New South Wales Auditor-General's Report to Parliament for 2002

Volume Four

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THE AUDIT OFFICE
OF NEW SOUTH WALES

AUDITOR-GENERAL
NEW SOUTH WALES

The Legislative Assembly
Parliament House
SYDNEY NSW 2000

The Legislative Council
Parliament House
SYDNEY 2000

Pursuant to section 52A of the *Public Finance and Audit Act 1983*, I present Volume Four of my 2002 Report.

R J Sendt

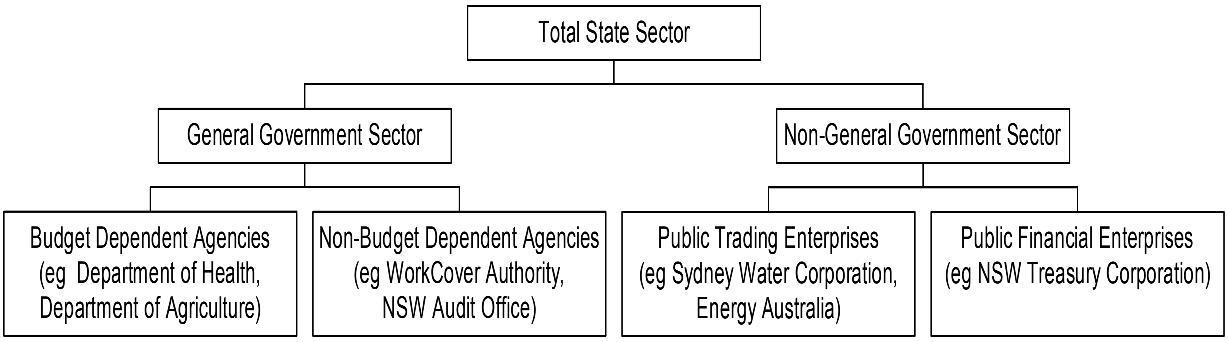
Sydney
31 October 2002

Contents

Audit Opinion and Key Issues

This section of the Volume comments on the Total State Sector Accounts.

The composition of the New South Wales public sector is:



AUDIT OPINION

The Independent Audit Report on the Total State Sector Accounts for the year ended 30 June 2002 was issued on 27 September 2002. A copy of the Independent Audit Report was included with the Treasurer's *Report on State Finances 2001-2002* released on 14 October 2002.

The Independent Audit Report was qualified because we considered that the Accounts should include:

- the collections assets of the Australian Museum
- cash and investments held in government school bank accounts
- WorkCover Scheme Statutory Funds.

The Accounts were also qualified because we could not obtain information and explanations that would enable us to form an opinion on the value of the State's investment in Snowy Hydro Limited.

Our Independent Audit Report on the Total State Sector Accounts was issued on 27 September 2002. This was 28 days earlier than last year and 25 days earlier than the statutory date of 22 October. This achievement was the result of a concerted effort by the larger public sector entities, Treasury and the Audit Office to have the Total State Sector Accounts prepared and audited by 30 September.

KEY ISSUES

Accountability of the Total State Sector and its Components

The *Report on State Finances 2001-2002* contains audited Total State Sector Accounts based on Australian Accounting Standards and an audited Statement of Budget Result prepared on a Government Finance Statistics (GFS) basis.

Parliament requires the Total State Sector Accounts to be audited and presented to help it hold the Government accountable. This Volume informs Parliament about matters that came to our attention during our audit.

The Treasurer's Report is one of several high-level financial accountability mechanisms. The following table summarises the range of measures that the Parliament has established.

	Financial Targets Set	Budgetary Controls Set?	Financial Report Required?	MD&A Required? (1)	Audit Opinion Required?
Total State Sector	No (2)	No	Yes	No (5)	Yes
Component sectors:					
General Government Sector	Yes (3)	Yes (4)	No	No	No (6)
Public Trading Enterprises	No	No	No	No	No (6)
Public Financial Enterprises	No	No	No	No	No (6)

Notes

(1) 'MD&A' = Management Discussion and Analysis

(2) A target has been established only in respect of superannuation liabilities (in the General Government Debt Elimination Act)

(3) Targets are set in the General Government Debt Elimination Act

(4) Annual State Budget approved by Parliament

(5) There is no legislative requirement for an MD&A but the Treasurer provides a 'Review of Financial Performance' in the Report on State Finances

(6) There is no legislative requirement for an audit opinion on the accounts of the component sectors. However because the Treasurer includes operating statements and statements of financial position of each sector as notes to the Total State Sector Accounts, we include them in our audit. The Treasurer also requests an audit opinion on the Statement of Budget Result, which is an operating statement for the General Government Sector on a GFS basis.

Although legislation sets financial targets and budgetary controls for the General Government Sector, there is no legal requirement that we audit the resulting financial report of that sector. It seems anomalous that the sector is sufficiently important for Parliament to set targets and budgets, yet it does not require an audit of the actual results.

On a broader issue, Parliament sets strategic financial principles, targets and budgets for the General Government Sector. However it sets no similar requirements for the public trading entities and financial trading entities where the financial risks may be greater. Indeed, Standard and Poor's has noted 'the credit strength of the general government sector will offset a weakening of the financial profile of the state's public trading enterprises' and suggested that the main credit issues for NSW currently relate to WorkCover and to the trading enterprises that hold 68 per cent of the State's total debt.

Treasury's current framework already monitors the performance of individual public trading entities and financial trading entities. The framework sets performance benchmarks, dividend and tax equivalent payments, a capital structure (debt/equity) policy and a social program. Giving key elements of this framework a legislative backing would improve the State's fiscal management.

Recommendations

Parliament should consider improving the State's fiscal management by establishing relevant principles and targets for public trading entities and public financial entities.

General Government Debt Elimination Act

We have examined the amendments to the fiscal principles in the *General Government Debt Elimination Act 1995* and suggested improvements to accountability under that Act. We discuss these in the 'General Government Debt Elimination Act' section elsewhere in this Volume.

Changed Financial Reporting Requirements

Parliament amended the *Public Finance and Audit Act 1983* in 2002 so that it no longer requires a separate financial report on the General Government Sector (known as the Public Accounts).

The Treasurer now reports on the operations of the General Government Sector in the notes to the financial report of the Total State Sector accounts. The Statement of Budget Result section in this Volume compares the actual financial performance of the General Government Sector with the Budget.

Results from Budget Initiatives

We asked selected agencies to supply information about expenditures and results on their 2001-02 Budget initiatives. We recommend that Treasury and agencies should publish this type of information so that Parliament can better evaluate public expenditure. The results from Budget Initiatives section elsewhere in this Volume discusses this recommendation**.**

State Taxation – Payroll Tax

The second largest source of State taxation is payroll tax which raised $3,851 million in 2001-02 ($3,817 million in 2000-01).

Despite the processes in place, the current self-assessment environment inevitably means that some of the payroll tax that is legally due is not received. No reliable and cost effective methodology currently exists to measure revenue not collected. Revenue agencies both in Australia and overseas have sought to develop reliable methodologies with only marginal success. However, the Office of State Revenue (OSR) extrapolates Australian Bureau of Statistics data and its own audit results to estimate the potential additional revenue. It concludes that it is likely to be significant but remains unquantifiable.

Some sense of the significance of the amounts may be drawn from the United States Internal Revenue Service which is reported to have estimated that the amount of taxes not voluntarily paid is about 17 per cent of total federal income tax due each year. However there are important differences between different taxes and jurisdictions.

Clearly, not all payroll tax due can be collected. Businesses will fail owing money to OSR and other creditors. Some will structure themselves and their payments to employees to legally reduce or avoid taxes. Others will simply not register or will understate their tax liability.

When some taxpayers do not pay all the taxes they should, part of the funding burden may be shifted to taxpayers that do comply. Equally, it could be argued that public services are constrained by the reduced funding available or that government debt levels are higher than they could be.

Recommendations

Given that the level of revenue lost is likely to be significant, OSR should keep Parliament informed. As the agency responsible for collecting payroll tax, OSR should comment in its Annual Report on such issues as:

- steps being taken to quantify revenue being forgone
- any available estimates of the amount involved
- available comparisons with other jurisdictions
- strategies in place to maximise the collection of revenue legally due.

Overview of Financial Aggregates

This section provides information on the State's Total State Sector finances.

The table below summarises key financial aggregates over five years. The aggregates are on an accounting standards, not GFS, basis.

Year ended 30 June	2002 $m	2001 $m	2000 $m	1999 $m	1998 $m
Total State Sector					
Operating surplus/(deficit)	**4,028**	(576)	5,496	1,620	1,937
State taxation	**12,588**	12,639	14,540	13,552	12,607
Commonwealth grants	**15,033**	12,967	9,460	8,911	8,366
Operating expenses	**42,415**	43,528	32,666	35,436	33,647
Net assets	**98,078**	91,156	87,556	78,470	72,204
Borrowings	**26,740**	27,128	28,003	30,968	27,557
Superannuation liability	**11,834**	8,226	5,579	8,334	12,112

The year-to-year changes in operating results largely reflect significant transactions relating to the valuation of the State's assets or liabilities.

