conditions on the measurement of liabilities earlier in this Volume. The impact of the low government bond rates at 30 June 2012 is evident in the results and demonstrates the concerns I have reported in previous years about the effectiveness of the legislation.

Whilst the targets may be unrealistic, the measures still give an indication of fiscal sustainability. For this reason, I have shown the progress achieved in recent years towards the long-term fiscal targets below. The current year's results reflect the impact of global economic conditions discussed earlier in this Volume.

General Government Sector Net Financial Liabilities

GGS net financial liabilities were 16 per cent of GSP at 30 June 2012, almost 40 per cent higher than last year

General Government Sector net financial liabilities were $72.7 billion at 30 June 2012 ($49.3 billion), equivalent to approximately 16 per cent (11 per cent) of GSP. The long term fiscal target was six per cent or less by 30 June 2015.

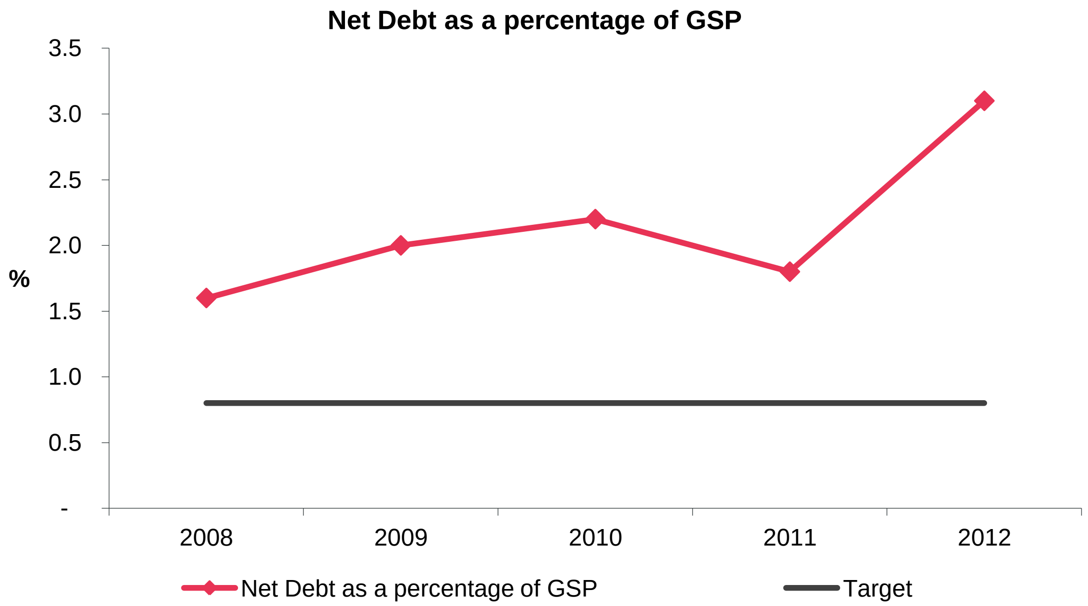


General Government Sector net financial liabilities include all liabilities of the General Government Sector less all financial assets (except for the government's equity in the public financing and public trading enterprise sectors).

General Government Sector Net Debt

GGS net debt was 3.1 per cent of GSP at 30 June 2012, almost twice the level of four years ago

General Government Sector net debt was $14.1 billion at 30 June 2012 ($8.0 billion) equivalent to 3.1 per cent (1.8 per cent) of GSP. Net debt at 30 June 2012 was over three times over the long term fiscal target.

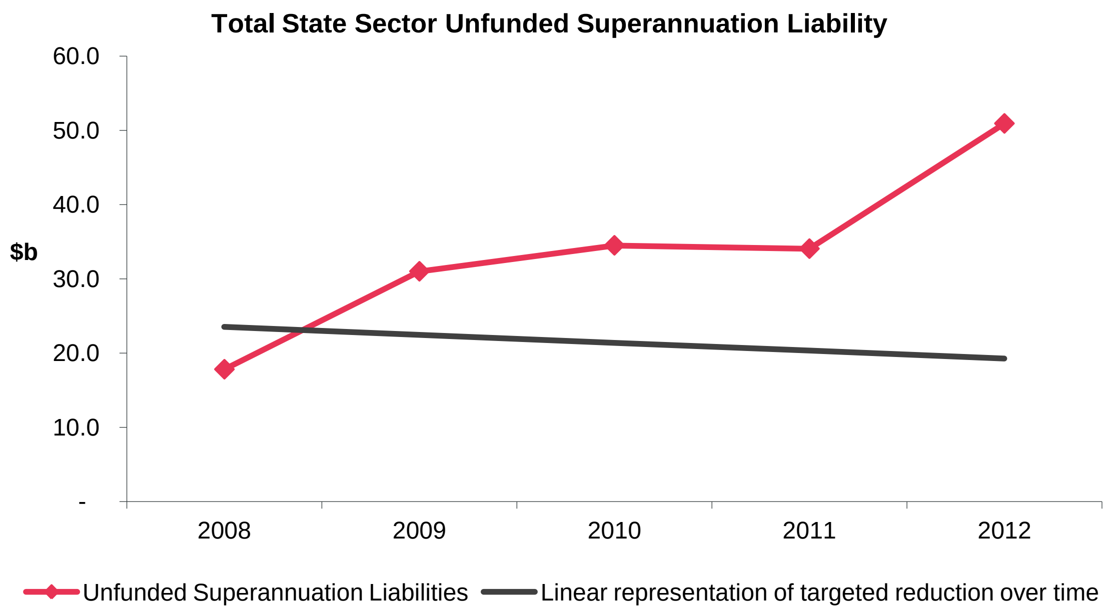


General Government Sector net debt is the sum of all deposits held, advances received and borrowings made by the General Government Sector, less the sum of cash and deposits held, advances paid and investments, loans and placements made by that sector. It excludes financial assets allocated to fund other liabilities through legislation or contract.

Total State Sector Unfunded Superannuation Liability

The government predicts unfunded superannuation liabilities of $50.9 billion will be eliminated by 2030

Total State Sector unfunded superannuation liabilities were $50.9 billion at June 2012 ($34.1 billion), almost all of which is within the General Government Sector. The long-term fiscal target in the 2005 Act was to eliminate Total State Sector unfunded superannuation liabilities by 30 June 2030. This target has been retained in the 2012 Act. Notwithstanding the current economic conditions, based on its regular assessments, the government predicts this target will be achieved.



Background on the *Fiscal Responsibility Act 2005*

The 2005 Act required the government to pursue its policy objectives in accordance with these fiscal targets:

- reduce the level of general government net financial liabilities as a proportion of GSP to 7.5 per cent or less by 30 June 2010
- reduce the level of general government net financial liabilities as a proportion of GSP to six per cent or less by 30 June 2015
- maintain underlying general government net debt as a proportion of GSP at or below its level as at 30 June 2005 (which was 0.9 per cent of GSP), unless an increase is required in net debt to reduce one or more components of general government net financial liabilities
- eliminate Total State Sector unfunded superannuation liabilities by 30 June 2030.

Quality and Timeliness of Financial Reporting

Timely and accurate financial reporting is essential for effective decision making, more effective and timely management of public funds and enhancing public accountability. Financial reporting occurs within hundreds of New South Wales government agencies annually and this financial information is used to prepare the General Government and Total State Sector Accounts (Total State Sector Accounts). Significant effort and resources are expended by agencies in discharging their reporting obligations.

Financial reporting is one aspect of sound financial management. Earlier this year, the NSW Commission of Audit, in its Interim Report on Public Sector Management, expressed surprise at the low importance attached to financial management across the New South Wales public sector. The Commission pointed to systemic weaknesses in financial management including poor reporting due to poor systems and a lack of capability. This need for improvement had been previously highlighted by the Public Accounts Committee.

This section of my report discusses progress towards improving the quality and timeliness of financial reporting across the New South Wales public sector.

Public Accounts Committee Recommendations

Recommendation

The Premier and Treasurer should continue implementing the Public Accounts Committee recommendations relating to the quality and timeliness of financial reporting.

In October 2010, the Public Accounts Committee released a report on the Quality and Timeliness of Financial Reporting. The Committee reported that a high standard of financial reporting was needed to better inform budget decisions, enable more effective and timely management of public funds by government agencies, and to improve accountability for public expenditure.