The 2001-02 operating result was increased by the recognition for the first time of Crown Land valued at $4,000 million. Higher than expected taxation revenue also helped the final operating result remain in surplus.

Superannuation fund earnings of the Total State Sector were $2,528 million lower than the actuarially-applied long-term earning rates.

Net assets also increased in 2001-02 as a result of the $4,000 million recognition of Crown Land, although a net increase of $1,724 million in the value of Roads and Traffic Authority infrastructure and property assets also contributed to asset growth.

Commonwealth grants have increased since the introduction of the Goods and Service Tax (GST) which the Commonwealth collects and pays to the States. GST revenue paid to New South Wales in 2001-02 was up on the previous year by $874 million, while Commonwealth Specific Purpose Recurrent Grants increased by $456 million in 2001-02. With the introduction of the GST a number of State Taxes and the taxes on petroleum products, alcohol and tobacco collected by the Commonwealth and passed on to the States have been abolished.

The 2000-01 operating result was lessened by a $950 million increase in the unfunded superannuation liability, which resulted from a changed actuarial demographic assumption, and a $600 million provision resulting from the HIH collapse.

The 1999-2000 operating surplus was inflated by a $2,572 million reduction in the State's unfunded superannuation liability, which followed changed actuarial assumptions.

Abridged Statement of Financial Performance

Year ended 30 June	2002 $m	2001 $m
State revenues	**28,413**	26,527
Deferred revenues – Olympic and Paralympic Games	**--**	3,145
Other operating revenues	**18,030**	13,280
TOTAL REVENUE	**46,443**	42,952
Employee related expenses	**20,548**	18,979
Deferred expenses – Olympic and Paralympic Games	**--**	3,046
Other expenses	**21,867**	21,503
TOTAL EXPENSES	**42,415**	43,528
SURPLUS/(DEFICIT) FOR YEAR	**4,028**	(576)

The following ratios show how state taxation, borrowing costs and total expenditure have moved over a five-year period compared to Gross State Product (GSP):

Year ended 30 June	2002*	2001	2000	1999	1998
State taxation/GSP %	**5.05**	5.29	6.46	6.41	6.28
Borrowing costs/GSP %	**0.65**	0.90	0.77	1.36	1.12
Total expenditure/GSP %	**17.00**	18.23	14.51	13.04	13.07

*GSP for 2001-02 is Treasury estimate. Australian Bureau of Statistics' estimate not yet available.

The table shows that over the five-year period:

- taxation revenue as a percentage of GSP has fallen by 19.6 per cent. This is mainly the result of some state taxes being phased out because of the Goods and Services Tax arrangements. The State also reduced payroll tax and land tax rates, and abolished the third party motor vehicle registration levy
- the ratio of borrowing costs to GSP fell 42.0 per cent because of lower interest rates and a reduction in interest bearing borrowings
- total expenditure as a percentage of GSP has risen by 30.1 per cent.

It is difficult to compare whole-of-government financial aggregates from one year to the next because most years include one or more large one-off transactions. The following table lists some of these transactions in recent years:

Year	Transactions	$m
1997-98	Increasing revenues:	
	net proceeds from the sale of the TAB	708
1998-99	Decreasing expenses:	
	decrease in superannuation liabilities	704
1999-2000	Decreasing expenses:	
	decrease in superannuation liabilities	2,976
	Increasing expenses:	
	corporatisation adjustments	(564)
2000-01	Increasing expenses:	
	increase in superannuation liabilities	(950)
	provision for HIH Insurance liability	(600)
2001-02	Increasing revenue:	
	recognition of Crown Land	4,000
	recognition of NSW interest in Snowy Hydro Ltd	469
	Increasing expenses:	
	loss on superannuation assets	(2,528)

These transactions are identified to help users of whole-of-government reports to understand the impact they have on published results.

Abridged Statement of Financial Position

	2002 $m	**2001 $m**
Current assets	**10,700**	9,063
Non-current assets	**142,168**	132,338
TOTAL ASSETS	**152,868**	141,401
Current liabilities	**12,991**	11,804
Non-current liabilities	**41,799**	38,441
TOTAL LIABILITIES	**54,790**	50,245
NET ASSETS	**98,078**	91,156
Reserves	**42,681**	40,911
Accumulated funds	**55,397**	50,245
TOTAL EQUITY	**98,078**	91,156

The following ratios show how interest bearing borrowings and unfunded superannuation liability have moved compared to GSP over a five year period:

At 30 June	2002	2001	2000	1999	1998
Interest bearing debt to GSP %	**10.72**	11.30	12.44	14.65	13.73
Unfunded superannuation liability to GSP %	**4.74**	3.45	2.48	3.94	6.03

Interest bearing borrowings have fallen as a percentage of GSP by 21.9 per cent since 1998. Unfunded superannuation liabilities were impacted by negative returns in 2001-02 and higher than average investment returns in 1999-2000.

Unfunded superannuation liabilities fell in 1999 as a percentage of GSP because the Government paid three years of employers' contributions in advance.

Unfunded Superannuation Liability

The unfunded superannuation liability increased by $3,742 million to $11,723 million. This was mainly the result of the 7.3 per cent loss on superannuation fund assets.

Liability for Insurance claims

Volume Six of the Auditor-General's 2001 Report to Parliament commented on provisions for claims from the collapse of HIH Insurance. In 2000-01 the State assumed a $600 million liability.

During the current year, the liability for insurance claims increased by $519 million as a result of:

- recognising $369 million in claims incurred by the Insurance Ministerial Corporation following a decision by the Australian Accounting Standards Board - Urgent Issues Group requiring liabilities for insurance claims to be based on an estimate of likely claims from incidents that have occurred rather than wait until a claim is actually made.

- $150 million liability recognised by the Insurance Ministerial Corporation as a result of the government indemnifying visiting medical officers treating public patients in public hospitals.

Investment in Snowy Hydro Limited

There was insufficient information available to form an opinion on the State's share of Snowy Hydro Limited. The corporation assumed the assets and liabilities of the former Snowy Mountains Hydro Electricity Authority under the *Snowy Hydro Corporatisation Act 1997.*

New South Wales owns 58 per cent of the corporation, with the Victorian and Commonwealth public sectors owning the balance. Despite the public ownership of Snowy Hydro, it is not required to be audited by an auditor-general.

At the time of the completion of the audit of the Total State Sector Accounts, the corporation's auditors had not completed their audit, and could not confirm to us the value of its assets and liabilities.

Identification of and Valuation of Crown Land

We qualified previous financial reports of the Total State Sector Accounts because undeveloped Crown Land was not brought to account. During 2001-02, the Treasury and the Department of Land and Water Conservation, in consultation with the Valuer-General, worked extensively to identify and value Crown Land that was not recorded in the accounts of public sector entities. As a result, Crown Land with a value of $4,000 million was recognised for the first time.

Australian Accounting Standards require that any gain on the recognition of assets be brought to account in the statement of financial performance.

The gain does not indicate any real change in the State's assets, but simply in the way the State accounts for them.

General Government Debt Elimination Act

INTRODUCTION

The *General Government Debt Elimination Act 1995* sets out principles for the financial management of the General Government Sector. It was a major step forward in the State's fiscal management, but for it to be effective the Government needs to set clear and unambiguous targets, and report regularly and comprehensively on progress towards these targets and principles. The Audit Opinion and Key Issues section of this Volume discusses ways that the State can improve its overall financial accountability mechanisms.

In 2001, the Treasurer reviewed the Act's operation as section 29 required. His report to Parliament in December 2001 found that the Act's objectives remain valid, and its terms remain appropriate. However, the Government introduced amendments to the Act and to the *Public Finance and Audit Act 1983* to change some aspects of the targets and principles.

We discuss below the principles and targets as they stand currently, and progress towards those targets.

FISCAL PRINCIPLES AND TARGETS

Fiscal Principle No. 1 – the Budget is to be framed to achieve a result for the general government sector consistent with fiscal targets

The Act specifies short-term, medium-term and long-term targets.

Short-term Target

The short-term target is to achieve a sustainable surplus budget within three years of the Act's commencement (ie by 1998-99). The wording of the Act does not clarify whether the target has any relevance beyond this three-year period.

On one interpretation, the Act only requires that the Government achieve a budget surplus in one year, and that the surplus not be based on, for example, unsustainable revenue levels. Another interpretation is that the Act requires achieving a budget surplus position within three years and sustaining that position (ie continuing surpluses).

The 2002-03 Budget Papers assume the first interpretation. They argue that the target was 'achieved' in 1998-99, and that the continuing surpluses since then (and in the forward estimates to 2005-06) demonstrate the sustainability of the 1998-99 result.

The successive budget surpluses achieved over recent years certainly provide significant evidence of sustainability. However, these years also coincide with a period of strong economic growth in Australia, and an extremely buoyant Sydney real estate market.

Recommendation

To generate more informed discussion about the sustainability of annual budget results, the Government should dissect the main financial aggregates (particularly tax revenues) into their underlying (ie trend) components and their cyclical components. The dissection would require some technical judgements to be made. Disclosure of those technical judgements would also assist to inform discussion.

Medium-term Target

The medium-term target in the Act is to reduce the level of General Government Sector net debt to a sustainable level by 30 June 2005.

The Act does not define 'sustainable' in quantifiable terms. It notes only that the Act's more general purpose of fiscal sustainability would allow government finances to absorb future financial shocks without requiring 'significant and economically or socially destabilising expenditure or revenue adjustments'.

The 2002-03 Budget Papers note that progress is 'on target' and that 'on current estimates, the medium-term target can be achieved by June 2005 or earlier'. The Budget Papers also estimate that General Government Sector net debt will be $4,075 million at 30 June 2004 and $3,907 million at 30 June 2005. This implies that a sustainable debt level is in the order of $4.0 billion, or around 1.4 per cent of GSP.

While the Budget Papers do not explain why this level of net debt is regarded as 'sustainable', it compares well to the Sector's net debt of $12.0 billion (7.3 per cent of GSP) at 30 June 1995. Treasury estimates the net interest expense in 2004-05 at only $86 million, a significant decrease from the $952 million in 1996-97.

This reduction in General Government Sector net debt has resulted from continuing budget surpluses and the 'transfer' of debt to the PTE sector. Volume Seven of the Auditor-General's 2001 Report to Parliament noted that the energy industry repatriated $3.0 billion in capital to government, and the re-gearing this required. Similar capital repayments occurred in 1995-96 ($1.5 billion) and are planned for 2002-03 (about $600 million).

Recommendation

To allow more informed judgements on its financial management, the Government should dissect debt level changes. The dissection should show those changes resulting from financial management within the General Government Sector and those resulting from debt transfers to PTEs.

Long-term Target

The long-term target is to eliminate net debt for the General Government Sector by 30 June 2020 and (since the June 2002 amendments) to eliminate Total State Sector unfunded superannuation liabilities by 30 June 2030.

The 2002-03 Budget Papers show a continuing decrease in the level of General Government Sector net debt, and note that the State has made substantial progress towards achieving the target. Treasury estimates that Underlying Net Debt will stand at $2,865 million (or 0.9 per cent of GSP) by June 2006. If this trend continues, the State should meet its long-term target.

The 2002-03 Budget Papers note that nominal unfunded superannuation liabilities will grow until around 2015, before declining gradually to zero in 2030. The objective originally was to fully fund superannuation liabilities by 2045, but a substantial improvement in recent years has made it possible to bring forward the target date by 15 years. Investment strategies to manage superannuation assets recognise that losses may occur in some years, as in 2001-02. Further comment on the superannuation liabilities appears under Fiscal Principle No. 3.

Fiscal Principle No. 2 – general government net worth should at least be maintained in real terms

Net worth is defined in the Act as total assets less total liabilities. General Government Sector net worth in the audited Total State Sector Accounts over the last five years have been:

At 30 June	2002 $m	2001 $m	2000 $m	1999 $m	1998 $m
General government net worth as per accounts	**50,337**	43,828	41,204	37,164	31,288
Deflator used by Treasury	**3.1%**	6.2%	2.4%	1.6%	--
Net worth in real terms	**43,642**	39,358	39,556	36,569	31,288

These figures demonstrate that NSW has adhered to this fiscal principle to date.

Increases in net assets can result from budgetary measures such as:

- capital expenditure allocations in excess of the annual depreciation charge
- budget surpluses that allow debt to be reduced or financial assets to be increased.

However, net assets can also result from non-budgetary measures such as:

- asset and liability revaluations
- recognising assets not previously included, for example the $4,000 million recognition of Crown land in 2001-02
- repayment of equity from the PTE sector.

If Fiscal Principle No. 2 is to promote sound financial management, its measurement should not be heavily influenced by valuation changes and equity repayments.

Recommendation

The Government should dissect changes in net worth between those arising from budget management measures and those arising otherwise.

Fiscal Principle No. 3 – total State sector unfunded superannuation liabilities are to be eliminated by 30 June 2030.

Superannuation benefits to employees form part of the Government's overall liabilities. This can arise either from past service of employees, or from the current (and future) service of employees.

In its previous form, the Act required the liability relating to *current* service to be funded as it occurred. The legislation did not specify the target year for funding liabilities for *previous* service, although successive Budget Papers noted a 2045 target.

The amended Act requires that the State fund total liabilities by 30 June 2030. It no longer requires that the Government fund the current liability as it accrues. There was no Crown employer funding during the year ($243 million in 2000-01).

Fiscal Principle No. 4 – the use of best practice asset maintenance and management policies is to be adopted in the general government sector.

Previously, General Government Sector agencies had to produce and maintain an asset maintenance plan, including a funding program, under directions from the Treasurer. The 2001 amendments to the Act recognised that asset maintenance plans do not by themselves ensure sound asset management. The Act now lists the high level principles of appropriate asset management, but removes the various instruments used to support these principles.

During the year, we conducted a special review of the maintenance of infrastructure assets. The report was presented to Parliament on 28 May 2002. The Other Audit Matters section of this Volume summarises our findings.

Fiscal Principle No. 5 – the growth in the net cost of services and expenses of the general government sector is to be kept at or below the annual growth (as a four-year average) in gross State product.

Previously, the growth in the net cost of services and budget outlays was to be kept at or below the growth in inflation and population. This meant zero real growth in per capita terms. The 2002-03 Budget Papers indicate that this target was not met.

The amended principle relates the net cost of services and outlays to the economic activity of the State. This amendment softens the principle by allowing the net cost of services and expenses to rise in line with economic activity. As the following table shows, this is typically greater than the growth in inflation and population:

Increase in population, inflation and Gross State Product	2001-02 %	2000-01 %	1999-2000 %	1998-99 %
Population	1.1	1.4	1.3	1.3
Inflation	2.9	6.2*	2.4	1.7
Gross State Product	4.5	6.0	6.6	5.2

*Impacted by the introduction of the GST.

The Act requires that the average annual growth in net cost of services and expenses of the General Government Sector be calculated over a four-year period and on a GFS basis. On the basis of information provided by Treasury, the average increase in the net cost of services for the four years to 30 June 2002 was 6.7 per cent and the average for expenses was 5.6 per cent. The annual increase for each of those four years was:

Annual Increase	2001-02 %	2000-01 %	1999-2000 %	1998-99 %
Net cost of services	7.7	7.7	1.9	9.3
Expenses	6.2	6.6	2.2	7.5
Gross State Product (GSP)	4.5	6.0	6.6	5.2

The average annual increase in GSP over the four years was 5.6 per cent. Had the amended principle applied in that period, the average annual growth in net cost of services would have exceeded that set by the principle.

Fiscal Principle No. 6 – financial risk is to be managed prudently on the basis of sound risk management principles.

Previously, the management of net debt was to be based on the sound risk management principles. Each General Government Sector agency was required to produce and maintain a risk management plan. Amendments to the Act properly separated the high level principles for prudent risk management from the mechanisms agencies should use.

We audited risk management within the NSW public sector and presented a Report to Parliament on 19 June 2002. The results are summarised in the Other Audit Matters section of this Volume.

Fiscal Principle No. 7 – any adjustments to legislated tax rates, thresholds and bases are to be made with the maximum possible restraint.

Previously, the level of taxes was to be restrained but there was no quantification of the target. The principle now focuses on the tax rates, thresholds and bases underlying the overall level of taxes. The result is that it now focuses on mechanisms rather than outcomes. The amended principle does not quantify or explain 'maximum possible restraint', and no longer recognises that tax revenues can grow significantly without legislative adjustments, because of 'bracket creep' and economic growth.

REPORTING ON PROGRESS

The Act requires that the Budget Papers assess progress against its fiscal targets and principles. Information in the Budget Papers gives some insight into progress against some of the targets and principles. Other relevant information is contained in a variety of other public documents, including the Treasurer's Report on State Finances, but no single document contains all of the information that Parliament should have to assess progress.

Treasury should release a single, comprehensive report containing the qualitative information needed to evaluate the allocation of public finances.

Financial information should help Parliament to predict the outcomes of events and/or confirm or correct past evaluations. A number of the principles and targets in the Act are medium or long-term (up to 30 years) or ongoing (without any specified target date). Parliament could better assess progress if its information covered a period long enough to identify medium and long-term trends. While future Budget Papers are required to show four-year forward projections that will assist medium-term evaluation, long-term historical information is of equal or greater importance.