The Committee made recommendations addressing the following aspects of financial reporting:

- implementing hard closes within agencies
- certification of financial systems by chief financial officers (CFOs)
- chief executive officer (CEO) accountability
- earlier dates for tabling agency Annual Reports
- minimum qualifications for CFOs.

The Government formally responded to these recommendations in April 2011. Overall, the government supported the recommendations. More detail on the government's initial response and Treasury's reporting of progress appears in the following table.

No.	Public Accounts Committee's recommendations made in October 2010	Summary of government response at April 2011	Current status of progress towards implementing responses October 2012
1	The Treasurer require all agencies to conduct a hard close of their accounts at 31 March from 2011	After relevant consultation, Treasury concluded a full hard close was impracticable, and instead started implementing a series of 'early close procedures' for larger agencies. This involved conducting some aspects of year-end financial reporting processes before year-end	For 2012 financial reporting, Treasury mandated larger agencies perform expanded 'early close procedures'
2	The Treasurer propose amendments to the *Public Finance and Audit Act 1983* requiring chief financial officers to certify their financial reporting systems	Treasury requested all chief financial officers to express an opinion as to the effectiveness of internal controls over financial information prepared by their agencies by 15 April 2011	Treasury requested all chief financial officers express an opinion as to the effectiveness of internal controls over financial information prepared by their agencies by 12 August 2012
3	The Premier ensure that accountability for accurate and timely financial reporting is included in all chief executive officers' performance agreements.	Recommendation to be incorporated as part of a broader reform of accountability of chief executive officers	Performance agreements for chief executive officers of principal departments include a section on budget compliance and financial reporting
4	The Treasurer develop and implement a program to bring forward the deadline for the tabling of annual reports in Parliament to three months after the end of the financial year by 2013 at the latest	'Early close procedures' will facilitate earlier tabling of annual reports	Unchanged
5	The Treasurer consider proposing amendments to prescribe minimum qualifications of chief financial officers in the *Public Finance and Audit Act 1983*	Premier's Circular 99-69 'Qualifications for Senior Financial Management and Accounting Positions' is still current and the government believed this issue could be managed more flexibly through current arrangements rather than legislative amendment	Unchanged

Early Close Procedures

It is generally accepted that timely year-end financial reporting is an indicator of sound financial management processes. Accordingly, measures aimed at earlier tabling of agency annual reports in Parliament should be a priority.

Treasury needs to continue with its 'early close procedures' initiative and look for further ways of expanding its scope

Treasury has implemented a stepped program of bringing forward certain aspects of the year-end financial reporting process. After a pilot for 2010-11, Treasury strongly encouraged large and medium sized agencies to perform early close procedures for the 30 June 2011 year-end. Agencies were encouraged to:

- prepare pro-forma financial statements
- identify and resolve complex or significant accounting issues, including changes to accounting policies or estimations
- conduct asset valuations
- identify matters that caused delays in prior years and develop action plans to address such matters.

I found most relevant agencies conducted some aspects of the ‘encouraged’ early close procedures. I reported an expectation that mandating the requirements would likely result in greater compliance. It was pleasing to see Treasury make the requirements mandatory for most agencies in 2011-12.

Treasury’s Circular TC12/03 ‘Mandatory early close procedures commencing in 2012’ required most large and medium sized agencies to perform procedures similar to those listed above for 2010-11 no later than 30 April 2012. The procedures were not mandatory for State owned corporations or for about 150 legal entities that make up a very small fraction of State transactions and balances. I believe Treasury should seek ways to make the procedures mandatory for State owned corporations.

Most agencies attempted relevant early close procedures in 2011-12

I found a high degree of compliance by agencies with the 2011-12 mandatory early close procedures. However, in some instances, early close procedures have failed to ensure accurate year end reporting and identification of potential year end accounting issues. These failures have occurred largely due to the ineffective implementation by agencies. There is room for improvement, particularly in the area of asset valuations, in agencies’ early close procedures.

As in 2010-11, early close procedures for this year also required agencies to ensure key account balances were reconciled on a monthly basis. I found less evidence in agencies that this is occurring in all instances. Some of the errors within agencies’ financial statements, which I discuss later in this Volume, indicate these reconciliations are not being performed.

In 2011-12, Treasury extended the monthly requirements to include the review process with a view to improving accountability. Treasury required agencies to:

- perform variance analysis for actual results compared to budget and prior years
- ensure management review and endorse monthly financial reporting information
- consider more frequent publishing of financial information.

I support these additional requirements. Not only will it improve information used by agencies for decision making, performing effective financial reporting practices throughout the year contributes significantly to accurate and timely year-end reporting.

Consistent with the requirements for review of monthly information by agencies, Treasury has changed the way it monitors agency monthly results. Greater focus on monthly results is designed to improve the accuracy of annual forecasts.

What has not changed from last year is the amount of clarity around what constitutes ‘high quality monthly financial reporting’. Last year I recommended Treasury consider developing minimum requirements for agencies’ month end reporting. Setting a clear standard of performance as to what is required on a monthly basis would help identify those agencies that can improve the accuracy of their monthly financial information. I still believe there is merit in creating a benchmark of this sort.

Best practice monthly financial reporting processes would mean agencies would no longer view year-end financial reporting as a significant one-off annual event. It would also help improve the effectiveness and scope of early close procedures.

Certification of Financial Systems

Recommendation

The Treasury should implement the Public Accounts Committee’s recommendation to make CFO certifications a legislative requirement.

It is important that accurate and complete agency financial data is available on a timely basis because it underpins whole-of-government financial information used for decision making. Treasury uses agency data not just in the preparation of the Total State Sector Accounts, but also when developing annual Budget Papers, for example.

To promote better quality data, starting in 2011, Treasury asked agency chief financial officers (CFOs) to formally assert that their agency had effective systems and processes to generate the financial information required by Treasury. Treasury asked about 130 agencies to make this assertion, which covers in excess of 95 per cent of the transactions and balances within the New South Wales public sector. Most CFOs provided these assertions as at 31 March 2011.

Building on 2011 processes, Treasury again wrote to CEOs requesting formal CFO assertions in 2012. To align with the financial year, these assertions were required by 12 August 2012 for the financial year just passed. Treasury records indicate 85 per cent of the 130 or so agencies provided certifications. Treasury advises it is following up outstanding certifications.

Last year I made recommendations aimed at improving the certification of systems. I am pleased to report that Treasury is actioning these recommendations. I recommended Treasury provide further guidance to agencies and details of its expectations as to what constitutes effective financial systems and processes. In its request to agencies to provide certifications, some guidance was provided and agencies were referred to relevant publications. This is a positive step.

I also recommended Treasury inform audit and risk committees of the certification requirements. This was in response to a finding that many agency audit and risk committees had no involvement in the 2011 certification process. Treasury’s 2012 request for certification advised that the requirement should be brought to the attention of the audit and risk committee chair and encouraged committees to verify and validate the substance of the certification. Treasury has no way of monitoring whether audit and risk committees were advised.

My final recommendation was that Treasury articulate the certification requirements in a Treasury Circular or Policy and Guideline Paper. This has not occurred, but I understand Treasury may consider this action. Formalising the approach will promote the visibility of the certification process and reinforce its importance. This would arguably go partway to addressing the Public Accounts Committee’s recommendation that the certification process form part of legislative requirements.

Accountability of Chief Executive Officers

As reported last year, the response to the Public Accounts Committee's recommendation about making CEOs accountable for accurate and timely financial reporting is limited to principal departments. The applicable requirements for other agencies could improve. More can still be done to address the Committee's recommendation.

The pro-forma performance agreement for principal departments includes a section on budget compliance and financial reporting, which states that accurate and timely financial reporting is mandatory. As previously reported, I think there are opportunities to strengthen current arrangements. Instead of assessing performance as either 'yes' or 'no', clear criteria on what standard of performance equates to accurate and timely financial reporting could be developed and CEOs assessed against that criteria.

The requirements applicable to most other CEOs do contain more detail on the standard of performance expected, but policies are past their scheduled review date and do not necessarily reflect the current structures and priorities of government. Attached to Premier's Memoranda M2008-04 'Chief Executive Performance Agreement Guidelines' are performance agreement guidelines and a performance agreement template. These attachments' contain linkages to the now superseded 2009 State Plan. They do not make reference to accurate and timely financial reporting.