It is important that financial information be reliable and free from bias. It should allow users to draw their own conclusions. The role of independent audit is important in relation to reliability. Given the significance of the fiscal principles and targets and the measurement of progress against them it would be useful to decide upon a standard reporting format with a settled basis of measurement which limits latitude in the compilation of the progress reports. Consideration could also be given as to whether an audit upon the progress report might add value.

At present, the Treasurer's Report on State Finances is provided in October. The section headed 'Financial Framework and Targets' usefully comments on progress and achievements against each of the fiscal principles and targets in the *General Government Debt Elimination Act 1995*, but only in broad narrative form.

Recommendation

We recommend that the 'Financial Framework and Targets' report include data in tabular form with the qualitative characteristics discussed above.

Comparison of 2001-02 Budget and Actual Result

Although the State's Budget Papers contain information on the Total State Sector, the Budget is essentially about the General Government Sector.

The General Government Sector financial operations are disclosed in the notes to the Total State Sector Accounts in the Treasurer's *Report on State Finances 2001-2002*. This allows a comparison to be made between the result as disclosed in the notes and the Budget projections.

The table below shows comparisons between the budget and actual expenses and revenues for the General Government Sector. These figures are on an accounting standards basis.

Year ended 30 June 2002	Actual $m	Budget $m	Amount Over/(Under) Budget $m
Total expenses	34,401	30,716	3,685
Total operating revenue	7,939	3,683	4,256
Net cost of services	26,462	27,033	(571)
Total State revenue	30,363	28,487	1,876
Surplus	3,901	1,454	2,447

OPERATING RESULT

The operating result was $2,447 million above budget. The *Report on State Finances* identifies a number of 'significant' items as contributing to this result. 'Significant' in this context implies unusual or one-off in nature, rather than necessarily being the major contributors to the overall variation from budget.

The significant items were:

- a $4,000 million revenue gain from the recognition of Crown Land
- a $469 million revenue gain from the recognition of the New South Wales share in Snowy Hydro Limited
- $1,928 million expense resulting from the fall in the value of superannuation fund assets
- $88 million expense recognising the sector's book loss on the sales of Freight Rail Corporation and the New South Wales share in National Rail Corporation
- $150 million expense recognising a provision for claims against visiting medical officers for work performed on public patients in public hospitals
- $48 million expense recognising land transferred by the Roads and Traffic Authority to 'land under roads'.

Excluding these items, the actual result was $192 million better than the budget estimate. State revenues exceeded budget by $1,876 million and were offset by a fall in operating revenue of $213 million, and a $1,404 million increase in expenditure.

EXPENSES

Expenses of the General Government Sector were $3,685 million higher than the budgeted amount.

Year ended 30 June 2002	Actual $m	Budget $m	Amount Over/(Under) Budget $m
Superannuation	3,859	1,741	2,118
Other employee	12,937	12,583	354
Other operating	6,994	6,808	186
Maintenance	1,308	1,160	148
Depreciation and amortisation	1,538	1,493	45
Grants and subsidies	6,823	6,046	777
Finance costs	942	885	57
Total	34,401	30,716	3,685

Superannuation expenses were $2,118 million above budget. This was mainly because the value of assets held by the superannuation funds fell by $1,928 million. The recorded asset values resulted from a negative 7.3 per cent return on superannuation fund assets, compared to the budget projection of a positive 7 per cent.

Higher-than-budgeted other employee expenditure mainly related to the Department of Education and Training.

Grants and subsidies exceeded budget mainly as a result of:

- additional cost of the First Home Owner Grants Scheme, $169 million
- additional capital grants for the Community Housing program, $107 million
- additional capital and recurrent grants for transport purposes, $103 million
- additional disaster welfare relief grants by the Rural Fire Service, $58 million.

OPERATING REVENUES

Excluding significant revenues of $4,469 million, operating revenues of $3,470 million were $213 million lower than the budget estimate. The major variation was the Insurance Ministerial Corporation's investment income, which was $140 million below the budget estimate.

STATE REVENUES

State revenues are the major source of revenue for the General Government Sector:

Year ended 30 June 2002	Actual $m	Budget $m	Amount Over/(Under) Budget $m
Taxation	13,207	12,084	1,123
Commonwealth grants	15,033	14,413	620
Financial distributions	1,331	1,129	202
Fines, regulatory fees and other	792	861	(69)
Total	30,363	28,487	1,876

Taxation revenues accounted for the bulk of the increase over budget, with duties increasing by $1,126 million. The major increase in duty revenues were:

- conveyances $968 million
- loan securities $68 million
- insurance $46 million
- motor vehicle registrations $44 million.

Results from Budget Initiatives

The State's Budget Papers cover the total finances of the General Government Sector and each of its agencies (and sector level totals for the PTE Sector). However they also provide Parliament and other readers with information on specific initiatives being introduced in the budget year.

The 2001-02 Budget Paper No. 2 set out details of spending initiatives in the areas of:

- ♦ health
- ♦ social security and welfare
- ♦ education
- ♦ public order and safety
- ♦ transport
- ♦ housing and water
- ♦ agriculture, forestry and fishing
- ♦ environment protection
- ♦ recreation and culture
- ♦ other economic services, mining, energy and construction.

In general, there is limited public disclosure on actual expenditures and related results from these iniatives. It may be helpful to Parliament in evaluating the Government's and agencies' performance if details were published on the results.

Relevant details might include the extent to which the budget allocations were spent and the results achieved. We asked selected agencies to supply information on expenditures on, and results from relevant initiatives set out in the Budget Papers. Their responses are set out below.

Recommendation

Treasury should consider requiring agencies to publish in their annual reports details of Budget initiatives, expenditure and related results so that a more useful evaluation of expenditure can be made.

Budget Paper No. 2 Initiative	**Agency Response on 2001-02 Expenditure and Results**
Education	
State Literacy and Numeracy Plan allocated $116.9 million.	Expenditure $116.9 million. National Literacy and Numeracy results for 2001 are not published until late November 2002.
Computers in Schools allocated $137.3 million.	Expenditure $149.1 million. Used to update 90,000 computers in schools and provide additional computers. Also to provide training to teachers in computers and enhanced internet facilities.
Schools Welfare Programs allocated $42.2 million.	Expenditure $37.3 million.
Teacher Training allocated $5.7 million.	Expenditure $5.0 million. As at 2001 19,839 teachers have been trained in use of technology. By 2003 40,000 teachers will be trained in technology.
School Maintenance allocated $157 million.	Expenditure $218 million including an additional appropriation of $56 million. School building maintenance backlog reduced from $143 million in 2001 to $83 million at 30 June 2002.
TAFE allocated $4.4 million to support scholarships and students at risk.	Expenditure $2.5 million.

Budget Paper No. 2 Initiative	Agency Response on 2001-02 Expenditure and Results
Transport	
$50 million for new passenger cars for Newcastle and the Hunter region.	Considerable work has been carried out to produce specifications and carry out the tender process ($1.1 million). Tenders closed in February 2002 and the contract is expected to be awarded in September 2002.
$270 million (over 4 years) for an additional 60 Millennium carriages and 40 new interurban cars.	Funding for the second tranche of Millennium trains was identified for expenditure in 2002-03 and 2003-04. Tender process is continuing for the outer suburban cars, expected to award contract during 2002-03.
Accelerating train maintenance ($38 million in 2001-02 and $122 million over 4 years).	The additional funds were utilised to enable an increase in the frequency of electric train maintenance. A presentation shop was constructed to enable the accelerated program to be delivered and a range of spare parts were also purchased.
Increasing track maintenance ($320 million over 4 years).	Funding of an additional $40 million was provided for the metropolitan network and $40 million for the country network.
New signalling and other safety works ($147 million over 4 years).	Fire safety work has been carried out in the city underground and at various selected locations ($32.1 million).
$41 million specifically for additional tracks within the Sydney network.	Works carried out during 2001-02 include completion of Richmond line amplification ($24.1 million) with some remaining work being carried out at Marayong station; and commencement of construction of Central turnback ($8.4 million).
The commencement of construction of the Parramatta Rail Link (approximately $145 million to be spent in 2001-02).	Significant progress was made during 2001-02, including obtaining planning approval, selection of a contractor for the Epping-Chatswood civil works and rail systems, land acquisition and development of concept designs. $119.3 million was spent during 2001-02, primarily on land acquisitions.
Millennium Trains – First Tranche $90 million.	Delivery of cars delayed. Cars have undergone extensive testing and are now being progressively delivered ($14.8 million in 2001-02). Forecast is for 16 four-car sets by the end of 2002-03.
A major upgrade of facilities, passenger information systems and security at stations across the rail network, with funding of $28.7 million in 2001-02.	Expenditure in 2001-02 included provision of cabling and computer networks to support passenger information systems ($2.1 million); installation of passenger information systems at stations ($2.6 million); continuation of work on crime prevention through environmental design ($4.8 million); and upgrading works at various locations ($8.5 million).
$31.5 million in 2001-02 to continue the program to provide easy access to railway stations.	Over $35 million was spent on the program, including completion of works at Allawah, Caringbah, Engadine and Katoomba.
Upgrading of the XPT fleet at a cost of $4 million in 2001-02.	XPT fleet upgrade was completed in April 2002. The program resulted in new engines for 19 XPT power cars. Expenditure in 2001-02 was $4.3 million.
Spending of $6 million for the electrification of the Dapto to Kiama rail line.	$4.2 million was spent in 2001-02. The project was completed in November 2001.

<table>
<tr><th>Budget Paper No. 2 Initiative</th><th colspan="4">Agency Response on 2001-02 Expenditure and Results</th></tr>
<tr><td colspan="5">Health</td></tr>
<tr><td rowspan="7">An increase in medical and surgical procedures undertaken across a variety of disciplines at hospitals throughout the State including those in the Hunter, Mid North Coast, Central Coast, Northern Rivers, and South West Sydney.</td><td colspan="4">2001/02 increases in medical and surgical procedures undertaken across the State are demonstrated by the following allocations:</td></tr>
<tr><td></td><td></td><td>$000</td><td>Additional Weighted Separations</td></tr>
<tr><td>Hunter</td><td>Additional Surgery & Medical Services</td><td>4,600</td><td>1,100</td></tr>
<tr><td>Mid North Coast</td><td>Long Wait Strategy</td><td>3,000</td><td>2,059</td></tr>
<tr><td>Central Coast</td><td>Additional Acute Inpatient Services
Additional activity above 2000/01 level</td><td>2,700
2,166</td><td>1,190
1,333</td></tr>
<tr><td>Northern Rivers</td><td>Extended Wait Surgery, Lismore</td><td>660</td><td>230</td></tr>
<tr><td>South West Sydney</td><td>Additional Medical & Surgical Services
Renal Services</td><td>4,100
507</td><td>1,600
500</td></tr>
<tr><td>Establishment of new community health centres at Wyong, Erina and Lake Haven on the Central Coast.</td><td colspan="4">The Wyong Community Health Centre was completed in July 2002 with expenditure of $1.4 million in 2001-02.

Planning for the Erina Community Health Centre is complete and tenders for construction have been called. Expenditure of $0.137 million was incurred in 2001-02.

The new $2.4 million Lake Haven Community Health Centre was officially opened on 10th October 2001.</td></tr>
<tr><td>An additional eight fully operational intensive care beds at a number of centres in Western Sydney and the Hunter.</td><td colspan="4">Hunter was provided $250,000 for intensive care beds whilst Western Sydney was allocated $853,000 which enabled an additional 148 separations at Westmead and Blacktown.</td></tr>
<tr><td>New funding to provide additional orthopaedic services at Shoalhaven and the restoration of obstetrics services at Shellharbour Hospital.</td><td colspan="4">$429,000 was expended on additional orthopaedic services involving an additional 177 weighted separations. $1.050 million was also expended on the restoration of obstetric services at Shellharbour Hospital.</td></tr>
<tr><td>Major redevelopment occurring in the Tweed Valley region involving an additional 36 beds, including surgical ward and theatre staff, increased community services and establishment of a 25 patient mental health unit at Tweed Heads.</td><td colspan="4">$4.7 million was expended on the Tweed Valley Strategy providing an increase of 1,000 weighted separations and 14,000 Non Admitted Patient Occasions of Service (NAPOOS).

Additionally, $1 million was expended on Mental Health beds in the Tweed which enabled a further 50 weighted separations and 200 NAPOOS.

Redevelopment of Tweed Hospital is due for completion in February 2003.</td></tr>
</table>

<table>
<tr><th>Budget Paper No. 2 Initiative</th><th>Agency Response on 2001-02 Expenditure and Results</th></tr>
<tr><td>Increase in activity in outpatient procedures particularly for chemotherapy, cardiac catheterisation, endoscopy, cancer radiotherapy and imaging services.</td><td>Health services have indicated that increases have occurred. However formal collection of statistical data only commenced 2001-02 resulting in the following feedback on the procedures/services delivered in non-admitted settings:

♦ Chemotherapy 41,749
♦ Endoscopy 2,463
♦ Cancer Radiotherapy 109,562
♦ Imaging 652,039</td></tr>
<tr><td>The provision of community-based acute and post-acute care services throughout Northern Sydney aimed at reducing inpatients length of stay.</td><td>Indicative of the provision of funding for community based acute and post acute care services are the following initiatives:
<table>
<tr><th></th><th>Expenditure $000</th><th>Weighted Separations</th><th>NAPOOS</th></tr>
<tr><td>Community Based Rehabilitation</td><td>2,400</td><td>2,380</td><td>--</td></tr>
<tr><td>Outpatient/ Ambulatory Care</td><td>2,150</td><td>--</td><td>20,800</td></tr>
</table></td></tr>
<tr><td>Expansion of aged care, cardiac, palliative and respiratory rehabilitation and extended care services in the Mid North coast.</td><td>Expenditures at the Mid North Coast Area Health Service include:
<table>
<tr><th></th><th>Expenditure $000</th><th>Weighted Separations</th><th>NAPOOS</th></tr>
<tr><td>Renal Services</td><td>350</td><td>203.2</td><td>--</td></tr>
<tr><td>Cancer Services</td><td>300</td><td>--</td><td>1,000</td></tr>
<tr><td>Chronic Care</td><td>644</td><td>--</td><td>1,200</td></tr>
</table></td></tr>
<tr><td>Improvements in the provision and management of chronic care patients with respiratory disease, cardiovascular and cancer related illnesses throughout the Mid Western area of New South Wales.</td><td>Expenditure at the Mid Western Area Health Service include:
<table>
<tr><th></th><th>Expenditure $000</th><th>NAPOOS</th></tr>
<tr><td>Chronic Care</td><td></td><td></td></tr>
<tr><td>- Respiratory Disease</td><td>128</td><td>120</td></tr>
<tr><td>- Cardiovascular Disease</td><td>128</td><td>80</td></tr>
<tr><td>- Cancer</td><td>144</td><td>50</td></tr>
<tr><td>- Best Practice Implementation</td><td>300</td><td></td></tr>
</table></td></tr>
<tr><td>Funding commenced in January 2001 to Area Health Services to support reform initiatives under the Government Action Plan, and amounting to $45 million for three years, will continue to be used to reduce pressure on local emergency departments, to improve the care of patients with chronic cardiovascular, respiratory or cancer related illnesses and to increase medical and surgical in-patient services.</td><td>In excess of 10,000 people state-wide engaged within 58 programs of Chronic Care improvement. Reported improvements in patient quality of life. Development of the personal health record 'My Health Record'. Development of clinical service frameworks.</td></tr>
<tr><td>Improving Day of Surgery Admission and Day Only surgery rates.</td><td>Management and follow up on strategies to reduce surgical waiting list and long wait patients.

Effective monitoring mechanisms updated and maintained for Day Only and Day of Surgery booked admission targets.</td></tr>
</table>

Budget Paper No. 2 Initiative	**Agency Response on 2001-02 Expenditure and Results**
Development of a coordinated discharge planning policy.	Issued 'Shared Responsibility for Patient Care between Hospitals and the Community – An Effective Discharge Policy' in July 2001. Based on this policy, developed a comprehensive Discharge Planning Framework for implementation in all Area Health Services from 2002/03.
A coordinated planning process for Metropolitan Specialty Services.	Publication of the Selected Specialty and Statewide Service plans for Pancreas Transplantation, Liver Transplantation and Heart-Lung Transplantation.
Development of an Acute Aged Care Interface policy.	Six pilots in metropolitan and rural NSW have been funded to trial transition services at the acute aged care interface. Participation in national aged care planning through the AHMAC Working Group on the Care of Older People including leading a national survey of older people in public hospitals.
Work on a whole-of-government approach to community and non urgent health transport.	Developed, distributed and analysed feedback on Discussion Paper – 'Non-Emergency Health-Related Transport – Facilitating access to health services in NSW' (December 2001). Based on the Discussion Paper, developed 'Transport for Health' initiative for progressive implementation in all Area Health Services in 2002/03; rural implementation funded from $2.5 million pa additional allocation; will involve NSW Health, Department of Ageing, Disability and Home Care, and non-government transport providers.
Expansion of NSW Telehealth services.	Extended the number of telehealth services by a further 48 sites involving 26 new or expanded clinical services bringing the total number of facilities involved in telehealth to 157.
Development of state-wide emergency services plan.	Release of the Emergency Department and Intensive Care (Adult) Service Plans. Development and implementation of a new system of networking emergency departments across Sydney Metropolitan Hospitals.
Creation of an Institute for Health Care Improvement and Excellence.	The Institute of Clinical Excellence (ICE) commenced operations in June 2001 with an annual budget of $2.5 million. ICE is a statutory Health Corporation involved with a range of clinical programs which have the potential to improve the safety and quality of healthcare in New South Wales. South Eastern Sydney Area Health Service provides a range of support services to ICE.
Redevelopment of Gosford Hospital to upgrade the emergency department, operating theatres, cardiac care and acute inpatient facilities at an estimated cost of $100.8 million.	Expenditure of $11.5 million was incurred in 2001-02 against the $100.8 million estimated total cost. Demolition and bulk earth works commenced during the year and the developmental application consent was received for the project.
Redevelopment of Wyong Hospital to provide additional acute inpatient and mental health beds and clinical, imaging and diagnostic facilities at an estimated total cost of $79.6 million.	Expenditure of $1.6 million was incurred in 2001-02 against the $79.6 million estimated total cost. The Development Application has recently been granted by Wyong Council. As at 30 June 2002 tenders had been sought with a close off date of late July 2002.