The requirements applicable to State owned corporations go some way to linking financial reporting to performance. TPP06-1 'CEO Contract Guidelines for Government Businesses' requires performance agreements to include measures for accountability in respect of financial management and an appendix lists examples of performance measures.

Overall, some streamlining and updating of the current requirements would likely promote more accurate and timely financial reporting across all agencies.

Earlier Tabling of Annual Reports

Recommendation

The Treasurer should prioritise amendments to financial and annual reporting legislation to ensure improvements in the timeliness of annual reporting.

The timeliness of tabling agency annual reports needs to improve

As I have previously reported, I believe the timeliness of tabling agency annual reports should and can be improved. Some other Australian jurisdictions have shorter timeframes than those applicable to New South Wales public sector agencies.

Currently, legislation requires agencies to provide annual reports to relevant ministers within four months of the financial year-end and ministers to table those reports in Parliament within one month of receipt. Audited financial statements are included in agency annual reports.

The Public Accounts Committee recommended the Treasurer develop and implement a program to bring forward the deadline for tabling annual reports. In its Circular 12/03, Treasury states that early close procedures will facilitate earlier tabling of annual reports. Whilst early close procedures assist in meeting the overall objective of earlier annual reporting, in isolation I doubt it will bring about significant change.

Based on past experience, legislative change will likely be the most effective mechanism for improving timeliness of annual reporting. The Government's response to the Public Accounts Committee's recommendation noted that amendment of the *Public Finance and Audit Act 1983*, the *Annual Reports (Statutory Bodies) Act 1984* and the *Annual Reports (Departments) Act 1985* would be required. It is disappointing that, 18 months after these observations, no legislative change has occurred. However, Treasury advises it is currently working on such proposals.

Minimum Qualifications for Chief Financial Officers

Recommendation

The government's reliance on Premier's Department Circular 99-69 'Qualifications for Senior Financial Management and Accounting Positions' to address the Public Accounts Committee's recommendation for minimum qualifications for CFOs should be reviewed.

As I reported last year, preparing agency financial statements requires a broad range of skills, which are not limited to an understanding of accounting concepts and requirements. Year-end financial reporting requires project management and stakeholder consultation, as well as knowledge of agency operations. In addition to formal accounting qualifications, agency CFOs need experience in financial management and corporate governance, including compliance and risk management, technology and internal controls.

The government's response to the Public Accounts Committee's recommendation for minimum qualifications for CFOs relies on a Premier's Department Circular that, in my view, has limitations.

Twenty year old requirements for CFO qualifications do not reflect the broad range of skills needed in today's environment

Premier's Department Circular 99-69 'Qualifications for Senior Financial Management and Accounting Positions' is only mandated for government departments. Statutory bodies, including State owned corporations, are only encouraged to adopt the minimum qualification requirements. There are almost 300 separate legal entities that make up the New South Wales public sector, of which, less than 60 are departments as defined in the Circular. Of these 60, about 40 are virtually dormant or exist in legal form only.

Low rates of attrition across the sector have reduced the Circular's effectiveness because it only applied to future recruitment into financial management and accounting roles. The Circular allows exemptions for existing officers taking on new roles within the sector. The Circular also includes other exemptions that mean not all financial management and accounting roles require minimum qualifications.

Aside from the limited application of the Circular, its requirements are limited to formal qualifications only and do not address the broad range of skills needed in today's environment. In my opinion, mandating the inclusion of relevant competencies as well as qualifications in all CFO role statements is required.

I am concerned reliance on the current Circular will not achieve the outcome intended by the Public Accounts Committee's recommendation. The Circular had existed for many years before the Committee's finding that financial reporting was falling short. This suggests it was not as effective as it might be.

The NSW Commission of Audit, in its Interim Report on Public Sector Management, observed that CFOs frequently did not participate in agencies' leadership groups. It referred to the membership of this group as being those with essential strategy positions that reported directly to the head of the agency. The Commission made a recommendation that CFOs be included in leadership groups.

The Commission did not explore the reasons contributing to this finding but did identify a lack of strategic financial management capability. This is a further indication that existing requirements, which are over twenty years old, do not ensure the current skills and capabilities required. It is crucial CFOs have the proper skills and capabilities to meet the challenges of being part of the leadership group.

2011-12 Agency Financial Statements

Quality of Financial Statements

Generally, users of financial statements will accept a level of inaccuracy in order to receive timely financial information. However, the level of error cannot be significant enough to affect their ability to make sound decisions based on that information.

The increased number of errors in agency financial statements is disappointing

The nature and extent of errors in agencies' financial statements provides valuable insight into the quality of financial reporting. Agencies' financial statements and other financial information are used to prepare the Total State Sector Accounts. Agencies' 2011-12 financial statements submitted for audit and used for whole-of-government financial reporting contained 37 errors each exceeding $20.0 million.

	Number of Errors		
	2011-12	2010-11	2009-10
$20 - $50 million	19	14	11
$50 - $100 million	7	4	5
$100 million - $1 billion	9	6	6
Greater than $1 billion	2	1	2
Total errors greater than $20 million	**37**	**25**	**24**

Agencies' financial statements were corrected as necessary to ensure compliance with Australian Accounting Standards and the requirements of the *Public Finance and Audit Act 1983*.

Recommendation

Agencies should implement more effective review into their financial reporting processes.

There are insufficient review mechanisms in agency financial reporting processes. My review of this year's errors identified the following common causes, which are consistent with prior years:

- mistakes in spreadsheet formulae and data entry errors when calculating carrying values and depreciation of property, plant and equipment
- deficiencies in determining year-end accruals and provisions
- errors in inter-agency payables and receivables, indicating agencies do not regularly reconcile these balances as part of effective monthly reporting processes.

Recommendation

Treasury should implement sector wide training and develop more guidance in accounting for property, plant and equipment.

There is also a clear trend for errors to occur when accounting for complex transactions and balances. Asset valuations are consistently a source of error. Insufficient expertise in the application of relevant accounting standard requirements is a common issue. Asset valuations in the public sector are generally quite complex. Assets are carried at fair value rather than cost, requiring complex modelling and expertise. The nature of the assets can also be unusual, such as museum collections, or complex, such as major infrastructure systems.

Financial management capability in agencies needs to improve

The NSW Commission of Audit, in its Interim Report on Public Sector Management, identified a trend for many Chief Financial Officers to focus on day to day activities, with agency finance functions focussed also on routine transaction processing. The Commission found a lack of strategic financial management capability. I believe improving this capability would also result in better year-end financial reporting outcomes.

Timing of Financial Statements

The *Public Finance and Audit Act 1983* allows agencies six weeks from the end of the financial year to submit their financial statements for audit. However, to facilitate preparation of the Total State Sector Accounts, Treasury determines an earlier reporting timetable for larger agencies. In 2011-12, in an effort to work towards the Public Accounts Committee's 2013 targets for annual reporting, this timetable was earlier than in previous years.

Over one third of the largest agencies did not meet Treasury's reporting timetable

In 2011-12, the 27 largest agencies needed to submit the financial statements and other relevant information to Treasury by 26 July 2012. Treasury advises sixteen of these agencies met this deadline, about 60 per cent, with the balance submitting financial statements or other relevant information between one and eight days late.

The next 33 agencies had a due date of 27 July 2012. Treasury advises 23 agencies met this timeframe, about 70 per cent. The due date fell on a Friday and most late agencies submitted items the following Monday.

About a further 80 agencies were required to submit financial statements and other information by 31 July 2012. Of these, Treasury advises about 90 per cent of the agencies met this timeframe.

Almost all of the further 150 or so agencies making up the Total State Sector submitted their financial statements for audit by the six week statutory deadline.

The audit process has also sped up. Treasury's timetable allowed me less time for audit than in previous years and I expect shorter timeframes in 2013. As a result of the shorter audit timeframe and earlier submission of financial statements, I had issued 165 opinions at 2 October 2012, compared to 67 at the same time last year.

Whilst the results above are an improvement on prior years' performance, more discipline is required if the State is to achieve the Committee's targets for earlier tabling of annual reports. This is because the audited financial statements must be included in annual reports.