Budget Paper No. 2 Initiative	Agency Response on 2001-02 Expenditure and Results
Implementation of a $19.4 million pilot project of the NSW Electronic Health Record which will enable information to be shared between hospitals, community health, general practitioners and other clinicians within the context of chronic and complex care.	The specifications and solution design for the Electronic Health Record project have been developed and a review process is under way with all Area Health Services and other stakeholders, including extensive consumer consultation. A prototype for the system has been developed. There will be two lead sites. The first will be the Hunter Area Health Service which will be trialling the system for Chronic Disease Management. The second implementation will be in the South Western Sydney, Western Sydney and Wentworth Area Health Services and the Children's Hospital, which will be undertaking a trial for child health. The implementation will commence in September 2003.
Provision of $7 million for rural information technology infrastructure.	Expenditure of $2.1 million was incurred in 2001-02 against the $7 million estimated total cost. Lan cabling upgrades were implemented at 46 rural health facilities.
A $7 million refurbishment of the Prince of Wales Parkes Block.	In 2001-02 feasibility plans and development plans for the Prince of Wales project were completed and approval given to proceed with the project. $74,000 was expended in 2001-02 against the $7 million estimated total cost.
Provision of $46.6 million for Ambulance Infrastructure works including enhancements to clinical care and information systems, medical equipment and fleet replacement.	Expenditure of $6.5 million was incurred in 2001-02, part of the $46.6 million estimated total cost.
An additional $25.1 million for the Mental Health program to address service priorities including an expanded inpatient and new ambulatory care facility at Liverpool Hospital.	The NSW Health Department is considering the Project Definition Plan for this development. The Project Management, Cost Planner and Design consultants were appointed in August 2002 and the target date for commissioning is 2005.
$4 million to finalise planning and commence work for the Newcastle and Western Sydney strategies.	Expenditure of $2.1 million was incurred in 2001-02 in respect of the Western Sydney Strategy. As at 30 June 2002, a project feasibility plan had been submitted to the Department of Health and resolution of service planning issues was being progressed. In respect of the Newcastle Strategy, expenditure of $6.1 million was incurred in 2001-02. As at 30 June 2002, project development plans for 3 elements of the Newcastle Strategy, i.e. the Access Project, Belmont and the Mater, had been submitted for approval. Construction is in progress for the Belmont Emergency Department

Other Audit Matters

INTRODUCTION

Our audit of the Total State Sector Accounts begins with an understanding of:

- any requirements that Parliament has imposed on executive government
- current events and issues which may impact the government's operations
- how government is structured, its priorities and the manner in which it conducts its affairs.

We also assess the Government's control structure by addressing each of the three elements in its overall control structure, its information systems and its controls procedures.

Each of the following audits and reviews published since 1 July 2001 assess one or more of the areas above. For convenience, we list each audit under its primary category although, each may have some relevance to more than one category.

REVIEWS RELEVANT TO SPECIFIC PARLIAMENTARY REQUIREMENTS

Compliance Review of Fully Depreciated Assets (tabled 13 December 2001)

Our audit examined how agencies were dealing with fully depreciated assets in terms of Australian Accounting Standards and Treasury Circulars and guidelines.

Key Finding

Many NSW agencies have fully depreciated assets that they still use. This occurs because agencies are not reviewing depreciation rates annually to assess whether estimated lives of assets are still appropriate. By doing this they are not observing appropriate accounting standards.

Impact

The impact at the General Government and Total State Sector levels is not material.

Recommendations

- Agencies should observe depreciation accounting standards and review depreciation rates annually.

- Agency accounting manuals should include annual depreciation procedures, particularly the need to review rates.

- Agencies should review their asset registers and delete fully depreciated assets they no longer use.

Background

The *General Government Debt Elimination Act 1995* established the principles of maintaining or increasing General Government Sector net worth in real terms, and constraining growth in the net cost of services and outlays. If agencies are still using assets that they have recorded in their books at nil value, then both net worth and the net cost of services will be understated.

Maintenance of Infrastructure Assets (tabled 28 May 2002)

Our audit looked at the Government's approach to asset planning based on its Total Asset Management policy and its requirement that agencies develop asset maintenance plans. The review examined six key government agencies – four public trading enterprises and two from general government.

Key Findings

Agencies substantially complied with best practice guidelines when developing maintenance plans. However the effectiveness of these plans is lessened by:

- significant maintenance backlogs
- insufficient information on the condition of infrastructure assets
- the absence of reliable and integrated asset management information systems.

Impact

Nothing in the review suggested that the values attributed to infrastructure assets in the Total State Sector Accounts, or at the general government level, may have been incorrect because of inadequate maintenance.

Recommendations

That the Government and agencies:

- give priority to resolving maintenance backlogs. Better information on the backlogs should be obtained; appropriate funding be assigned and monitored

- address the shortcomings we have identified, such as inappropriate asset management information systems or poor data.

That the Government:

- ensure agencies continue to follow best practice guidelines

- consider inherent risks in the funding of maintenance based on asset values, and the time lag of maintenance expenditure. These risks should be closely managed so they do not have an unfavorable affect on the maintenance of infrastructure assets.

Background

Fiscal Principle No 4 under the *General Government Debt Elimination Act 1995* specifies that long-lived physical assets of general government sector agencies should be properly maintained. Apart from that, asset maintenance practices have a direct impact on shortening or extending the useful life of assets and affect their accounting value and depreciation costs.

Compliance Review of the Timing Requirements of the Annual Reports Legislation (tabled 28 May 2002)

We reviewed 25 agencies, including 10 statutory authorities, eight departments, four statutory State-owned corporations and three universities.

Key Findings

Despite similar findings in a previous review:

- some agency CEOs did not provide their annual report to the Minister and a copy to the Treasurer on time

- the CEOs who missed their submission deadline had not applied for an extension of time from the Treasurer

- some Ministers did not table their agencies' annual reports in the timeframe required by the legislation.

Impact

Parliament is not receiving timely information about agency performance.

Recommendations

- Treasury should again inform Ministers and agency CEOs that complying with legislative reporting deadlines is vital to accountability.

- Because electronic distribution of annual reports is becoming more widespread, Parliament should review the legislation that requires agencies to disclose the cost per copy of the annual report. The total cost of producing the report may be more appropriate. To ensure consistency across agencies, Treasury should determine the components of costs to be included.

Background

Parliament has determined that, as part of the accountability process, government agencies should give their annual report to their Minister and the Treasurer within four months of the end of the financial year. The Minister must table the report in both Houses of Parliament within one month.

REVIEWS RELATING TO GOVERNMENT PRIORITIES

Collapse of HIH Insurance (tabled 4 September 2001)

Responding to the collapse of HIH Insurance was a government priority in 2001-02. Our review considered the financial impacts on State Government finances and the role of the State's regulators.

Key Findings

The collapse of HIH Insurance (HIH) in early 2001 will significantly affect NSW Government finances:

- The 2001-02 NSW Budget includes an estimated $600 million liability for a Government support package for NSW residents who have HIH Compulsory Third Party (CTP) and home-owner warranty insurance claims

- NSW public sector agencies have $30.5 million of outstanding and potential claims with HIH Insurance

- a $28 million liability (relating to the *Workers Compensation Act 1926)* will now be recognised in the WorkCover Authority from the failure of HIH

- some investment losses will be incurred by State agencies holding HIH shares.

Impact on Total State Sector Accounts

At 30 June 2002 the liability for the support package stood at $467 million.

Recommendations

We recommended that the:

- $600 million (estimated) liability for HIH CTP and home-owner warranty insurance claims should be closely monitored as such claims are usually subject to uncertainty and volatility
- regulatory roles of the Motor Accidents Authority and WorkCover Authority should be reviewed once the causes of the HIH collapse are determined
- current structure of the Treasury Managed Fund should be reviewed to determine whether it is beneficial to include all non-budget dependent agencies under the cover provided.

e-government: Use of the Internet and Related Technologies to Improve Public Sector Performance (tabled 9 September 2001)

NSW was one of the first governments to lay out a program for public sector reform using the Internet. The vision announced in the *Information Management and Technology Blueprint for NSW* and *connect.nsw* was far reaching.