In addition, Treasury needs to confirm the 2013 financial reporting timetable as soon as possible. The 2012 timetable was not published until 16 February 2012. Agencies also did not have clarity about applicable early close requirements until this date, even though the requirements had to be implemented no later than the end of April. Treasury Circular 12/03 contained tentative financial reporting deadlines, of which agencies will want early confirmation.

Recommendation

I recommend Treasury issue its 2013 reporting timetable and any related early close procedures requirements no later than 31 December 2012.

Other Matters Affecting Financial Reporting

The Impact of Agency Restructures on Financial Reporting

Last year I reported the quality and timing of financial reporting is generally adversely impacted by agency restructures. This comment was in the context of a financial year that saw significant restructures. There have been fewer restructures in the current year. However, the financial reporting challenges associated with restructures remain in many circumstances.

The impact of restructures was a topic explored by the NSW Commission of Audit, which reached similar conclusions in its Interim Report on Public Sector Management. The Commission observed the impediments to strong financial management that occur with the existence of many separate information systems. No cluster in New South Wales can currently access financial information of all cluster agencies using a single system.

The Impact of Significant Transactions on Financial Reporting

Last year I observed various delays in identification and resolution of accounting issues arising from significant transactions. I recommended Treasury implement better processes for dealing with the accounting implications. I am pleased to report I observed improvement in this area with a greater level of proactivity in communication between stakeholders.

Developments in Processes for Collection of Information

Recommendation

Treasury should ensure all agencies adopt its improved processes for submitting financial reporting data.

Treasury advises that some agencies have not yet adopted new processes for data submission. Agencies use data from their financial systems to populate Treasury's Online Entry System (TOES). Treasury uses this information for whole-of-government financial reporting processes. During 2010-11, Treasury developed an improved agency process of uploading agency financial data to TOES, aimed at eliminating manual aspects of the data submission process.

Implementing seamless processes for collecting agency data will facilitate more regular and timely collection of financial information, improve data consistency and reduce the risk of errors.

More recently, Treasury has improved the way it collects agencies' monthly budget data used in whole-of-government budgeting processes. Treasury has replaced the old method of submitting excel files via email with using the TOES system.

Treasury has started scoping a new Financial Management System that may replace TOES. This is in response to recommendations from the NSW Commission of Audit in its Interim Report on Public Sector Management. In the meantime, I encourage all efforts to streamline current processes.

Other Governance Matters

Progress on 2011 Recommendations

Most of my 118 recommendations made last year have been, or are being, actioned

In my 2011 Reports to Parliament, I made 118 recommendations for the government and its agencies, excluding the university sector and performance audits, to improve their operations. I reviewed the status of these recommendations and agencies advise most have either been actioned or are in the process of being actioned.

Most unactioned recommendations are those I did not direct to an individual agency. It appears no central agencies believed or felt these recommendations warranted their consideration or follow up to ensure the matters were appropriately addressed.

Last year, I recommended the government establish a distinct, independent audit and risk committee dedicated to the whole-of-government to help ensure matters affecting the whole-of-government were dealt with appropriately in a co-ordinated and timely manner. During 2011-12, Treasury engaged consultants to advise it of options to address my concerns and recommendation. The consultants presented four options:

1. retain the existing Treasury Audit and Risk Committee with an expanded charter to monitor whole-of-government issues with increased resource support
2. create a second Treasury Audit and Risk Committee responsible for the Total State Sector Accounts and monitoring of whole-of-government issues identified by the NSW Auditor-General
3. create a cross agency management committee that reports progress to the Treasury Audit and Risk Committee on whole-of-government audit issues
4. create a second Treasury Audit and Risk Committee (as in option two) and create a Management Committee (as in option three) to work through whole-of-government issues and report into the Audit and Risk Committee.

The Secretary to the Treasury determined the existing Treasury Audit and Risk Committee should continue to monitor the Total State Sector Accounts financial statements, but should not monitor the whole-of-government issues and recommendations. Instead, the Secretary has suggested the Public Accounts Committee perform this monitoring function.

I made 237 recommendations in 2010. The significant decrease in 2011 was mainly due to my focus on workforce management issues across the New South Wales public sector in 2010, which identified numerous issues.

Public Accounts Committee Follow Up of 2010 Repeat Recommendations

In 2011-12, the Public Accounts Committee held an inquiry to follow up 19 of the recommendations made in my 2010 financial audit Reports to Parliament. In its report, the committee made 12 recommendations to agencies.

In determining which recommendations to follow up, the committee focused on 'repeat recommendations' it considered to be high priority based on an assessment of their importance to the relevant agency and to the public sector as a whole.

I welcome the committee's interest in following up my recommendations and look forward to working with the committee if it decides to follow up my 2011 recommendations.

Internal Audit and Risk Management in Agencies

Background to Treasury's Policy

The *Public Finance and Audit Act 1983* contains broad requirements for agencies to maintain effective internal control environments and internal audit functions. Treasury's Policy and Guidelines Paper 09-05 'Internal Audit and Risk Management Policy for the New South Wales Public Sector' (TPP 09-05) requires most New South Wales government agencies to comply with six core requirements aimed at meeting minimum internal audit and risk management standards.

Compliance with Treasury's Policy

During 2012, I reviewed a sample of agencies' compliance with aspects of Treasury's Policy. The results of my review appear later in this Volume.

Risk Management Toolkit

TPP 09-05 requires agencies to have risk management processes consistent with the current Australia/New Zealand standard on risk management. Following a review of its internal audit and risk management policy in 2011, Treasury issued further guidance to agencies in respect of this requirement.

Policy and Guidelines Paper 12-03 'Risk Management Toolkit for the NSW Public Sector' was released in August 2012. The Toolkit is designed to help agencies develop and implement a risk management framework and processes.

Shared Oversight Arrangements

TPP 09-05 predates the current structure of the New South Wales public sector, where agencies are arranged in a cluster around a principal department. Treasury's Policy and Guidelines Paper 12-04 'Guidance on Shared Arrangements and Subcommittees for Audit and Risk Committees' (TPP 12-04) was also released in August, following the review of TPP 09-05.

TPP 12-04 aims to help agencies comply with certain core requirements in TPP 09-05. It provides guidance on setting up shared arrangements for internal oversight, with a view to minimising costs, particularly for very small agencies. It also provides guidance on the establishment of subcommittees to oversight functions, divisions or projects within very large agencies.

Compliance Review Report – Internal Audit and Risk Management Policy for the New South Wales Public Sector

Background

The Treasury issued TPP 09-05 'Internal Audit and Risk Management Policy for the New South Wales Public Sector' in August 2009. The policy aims to strengthen the public sector's corporate governance practices by establishing core requirements for internal audit, enterprise risk management and audit and risk committees.

The Treasury developed the policy after a comprehensive review of internal audit capacity in the public sector by the Department of Premier and Cabinet. The review found the sector could improve its internal audit and risk management practices. The policy applies to departments and statutory bodies subject to annual reporting legislation. Agencies must attest compliance with the policy on an annual basis.

Treasury Circular 09/08 'Internal Audit and Risk Management policy' implements the policy. The policy can be found at www.treasury.nsw.gov.au/Treasury_Policy_Papers_Index_Page.

The Compliance Review

I reviewed 24 agencies' compliance with the following five of the six core requirements in the policy for the year ended 30 June 2011:

- Core Requirement 1: Internal Audit Function
- Core Requirement 2: Audit and Risk Committee
- Core Requirement 3: Independent Chairs and Members
- Core Requirement 4: Model Charter and Committee Operations
- Core Requirement 6: Internal Audit Standards.

I excluded Core Requirement 5 'Risk Management Standards' as the Treasury was developing a risk management tool kit to help agencies implement more effective enterprise risk management practices in their organisations.

The agencies I selected were a mix of departments and statutory bodies, and varied in size from small agencies to large principal departments. I chose a cross section of agencies to help me identify any trends in non-compliance.

There are inherent limitations in undertaking an engagement of this nature. My work was conducted as a review engagement, not an audit. Consequently, my procedures were not designed to detect all instances of non-compliance. My review provides limited assurance and expresses my conclusion about whether the agencies reviewed had complied with the policy.

I have issued review reports to the individual agencies.

Overall Conclusion

I found a reasonable level of compliance with the core requirements of the Policy

I found a reasonable level of compliance with the core requirements. Ten of the 24 agencies selected materially satisfied all aspects of the core requirements and received unmodified review reports. Most of the other 14 agencies recorded some departures from the core requirements and received modified review reports. I am pleased no agencies recorded widespread non-compliance and I commend all agencies for making a concerted effort to comply with this important corporate governance policy. The table below shows the number of agencies that materially complied with each core requirement.

	Core Requirement 1	Core Requirement 2	Core Requirement 3	Core Requirement 4	Core Requirement 6
Number of agencies that materially complied	21	24	23	14	19
Percentage of agencies that materially complied (%)	87.5	100.0	95.8	58.3	79.2

The table shows the highest level of non-compliance related to core requirement 4, dealing with the audit and risk committee charter and operations.

I have made a number of recommendations in this Volume. I will follow up the agencies' status in implementing the recommendations during next year's audits and will report the findings in my 2013 Report to Parliament.

Key Findings

One agency had not established an internal audit function independent of operational management

Core Requirement 1 – Establishing and Maintaining an Internal Audit Function

Three agencies had not materially complied with all aspects of core requirement 1. Under this requirement, agencies must establish an internal audit function that is appropriate to their needs, adequately resourced and separate from operational management. Each agency is also required to appoint a Chief Audit Executive to head the internal audit function.

One of these agencies failed to establish an internal audit function independent of operational management and used staff from operational areas to conduct internal audits. This is concerning, as it compromises the independence and objectivity of the internal control environment. While the agency is relatively small (annual expenditure of $19.0 million) it is big enough to justify an internal audit function that is independent of operational management.

Other areas of non-compliance were:

- one agency had its internal audit function reporting functionally to the agency head instead of the audit and risk committee
- one agency head had not approved the internal audit charter.

All 24 agencies reviewed had established an audit and risk committee

Core Requirement 2 – Establishing an Audit and Risk Committee

All agencies had established an audit and risk committee, which was directly accountable to the department head or governing body.

Core Requirement 3 – Audit and Risk Committee Membership

Recommendation

The Department of Finance and Services should require all members on the pre-qualification scheme to update their records annually.

Apart from one agency, all had appointed the audit and risk committee members from the Department of Finance and Services' prequalification scheme for audit and risk committee independent chairs and members.

It is important for agencies to only appoint people on the pre-qualification scheme because it improves probity standards and quality assurance by independently assessing the suitability of candidates through extensive reference checks and consideration of potential conflicts of interest.

While members are required to tell the Department of Finance and Services of any changes, I found some members had not updated their profiles on the pre-qualification scheme register to reflect changes to the committees they chaired or were members of, or that they were on the maximum of five committees. I recommend the Department of Finance and Services require members to update their profiles annually so agencies can use the register effectively to review and identify potential candidates for vacant audit and risk committee positions.

Core Requirement 4 – Audit and Risk Committee Charter and Operations

Some committees, chairs and agency heads are not adequately reviewing and documenting annual performance assessments

Recommendation

All department heads, statutory bodies and audit and risk committees should review their performance assessment process to ensure it meets the policy requirements.

The most significant area of non-compliance with core requirement 4 related to assessing the performance of the audit and risk committee, the chair and the independent members. Seven agencies had not materially complied with the performance assessment requirements, while many others' practices and documentation could be improved. Common issues included:

- department heads, statutory bodies and audit and risk committees not establishing formal performance assessment processes
- department heads and statutory bodies not formally reviewing the performance of the chair.

I also found instances where the committee chairs had not formally provided feedback to individual members on their performance. All agencies should review how they conduct their annual performance assessments to ensure they comply with the policy.

The annual performance assessment process is important as it gives the department head, statutory body, individuals, and the committee as a whole, an opportunity to formally recognise each other's contribution and identify improvement opportunities. The assessment process should be formally documented.

Recommendation

All audit and risk committees should meet with the external and internal auditors at least once a year without the presence of management.

I found some audit and risk committees had not met with the external and/or internal auditors at least once during the year without management being present. Meeting confidentially with the auditors gives the auditors an opportunity to voice concerns privately with those charged with the governance of an organisation and allows the audit and risk committee to question the auditors on matters of concern.

Recommendation

Agencies must give meeting papers to committee members on a timely basis.

Audit and risk committee members did not always receive meeting papers in a timely manner. All charters I reviewed require agencies to give meeting papers to members one week before the meeting. I found instances where papers were distributed the day before the meeting, and in some cases, at the committee meeting. This diminishes the effectiveness of the audit and risk committee because it limits members' time to review and analyse the papers.

Core Requirement 6 – Internal Audit Standards

Recommendation

Agencies with outsourced internal audit arrangements should review the contract terms to ensure they comply with the policy.

Five agencies did not materially comply with some aspects of core requirement 6, including:

- one agency did not have an internal audit manual
- two agencies had a manual, but the audit and risk committee had not approved it.

My review also found the contracts with some outsourced internal audit service providers did not comply with the policy requirements. For example, they did not stipulate:

- that the internal audit working papers remained the property of the agency
- the provider would be consulted in developing and maintaining the Internal Audit Manual
- the provider would make the audit methodologies it used accessible to the agency.

Core requirement 6 requires agencies to have an internal audit function which complies with the Institute of Internal Auditors' 'International Standards for the Professional Practice of Internal Auditing' (the IIA Standards). This includes having a risk based audit methodology, ensuring all recommendations have agreed action plans, monitoring progress in implementing recommendations and maintaining an internal audit manual that governs the internal audit function.

Other Information

As part of my review, I also considered the 24 agencies' general compliance environments, the policy's attestation and exception processes and the Treasury's response to my 2010 readiness survey recommendations. I also collected and analysed other information on the internal audit functions, the results of which are reported below.

Agencies need to do more work in establishing their regulatory compliance framework

General Compliance Environment

Recommendation

I recommend all agencies review the adequacy of their regulatory compliance framework against the principles in Australian Standard AS 3806-206-Compliance Programs.

During my review I noted some agencies need to improve their overall regulatory compliance framework. While agencies subscribe to services which provide them with legislative and central government policy updates, what appears to be lacking is a formal, documented regulatory compliance management framework. A framework is important as it:

- promotes a culture of compliance
- fosters continuous improvement in compliance processes
- ensures obligations are always met and helps the agency demonstrate its social corporate responsibilities.

Key attributes of a sound regulatory compliance management framework include having:

- the objective and strategy of the framework endorsed by the department head or statutory body
- compliance obligations identified and assessed
- accountability and responsibility for compliant outcomes clearly articulated and assigned
- competence and training needs identified so employees meet their compliance obligations
- controls in place to manage compliance obligations
- performance of the compliance program monitored, measured and reported.

The absence of a formal regulatory compliance framework is evident in the limited compliance reporting to audit and risk committees. Some committees see very little information on key legislation affecting an agency, how management addresses and monitors legal and compliance risks, and identifies breaches and the implications.

38 agencies received Ministerial approval for an exception from complying with the Policy

Exceptions from the policy

Recommendation

The Treasurer should seek explanations from Portfolio Ministers who continually grant exceptions to agencies.

The policy allows agencies to seek an exception from complying with any core requirement from their Portfolio Minister. For the year-ended 30 June 2011, 38 agencies were granted an exception from one or more core requirements. In the interests of promoting consistency and better governance across the public sector, I believe the Treasurer, as the owner of the policy, should seek explanations from Portfolio Ministers who continually grant exceptions to agencies.

Some exceptions granted by ministers included:

- allowing committee members to be appointed for terms outside the limits set by the policy
- appointing people to audit and risk committees who are not on the pre-qualification panel
- allowing more committee members than the maximum number allowed by the policy.

16 agencies have yet to give the Treasury their 2010-11 attestation statement

Attestation statements

Recommendation

Agencies should be more rigorous in assessing the degree of compliance with the policy before the department head or statutory body signs the attestation statement.

All agencies must attest compliance with the policy to The Treasury by 31 August each year. The Treasury's records show 16 agencies, including two departments, have yet to submit 2010-11 attestation statements. The Treasury is pursuing the outstanding attestations.

Four agencies I reviewed submitted attestation statements after the due date.