Key Findings

The following key issues need to be urgently addressed:

- more robust mechanisms are needed to monitor, review and report publicly on progress and benefits
- a greater emphasis should be placed on central coordination to ensure that agencies act in a more uniform and integrated manner
- the achievement of significant reform of business processes will require a substantial strengthening of accountability mechanisms and more comprehensive, rigorous and systematic approaches to e-government project and risk management
- despite an array of guidance material and support provided by central agencies, line agency needs for assistance do not seem to be being met to sufficiently advance matters across the sector at the pace and scope desired
- the Government's e-government aspirations and funding are not always effectively harmonised. Agencies typically have limited resources available to trial or experience new technologies, and display an aversion to the associated risks.

Impact

The report focuses attention on the key challenges and impediments that need to be urgently resolved to allow NSW to move as far and as fast as it hopes to with e-government.

A Guide to Better Practice was produced as a corollary to the audit, to assist agencies to assess the extent of their readiness to implement e-government.

Recommendations

We recommended:

- progressing e-government directions, guidance and accountability
- accessing and deploying people with the necessary knowledge and skills
- harmonising funding levels with the Government's aspirations for e-government
- e-government security
- reconciling privacy considerations with the benefits from increased information sharing
- increasing information and systems sharing across government, and reconciling privacy concerns associated with this
- accelerating the broad uptake of e-procurement.

REVIEWS RELEVANT TO INTERNAL CONTROL STRUCTURE

REVIEWS RELATING TO INTERNAL CONTROL ENVIRONMENT

Compliance Review on the Delegation of Authority (tabled 4 October 2001)

The review examined fourteen agencies from all major areas of the public sector. These agencies included budget dependent agencies, statutory authorities and universities.

Key Findings

The agencies we tested delegated satisfactorily, but in some cases officers performed functions without the required delegation.

Impact

Inappropriate expenditure may occur if staff perform functions without the required delegation.

Recommendations

The report highlights the need for staff to be aware of delegations, and for agencies to document and update them.

Background

Acts of Parliament delegate the provision of Government services, usually to the Ministers of the Crown. For practical application, the Minister delegates these functions to an officer of a Government agency, usually the Chief Executive Officer (CEO). The CEO, in many instances, is given the ability in the particular Act to further delegate these functions to other officers of the agency.

Our review identified when an agency could delegate services under legislation or existing policy. We then assessed whether the agency properly used and documented this power.

Compliance Review of the Operations of Audit Committees (tabled 28 May 2002)

The review examined the operation of audit committees in 14 NSW Government agencies, and surveyed whether audit committees existed in 69 large agencies.

Key Findings

- Audit committees, while operating in the vast majority of NSW Government sector agencies, are not present in some of the larger agencies.

- Audit committees would be improved if:
    - in government departments, at least one member of the committee is an independent person
    - neither the CEO nor the chair of the board is chair of the audit committee
    - they annually assess the performance of the internal audit function
    - in government departments, they oversee the preparation of the agency's annual financial report and assist the CEO during the audit
    - agencies report externally what the committee does, the expertise of its members, and how often they attend meetings
    - their performance is periodically reviewed.

Impact

Without effective audit committees agencies will not fulfil their corporate governance responsibilities.

Recommendations

- All large NSW Government agencies should have audit committees.
- Audit committees, particularly those operating in government departments, should review and improve their activities to match best practice.

Risk Management: Managing Risk in the NSW Public Sector (tabled 19 June 2002)

Key Findings

While agencies are aware of the need to manage risk, their risk management falls short of better practice.

Many agencies do not consider their risk management to be adequate. Also a number of agencies may not be adequately managing risk, especially in the General Government Sector.

Some agencies, mainly those in the Public Trading Enterprise Sector, have approached risk management in a systematic way and achieve better practice standards.

Others, mainly departments not subject to commercial imperatives, do not adequately manage risk beyond insuring against the more common types of risk.

Impact

Without proper risk management an organisation is less likely to achieve its objectives in an efficient and effective way.

Recommendations

The Audit Office recommends that:

- agencies broaden their view of risk beyond an insurance focus
- agencies recognise that risk aversion can diminish opportunities to improve efficiency and effectiveness

- Treasury oversee risk management practices and encourage better practice where necessary
- there is clearly a role for greater consistency in the way risk management is considered and applied.

Our recommendations also were designed to:

- improve government agencies risk management practice
- better public reporting by agencies on risks faced and their management.

Background

The *General Government Debt Elimination Act 1995* requires that agencies in the General Government Sector have a risk management plan that includes strategies to deal with risks. The Act does not apply to the Public Trading Enterprise Sector.

The Australian/New Zealand Standard on risk management requires that both public and private organisations measure risk in terms of the likelihood of something happening and the consequences of it happening.

REVIEWS RELATING TO INFORMATION SYSTEMS

Compliance Review on Production of Year-end Financial Reporting (tabled 13 December 2001)

Accurate and timely financial reports are important for both accountability and management purposes.

Key Finding

New financial reporting requirements have placed increasing demands on finance officers in the NSW public sector. Although most finance officers meet their professional obligations due to agencies providing adequate training resources, some organisations are not satisfying the new requirements.

Impact

Parliament may not be receiving accurate and timely reports from agencies.

Recommendations

NSW agencies should review:

- their financial reporting to ensure that they meet all current requirements
- the competence and performance of their finance officers
- the adequacy of the level of professional development provided for their finance officers.

Department of Information Technology and Management – Government Property Register (tabled 31 January 2001)

This audit reviewed the extent to which the Government Property Register provides access to accurate, up-to-date and relevant information.

Key Findings

Despite the issue being on the agenda for many years (formally, at least since 1988), at present there is no comprehensive record of all government property assets in NSW.

Current initiatives are promising and they will require continued priority to achieve tangible results. Careful coordination will be required to avoid duplication and waste.

Impact

The State continues to be unable to manage its property assets effectively at a macro level.

Recommendations

Our recommendations sought to raise the priority being given to resolving this longstanding issue, and to ensure that accountability was clearly defined.

Background

The NSW Government holds property worth about $40 billion, which costs about $4 billion each year to hold. Good property management requires access to good information. The Curran Commission (1988) and the Council on the Cost of Government (1997) gave high priority to improving property information.

REVIEWS RELATING TO CONTROL PROCESSES

Compliance Review of Credit Card Use (tabled 4 September 2001)

Key Findings

Agencies have improved many operational aspects of credit cards, but some are not complying with key responsibilities introduced in 1999.

Operational areas where agencies fell short of best practice included obtaining approvals prior to expenditure; ensuring business use of credit cards; and retaining supporting documentation.

Since 1999, the CEOs of Budget dependent agencies must attest to the Minister, as part of their performance review, that credit card use accords with government policy. These agencies must include this statement in their annual report. In addition, officers issued with credit cards must sign a statement of responsibilities. The majority of agencies tested are not meeting these requirements.

Impact

Credit card use may not comply with government policy.

Recommendations

Treasury should review whether agencies should still include their CEO's certification in the annual report.

If it is decided to retain this requirement:

- Treasury should update the annual reports legislation, and the checklist on its website, to include the credit card certification required by Treasury Circular 99-6

- CEOs of agencies independent of government should include a statement on credit card use in their annual report.

Treasury should reinforce with those agencies required to follow the Treasurer's Directions, the responsibilities imposed on the CEO and individual card holders.

Agencies must enforce with staff the need to:

- obtain approval prior to spending
- only use credit cards for business purposes
- retain supporting documentation for all purchases.

Background

Corporate credit cards were introduced in the NSW public sector in 1987 to pay for official travel. This was later extended to general goods and services, and to hospitality. It was seen as an efficient procurement method for large volume, low value, low risk purchases.

A 1997 Audit Office performance audit report on 'The Corporate Credit Card', and a 1998 compliance review, found that:

- some credit card spending by NSW agencies was questionable
- some purchases were made without documented prior approval
- some agencies did not maintain a register of credit cards
- individual credit limits were not based on expected use.

Compliance Review on the Issuing of Fines and Penalties (tabled 4 September 2001)

Key Findings

State Electoral Office

- high level of non-voters deemed not liable to a fine, penalty or prosecution

- although not formally delegated to do so, for practical reasons the staff of the Electoral Office, in accordance with guidelines provided by the Electoral Commissioner, assesses reasons tendered by non-voters. In the absence of a proper delegation by the Electoral Commissioner, there were doubts as to the legality of staff deciding whether non-voters' excuses are reasonable.

General Issues

Some agencies sampled in the audit had:

- issued warning notices or withdrawn penalty notices without the legislative power
- accepted the payment of fines after commencing court action
- not been informed of the outcome of recovery action by the collecting agencies
- not accounted for fines revenue on an accrual basis.