The process used by agencies to support attestation statements varied. Some agency heads asked the chief audit executive to complete a self assessment checklist before signing the attestation, while others relied on their understanding and discussions at audit and risk committee meetings to attest compliance. Before an agency head signs an attestation statement:

- the chief audit executive should complete and document a self assessment checklist
- the audit and risk committee should review the self assessment results
- the audit and risk committee should endorse the agency head signing the attestation statement.

Professional Development - Internal Audit staff

Recommendation

Chief Audit Executives should:

- set minimum professional development targets for all internal audit staff
- inform the audit and risk committee of planned and actual time spent on professional development each year.

In some agencies, some internal audit staff spent only two days on formal professional development activities in 2010-11. This is concerning given the Institute of Internal Auditors Australia (the Institute) expects members to complete 60 hours of continuing professional education over a two year period, with a minimum of 15 hours in any one year. In other agencies, internal audit staff participated in ten days of professional development.

Whilst some internal audit staff may not be members of the Institute, it is important for staff to remain abreast of latest industry developments, methodology and technology changes in the audit environment, which is subject to continual change. Professional development and training contributes to an effective internal audit function. I recommend each chief audit executive set minimum professional development targets for all internal audit staff and report professional development activities to the audit and risk committee.

Some agencies failed to complete their approved 2010-11 internal audit program

Completion of Internal Audit Programs

Recommendation

Chief Audit Executives should be more diligent when setting the internal audit program.

Ten agencies did not complete the approved 2010-11 internal audit program with one agency only completing 31 per cent of its approved program. Agencies did not complete approved programs because of staff shortages, unexpected investigations, delays in approving programs and appointing external service providers, overly ambitious programs, scope changes, and the administrative restructures that occurred in 2011.

Unforeseen circumstances may affect an agency's ability to complete its approved internal audit program and Chief Audit Executives should allow for this in their planning.

Time Recording

Recommendation

All internal audit functions should have a time recording system.

Not all internal audit functions capture time spent on individual audit assignments. Where they do, some agencies use manual spreadsheets, while others use an electronic time recording system. All agencies should capture time worked by staff on specific assignments, so they can:

- monitor time worked on each individual project
- monitor time worked against budgeted hours
- capture data to:
  - help set future budgets
  - measure the efficiency and productivity of internal audit staff
  - facilitate comparisons with industry benchmarks
  - analyse possible causes for delays or inability to complete the annual internal audit program.

Some agencies take more than eight weeks to respond to internal audit recommendations

Responding to Internal Audit Recommendations

Recommendation

Agencies should ensure Internal Audit Manuals stipulate timeframes for management responses to reports.

Management should have no more than four weeks to respond to an internal audit report.

Of the agencies reviewed, management took two weeks to six months to respond to internal audit reports. Given the importance of the internal audit function in improving an agency's control environment, agencies should respond to internal audit reports within four weeks. Taking longer to respond may expose agencies to significant risk.

To ensure timelier responses, I recommend all agencies stipulate a response timeframe of no more than four weeks in the Internal Audit Manual.

There is a general pattern of agencies not implementing internal audit recommendations within the agreed timeframe

Outstanding Internal Audit Recommendations

Recommendation

Agencies need to implement internal audit recommendations within agreed timeframes.

Agency heads should ensure review of outstanding internal audit recommendations is a standing agenda item at executive management meetings.

At 30 June 2011, several of the agencies I reviewed had long overdue internal audit recommendations. One agency had 58 overdue recommendations and in another, 88 per cent of its outstanding recommendations were overdue. This is concerning, particularly when some agencies take more than two months to respond to draft internal audit reports and it highlights the need for agencies to address internal audit recommendations within the agreed timeframes.

In some agencies, review of outstanding internal audit recommendations is a standing agenda item at monthly executive management meetings, which has led to timelier implementation. All agencies should implement a similar reporting process, which gives the executive visibility of how well the agency is responding to recommendations. It also allows the executive to decide, as a group, on what corrective action may be needed if the agency is unable to meet agreed dates.

Recommendations from my 2010 Readiness Survey

The Treasury advises it has addressed all recommendations arising from my 2010 survey to assess agencies' readiness to comply with the policy. The survey identified some implementation issues, including:

- inconsistencies in the policy and Annexure documents
- lack of guidance in the policy on how agencies should determine if they had 'materially' complied with the core requirements
- the policy's need to deal with agency clustering arrangements.

It is pleasing the Treasury has addressed the recommendations. Actions taken by the Treasury to address my recommendations include:

- consulting with agencies on implementation issues they experienced
- amending the Annexures to address inconsistencies with the policy
- issuing further guidance on shared arrangements for agency clusters and sub committees of audit and risk committees
- providing guidance on what it means to comply with the policy 'in all material respects'
- implementing mechanisms to monitor the effectiveness of the policy, such as reviewing and tracking attestation statements and identifying areas for improvement, such as enterprise risk management.

The results of my 2010 readiness survey can be found in Volume Eleven of my 2010 Report to Parliament.

Appendix A: Financial Statements

Statement of Comprehensive Income

Year ended 30 June	General Government 2012 $m	General Government 2011* $m	Total State Sector 2012 $m	Total State Sector 2011* $m
Revenues				
Taxation	20,660	20,395	19,858	19,318
Grants and subsidies	26,743	25,617	26,554	25,414
Sales of goods and services	4,961	4,658	18,625	17,809
Interest	530	468	1,203	1,477
Dividends and income tax equivalents	2,138	1,982	--	--
Other dividends and distributions	410	430	446	446
Fines, regulatory fees and other	3,590	3,594	4,543	4,180
Total revenues	**59,032**	**57,144**	**71,229**	**68,644**
Expenses				
Employee costs	28,540	27,322	32,671	30,989
Depreciation and amortisation	2,978	2,818	6,078	5,928
Interest	2,061	1,826	4,188	4,149
Grants and subsidies	11,363	11,399	7,277	8,250
Other	13,410	12,439	19,419	18,576
Total expenses	**58,352**	**55,804**	**69,633**	**67,892**
Transactions from discontinuing operations	**--**	**--**	**103**	**497**
Net operating balance – surplus	**680**	**1,340**	**1,699**	**1,249**
Other economic flows – included in the operating result				
Gain/(loss) from liabilities	(1,074)	86	(1,133)	86
Other net gains/(losses)	(824)	72	(5,429)	3,544
Share of earnings from associates (excluding dividends)	(22)	153	(22)	153
Dividends from asset sale proceeds	12	3,406	--	--
Deferred income tax expense/(benefit) from other sectors	(727)	(174)	--	--
Other gains/(losses)	96	(304)	68	(299)
Operating result – surplus/(deficit)	**(1,859)**	**4,579**	**(4,817)**	**4,733**
Other economic flows – other comprehensive income				
Revaluations	5,838	935	5,647	4,948
Share of earnings from associates from revaluations	546	41	546	41
Actuarial gain/(loss) from superannuation	(19,407)	447	(21,574)	425
Net gain on equity investments	(5,479)	4,347	--	--
Net gain/(loss) on financial instruments	3	--	(97)	71
Other gains/(losses)	(41)	46	(104)	177
Comprehensive result - total change in net worth before transactions with owners as owners	**(20,399)**	**10,395**	**(20,399)**	**10,395**

* 2011 amounts have been restated for changes made in accordance with Australian Accounting Standards.

Statement of Financial Position

Year ended 30 June	General Government		Total State Sector	
	2012 $m	2011* $m	2012 $m	2011* $m
Assets				
Financial assets				
Cash and cash equivalents	6,576	8,258	9,975	11,758
Receivables	6,012	5,785	5,902	6,763
Tax equivalents receivable	470	408	--	--
Financial assets at fair value	7,235	7,577	20,777	19,987
Advances paid	936	891	454	447
Deferred tax equivalents asset	4,733	5,363	--	--
Equity investments	82,542	87,963	4,240	3,738
Total financial assets	**108,504**	**116,245**	**41,348**	**42,693**
Non financial assets				
Inventories	284	276	1,451	1,340
Forestry stock and other biological assets	8	9	746	759
Assets classified as held for sale	432	248	504	293
Investment properties	169	236	749	782
Property, plant and equipment	135,731	128,076	254,309	245,528
Intangibles	1,710	1,292	3,251	2,828
Other	1,495	1,235	1,778	1,532
Total non financial assets	**139,829**	**131,372**	**262,788**	**253,062**
Total assets	**248,333**	**247,617**	**304,136**	**295,755**
Liabilities				
Deposits held	1,233	1,378	1,847	1,858
Payables	4,423	3,937	6,053	6,710
Tax equivalents payable	18	47	--	--
Borrowing and derivatives at fair value	16	21	69,444	59,271
Borrowings at amortised cost	26,870	22,509	2,899	2,721
Advances received	755	770	755	770
Employee provisions	12,802	11,627	15,289	13,737
Superannuation provision	47,181	32,333	50,922	34,054
Deferred tax equivalent provision	780	660	--	--
Other provisions	6,252	5,878	8,571	7,939
Other	2,492	2,547	2,845	2,785
Total liabilities	**102,822**	**81,707**	**158,625**	**129,845**
Net assets	**145,511**	**165,910**	**145,511**	**165,910**
Net worth				
Accumulated funds	10,650	30,437	44,904	69,957
Reserves	134,861	135,473	100,607	95,953
Total net worth	**145,511**	**165,910**	**145,511**	**165,910**

* 2011 amounts have been restated for changes made in accordance with Australian Accounting Standards.

Appendix B: Snapshot of the Public Trading Enterprise Sector

The Public Trading Enterprise (PTE) sector supplies public infrastructure services through commercial and non-commercial operations. Commercial operations include:

- Electricity (including generation and transmission)
- Water (including catchment and supply of water)
- Sporting and Recreation
- Ports
- Other (including land development and management, forestry operations, mining, and waste management).

Commercial operations are generally self-funding, receiving most of their revenue from customers and financing capital expenditure from those revenues and borrowings. The Government expects a commercial rate of return on the resources employed and receives dividends from commercial PTEs.

Non-commercial operations rely on funding from the General Government Sector to meet operational and capital expenditure. These PTEs often provide services to meet social policy objectives and revenue from customers is generally limited. Non-commercial operations include:

- Social Housing (including provision of public and social housing)
- Transport.

Both commercial and non-commercial PTEs make payments to the General Government Sector to put them on equal footing with private sector operations. Because PTEs can access borrowings leveraging off the State's credit rating, they pay government guarantee fees so their cost of debt reflects their standalone credit rating. PTEs are exempt from Commonwealth income tax, but make tax equivalent payments to the State.

The PTE sector is also referred to as the Public Non-Financial Corporations Sector.

Highlights

The following page gives a snapshot of financial information for the PTE sector and highlights that:

- PTEs hold a significant proportion of State assets and liabilities. Over 90 per cent of PTE assets are property, plant and equipment used in delivery of services.
- electricity PTEs have the highest asset levels, are the most geared and contribute the most money back to the General Government Sector through dividends, government guarantee fees and tax equivalent payments.
- water PTE assets and liabilities fell in 2011-12 after the sale of the desalination plant and repayment of associated debt. A special dividend from this transaction had not yet been paid to the General Government Sector at 30 June 2012.
- port PTEs receive no General Government Sector contributions to help them meet community service obligations.
- transport PTEs need significant contributions from the General Government Sector to meet their costs despite generating revenues from customers.

	Commercial Operations										Non-Commercial Operations			
	Electricity		Water		Ports		Sporting and Recreation		Other		Social Housing		Transport	
	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011	2012	2011
Total assets ($m)	37,373	36,291	19,111	20,649	3,062	2,882	3,627	3,526	4,196	4,280	33,078	32,399	29,596	29,645
Total liabilities ($m)	28,522	25,762	10,552	11,601	1,282	1,195	156	168	1,550	1,399	975	1,181	3,651	3,352
Net assets ($m)	8,851	10,529	8,559	9,048	1,780	1,687	3,470	3,358	2,647	2,881	32,103	31,218	25,945	26,293
Total property, plant and equipment ($m)	31,430	30,322	18,371	19,920	2,528	2,326	3,456	3,351	1,787	1,908	32,816	31,854	28,213	27,776
Total borrowings ($m)	19,554	17,464	7,154	8,756	723	726	52	78	268	262	220	195	957	1,323
Ratio of borrowings to net assets	2.21	1.66	0.84	0.97	0.41	0.43	0.01	0.02	0.10	0.09	0.01	0.01	0.04	0.05
Total revenue ($m) [(a)]	8,645	8,294	2,908	2,586	426	382	354	366	756	804	1,027	1,748	5,313	4,694
Total expenses ($m) [(a)]	7,691	7,901	2,477	2,135	320	270	312	278	1,031	912	1,025	2,348	4,649	4,395
Total surplus/(deficit) after tax ($m) [(a)]	954	393	431	451	106	112	42	88	(275)	(108)	2	(600)	664	299
Return on average equity (%)	9.9	3.7	4.9	5.2	6.1	7.0	1.2	2.7	(10.0)	(3.8)	--	(1.9)	2.5	1.2
Contributions from the general government sector ($m)	133	38	48	54	--	--	125	144	33	106	204	972	3,457	2,970
Distributions to the general government sector ($m) [(b)]	1,821	[(c)]4,844	501	508	65	51	1	1	76	107	--	--	9	8
Net return on investment (%)	17.4	[(c)] 45.6	5.2	5.2	3.8	3.2	(3.6)	(4.3)	1.6	--	(0.6)	(3.1)	(13.2)	(12.3)

a From continuing operations.

b Includes dividends/distributions, income tax, and government guarantee fees.

c Includes $3.41 billion special dividend from the electricity sale transaction.

Note – transactions between the PTE sector categories have been eliminated.

Appendix C: Legal Opinions Provided by the Attorney General or Crown Solicitor

I am required by section 52(2) of the *Public Finance and Audit Act 1983* (PF&A Act) to publish any requests for a legal opinion submitted to the Attorney General or the Crown Solicitor under section 33 of the PF&A Act. I am also required to publish their responses.

I have received one such legal opinion since my last report in Volume Three 2011, which was released on 31 October 2011.

The opinion relates to whether the Minister for the Environment and Minister for Heritage could direct me to undertake a financial audit or performance audit of the National Trust of Australia (New South Wales). The legal opinion was jointly prepared for the Minister.

CROWN SOLICITOR
NEW SOUTH WALES

Advice

Power of Minister to direct Auditor-General to conduct audits of National Trust

Contents

Prepared for:	DEC766 Minister for the Environment & Minister for Heritage
Date:	15 November 2011
Client ref:	Katherine O'Regan
CSO ref:	201103257 T08 Alison Merridew

 201103257 D2011/455860

1. Advice sought

1.1 You seek my urgent advice by noon today as to:

1. whether the Minister for the Environment & Minister for Heritage can direct the Auditor-General to undertake a financial audit of the National Trust; and

2. whether the Minister for the Environment & Minister for Heritage can direct the Auditor-General to undertake a performance audit of the National Trust.

1.2 I confirm you have advised the advice is to be prepared jointly for the Minister and the Auditor-General.

2. Advice

2.1 By "National Trust" I take you to refer to the National Trust of Australia (New South Wales) established by the *National Trust of Australia (New South Wales) Act 1990* ("*NTA Act*").

As to question 1

2.2 In relation to financial audits, s. 34(2) of the *NTA Act* provides:

> "(2) If the Minister so directs, the Auditor-General is to inspect, examine and audit, and report to the Minister on, the books and accounts of the Trust and for that purpose Division 2 (Audit–generally) of Part 3 of the *Public Finance and Audit Act 1983* is to apply as if the Trust were an authority within the meaning of that Act."

2.3 It is to be noted, however, that under s. 34(2) of the *NTA Act*, the Auditor-General can only be directed to inspect, examine and audit, and report to the Minister on, the "books and accounts" of the Trust. Division 2 of Pt. 3 of the *Public Finance and Audit Act 1983* ("*PFA Act*") is applied to the National Trust only for that purpose.

As to question 2

2.4 Section 34 of the *NTA Act* does not confer power on the Minister to direct the Auditor-General to conduct a "performance audit" of the National Trust.

2.5 In the time available, I do not consider that the National Trust is an "authority" within the meaning of Pt. 3 Div. 2A of the *PFA Act* entitled, "Performance audit" (see definition in s. 38A, *PFA Act*). Accordingly, I do not consider that s. 38B of the *PFA Act* authorises the Auditor-General to conduct a "performance audit" of activities of the National Trust.

2.6 In the time available, I do not consider that s. 27B(3)(c) of the *PFA Act* permits the Minister to request (or direct) the Auditor-General to conduct a performance audit of

201103257 D2011/455860

the National Trust under s. 38B of the *PFA Act*. I doubt s. 27B(3)(c) is intended to permit a request which would render a particular statutory audit a function of the Auditor-General when that would not otherwise be the case. Rather, I think, it is about requesting some audit or audit-related "service" which a Minister requires in relation to matters within the Minister's purview and presumably where the relevant materials are within the control of the Minister or are publicly available. Even if I am wrong in that, I note that s. 27B is a generally applicable provision and was inserted in the *PFA Act* in 2001, that is, subsequent to the enactment of the *NTA Act*. It is a principle of statutory construction that general enactments (such as s. 27B, *PFA Act*) which are enacted subsequently to a specific Act (such as the *NTA Act*) do not impliedly amend or repeal the earlier Act. There is a strong argument that s. 34 of the *NTA Act* evinces the intention of that Act as to the extent to which the Minister may direct an audit of the National Trust.

Signed:

I V Knight
Crown Solicitor

201103257 D2011/455860

Appendix D: Prescribed Entities

Section 45 of the *Public Finance and Audit Act 1983* requires me to perform audits of the financial statements of entities prescribed for the purposes of that section. I am required by section 45(2A) of the *Public Finance and Audit Act 1983* to publish a list of any such audits.

The following were prescribed entities as at 30 June 2012:

Entity	Latest financial statements audited	Type of audit opinion issued
Agricultural Scientific Collections Trust	30 June 2011 [(a)]	Unmodified
Ambulance Service of NSW	30 June 2006 [(b)]	Unmodified
AustLII Foundation Limited	31 December 2011	Unmodified
The Australian Institute of Asian Culture and Visual Arts Limited	30 June 2011 [(a)]	Unmodified
Belgenny Farm Agricultural Heritage Centre Trust	30 June 2011 [(a)]	Unmodified
The Brett Whiteley Foundation	30 June 2011 [(a)]	Unmodified
Buroba Pty Ltd	30 June 2012	Unmodified
C. B. Alexander Foundation	30 June 2011 [(a)]	Unmodified
CCP Holdings Pty Limited	30 June 2012	Unmodified
Cobbora Coal Unit Trust	30 June 2012	Unmodified
Cobbora Management Company Pty Limited	30 June 2012	Unmodified
Cobbora Unincorporated Joint Venture	30 June 2010 [(f)]	Unmodified
Coffs Harbour Technology Park Ltd	30 June 2012	Unmodified
Cowra Japanese Garden Maintenance Foundation Limited	31 March 2012	Unmodified
Cowra Japanese Garden Trust	31 March 2012	Unmodified
Dumaresq-Barwon Border Rivers Commission	30 June 2011 [(c)]	Unmodified
Eif Pty Limited	30 June 2011 [(a)]	Unmodified
Gosford City Council, being a water supply authority listed in Schedule 3 to the *Water Management Act 2000*	30 June 2011 [(a)]	Qualified
Illawarra Health and Medical Research Institute Limited	30 June 2012	Unmodified
Local health districts [(d)] within the meaning of the *Health Services Act 1997*:		
Sydney Local Health District	30 June 2012	Unmodified
South Western Sydney Local Health District	30 June 2012	Unmodified
South Eastern Sydney Local Health District	30 June 2012	Unmodified
Illawarra Shoalhaven Local Health District	30 June 2012	Unmodified
Western Sydney Local Health District	30 June 2012	Unmodified
Nepean Blue Mountains Local Health District	30 June 2012	Unmodified
Northern Sydney Local Health District	30 June 2012	Unmodified
Central Coast Local Health District	30 June 2012	Unmodified
Hunter New England Local Health District	30 June 2012	Unmodified
Murrumbidgee Local Health District	30 June 2012	Unmodified
Southern NSW Local Health District	30 June 2012	Unmodified
Western NSW Local Health District	30 June 2011 [(a)]	Unmodified
Far West Local Health District	30 June 2011 [(a)]	Unmodified
Mid North Coast Local Health District	30 June 2012	Unmodified
Northern NSW Local Health District	30 June 2012	Unmodified

Entity	Latest financial statements audited	Type of audit opinion issued
Marine Parks Authority	30 June 2011 (a)	Unmodified
Minister administering the *Environmental Planning and Assessment Act 1979* (a corporation)	30 June 2012	Qualified
Minister administering the *Heritage Act 1977* (a corporation)	30 June 2011 (a)	Unmodified
National Art School	30 December 2011	Unmodified
NSW Businesslink Pty Limited	30 June 2012	Unmodified
NSW Fire Brigades Superannuation Pty Limited	30 June 2012	Unmodified
State Super Financial Services Australia Limited	30 June 2012	Unmodified
Trustees of the Farrer Memorial Research Scholarship Fund	31 December 2011	Unmodified
The trustees for the time being of The Art Gallery of New South Wales Foundation	30 June 2011 (a)	Unmodified
Trustee of the Home Purchase Assistance Fund	30 June 2012	Unmodified
Each board of management, state conservation area trust and trust board established for a state conservation area within the meaning of the *National Parks and Wildlife Act 1974*	-- (e)	--
The trustees for the time being of each superannuation scheme established by a trust deed as referred to in section 127 of the *Superannuation Administration Act 1996*:		
Energy Industries Superannuation Scheme Pool A	30 June 2011 (a)	Unmodified
Energy Industries Superannuation Scheme Pool B	30 June 2011 (a)	Unmodified
Uniprojects Pty Limited	30 June 2011 (a)	Unmodified
United States Studies Centre Limited	31 December 2011	Unmodified
Universities Admissions Centre (NSW and ACT) Pty Limited	30 June 2011 (a)	Unmodified
Valley Commerce Pty Ltd	30 June 2012	Unmodified
Wyong Council, being a water supply authority listed in Schedule 3 to the *Water Management Act 2000*	30 June 2012	Unmodified
Crown Employees (NSW Fire Brigades Fire Fighting Staff Death and Disability) Superannuation Fund	30 June 2012	Unmodified
Energy Investment Fund	30 June 2011 (a)	Unmodified
Home Warranty Insurance Fund	N/A (a)	N/A
Macquarie University Professorial Superannuation Scheme	30 June 2012	Unmodified
Parliamentary Contributory Superannuation Fund	30 June 2012	Unmodified
State Super Allocated Pension Fund established by State Super Allocated Pension Fund Trust Deed dated 23 November 1993	30 June 2012	Unmodified
State Super Fixed Term Pension Plan established by State Super Fixed Term Pension Plan Trust Deed dated 14 July 1999	30 June 2012	Unmodified
State Super Personal Retirement Plan established by State Super Personal Retirement Plan Trust Deed dated 3 April 1990	30 June 2012	Unmodified
State Super Investment Fund established by State Super Investment Fund – Cash Fund Constitution dated 22 November 1991, State Super Investment Fund – Capital Stable Fund Constitution dated 22 November 1991, State Super Investment Fund – Balanced Fund Constitution dated 22 November 1991 and State Super Investment Fund – Growth Fund Constitution dated 24 April 1997	30 June 2012	Unmodified

Entity	Latest financial statements audited	Type of audit opinion issued
The superannuation fund amalgamated under the *Superannuation Administration Act 1991* and continued to be amalgamated under the *Superannuation Administration Act 1996*	30 June 2012	Unmodified
University of Sydney Professorial Superannuation System	31 December 2011	Unmodified

N/A Added as a prescribed audit during 2011-12.

a 30 June 2012 financial statements have been submitted for audit. My audit is still in progress as at 19 October 2012.

b No financial statements submitted for individual audit since 2006. The NSW Ministry of Health advises they are seeking to remove the Ambulance Service of NSW from the list of prescribed entities.

c The Commission's 30 June 2012 financial statements are being audited by the Auditor-General for Queensland.

d Formerly referred to as networks.

e No financial statements have been submitted for audit since this group of entities was prescribed.

f Cobbora Holding Company Pty Limited advises they are seeking to remove the unincorporated joint venture from the list of prescribed entities.

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