Impact

Agencies are acting outside the legislation and may not be complying with Parliament's wishes.

Recommendations

The Electoral Commissioner should, with the consent of the Governor, exercise his power to delegate the responsibility to assess the validity of reasons tendered by non-voters to appropriate officers of the Public Service.

The Government and the Parliament should consider whether:

- the Electoral Commissioner is appropriately applying the discretionary power to accept reasonable excuses from those who do not vote

- non-voters should be required to provide corroborative evidence to support their excuse for failing to vote

- the current process of accepting excuses without providing corroborative evidence, is equitable to those non-voters who pay the fine without offering an excuse.

Agencies undertaking practices such as issuing warnings and/or withdrawing penalty notices, where these actions are not provided for by their legislation, should take the necessary steps to have the legislation amended.

The IPB and the SDRO should consult with the users of their services in order to ascertain the nature and frequency of reports each requires. For most agencies, this will include information required for year-end financial reporting purposes.

Background

Many government agencies administer legislation which requires individuals, companies or other sections of the community to follow particular requirements of the law. Agencies may act against offenders who do not comply with the law by issuing a warning, an order to mitigate damage or by suspending a licence.

They may also prosecute via a court summons or an on the spot fine often referred to as an infringement notice. An offender who is issued an on the spot fine may elect to have the matter decided by a court.

Fines resulting from the court process become the responsibility of the Attorney General's Department and ultimately the State Debt Recovery Office (SDRO). On the spot fines mainly require payment directly to the Infringement Processing Bureau (IPB). If unpaid within the stipulated time period (72 days after infringement for IPB cases), the IPB uses the SDRO to follow up outstanding fines. Continued non-payment can result in the loss of the offender's driving licence, even for a fine unrelated to the motor traffic legislation.

The responsibility for ensuring that non-monetary penalties are enforced lies with the individual agency charged with administering the particular piece of legislation.

Intellectual Property: Management of Intellectual Property (tabled 17 October 2001)

Key Findings

Good public sector management of IP relies on an adequate and coordinated framework to guide agencies in developing their own policies. The current framework for IP is incomplete because it does not help agencies to:

- develop policy
- identify the IP assets that need to be managed
- integrate management of IP with agency objectives
- access expert help when they need it
- encourage staff to be innovative and so create and promote the uptake of IP
- monitor and defend IP against unauthorised use.

It is also important to improve coordination between agencies responsible for developing whole-of-government policy in regard to IP.

Impact

The lack of an integrated framework and co-ordinated support for agencies means that the management of IP has varied across the public sector and in general is not adequate.

Recommendation

A whole of government response to the management of IP should be built on existing initiatives to better coordinate IP across the public sector.

Background

Intellectual Property refers to legal rights that protect both creative effort and economic investment in creative effort.

In the public sector, Intellectual Property exists in most works containing information and in many innovations and technologies.

Compliance Review of NSW Government Superannuation Schemes (tabled 13 December 2001)

Key Finding

We found that the Superannuation Administration Corporation (SAC) complied with its processing and reporting requirements.

Recommendations

The Trustee and SAC should continue to educate New South Wales Government agencies about their superannuation obligations.

More agencies should provide information to SAC electronically.

Background

This was the second part of a review of this topic. The first part assessed how individual government agencies maintained relevant records, provided information to the SAC and forwarded contributions to SAC. The findings were included in Volume Two of the Auditor-General's 2001 Report to Parliament.

The second part of the review looked at the way SAC processed this information.

Compliance Review on Long Service Leave Entitlements (tabled 13 December 2001)

We assessed whether 127 agencies complied with their long service leave obligations.

Key Findings

New South Wales Government agencies substantially complied with long service leave legislation and other mandatory requirements.

Some agencies had problems with:

- the computer systems they use to administer long service leave
- obtaining prior service documentation for staff transferring from other public sector agencies.

A number of issues affected the accuracy of staff entitlements and termination payments. The most common one related to a lack of understanding by agencies' staff on how to calculate leave entitlements for staff working non-standard hours.

Recommendations

Computer Systems

Agencies experiencing computer system software problems should consult with the supplier, as remedies are available in some cases.

Prior Service

Agencies should meet their obligation to forward details of service history when employees transfer between agencies. Premier's Department should also consider an alternative of requiring transferring employees to bring service details with them.

Training

Agencies, particularly small and medium sized, should ensure staff responsible for leave administration understand entitlements for some of the less common work practices, such as part-time work, non-standard hours and leave on half-pay.

Universities

Universities should consider standardising how they recognise prior service at other universities and agencies.

Compliance Review on Motor Vehicle Operations and the Usage of Fuel Cards (tabled 13 December 2001)

The review examined whether NSW Government agencies complied with all aspects of motor vehicle policy. We assessed 20 agencies from all major areas of the NSW public sector, including 12 budget dependent agencies and two agencies from each of the categories of statutory authorities, universities, statutory health corporations and statutory State-owned corporations.

Key Findings in Relation to Motor Vehicle Policies

The large number of issues raised in this review is a clear indication that many aspect of motor vehicle policies are being widely disregarded. In part this reflects policies not being kept up-to-date. It may have also been due to agencies not being able to access all policies in one centrally located document.

Of particular concern are some of the practices that are in place for the operation of private/business arrangements.

Our major findings were:

- many agencies are not reviewing the size of their motor vehicle fleets on a regular, business case basis
- vehicles are apparently being acquired specifically to enable eligible officers to use them on a private/business basis, but with no assessment of whether a business need component exists
- the amount charged to eligible officers for private use is often based on doubtful or out of date data, favouring the officers concerned
- officers with private/business vehicles appear to be reluctant to make these vehicles available to other staff during working hours for legitimate business purposes
- a small number of agencies are making vehicles available to staff on a private business arrangement at charges substantially below charges determined by Premier's Department (and substantially below the true cost).

The degree and extent of non-observance means that the Premier's Department and agencies with motor vehicle fleets need to address the issues raised in this report as a matter of urgency.

Key Findings in Relation to Fuel Card Usage

- Treasury needs to update the Treasurer's Directions for fuel cards
- Treasurer's Directions and government contract requirements are not being observed by some agencies.

Recommendations

Vehicle Operations

For private/business arrangements, the split of costs should be determined annually based on the actual levels of private and business usage across the entire year.

Premier's Department should ensure that clear direction is given in its 'Motor Vehicle Policy and Guidelines for NSW Government Agencies' to cover deficiencies highlighted in this report.

When traffic and parking infringement notices are received, agencies should immediately identify the driver and forward the name to the Infringement Processing Bureau so that the notice can be re-issued. The original notice should not be given directly to the officer for payment.

Central agencies should consider the benefits of introducing a 'condition of use' that rewards or penalises officers on the condition of the vehicle when presented for disposal.

Fuel Card Usage

Treasury should review all relevant Treasurer's Directions as a matter of urgency.

Agencies that have outsourced fleet management operations need to put practices in place to make all necessary records available to the manager. This will enable checks required by the Directions to be carried out by the manager.

Agencies should make better use of the management reports available on the overall fleet and on individual vehicle usage.

Background

Most agencies have fleets of motor vehicles that they either lease or own outright. Some vehicles are maintained in a pool environment and are available to staff for short-term official duties. Others are part of salary packaging arrangement where officers have either 100 per cent private usage of the vehicle or where the vehicle is used in a private/business arrangement. The arrangement involves a sharing of costs of the vehicle between the agency and the staff member.

State Debt Recovery Office: Collecting Outstanding Fines and Penalties (tabled 17 April 2002)

This audit examined State Debt Recovery Office's efficiency and effectiveness in recovering outstanding fines.

Key Findings

SDRO deals well with very high volumes and collects substantial sums of money. However, there are a number of factors which limit the effectiveness of the fine enforcement process and affect SDRO's capacity to recover debt.

SDRO has conflicting roles as both a law enforcer and debt collector. As a law enforcement agency, it treats all matters the same. But as a debt collector, other approaches could be pursued which would recover more outstanding dollars.

SDRO successfully collects about one in every three of unpaid fines referred to it. As at June 2001, over $460 million remained to be recovered, with SDRO treating $334 million of this as unlikely to be collected.

Many of the factors which inhibit SDRO's ability to collect unpaid fines are beyond its control and require legislative change or a coordinated inter-agency response. Until these problems are fixed, the credibility of the fine enforcement process, and people's willingness to pay outstanding fines, will continue to be undermined.

Impact

A greater focus on debt collection instead of law enforcement would recover more outstanding dollars.

Recommendation

Recommendations were framed to accelerate the pace of reforms and to resolve inter-agency inefficiencies and legislative impediments.

Background

The SDRO is responsible for collecting outstanding fines and debts owed to the NSW Government, local councils and some Federal Government agencies.

SDRO operates in a high volume processing environment. In 2000-01, SDRO:

- commenced enforcement action against almost 3000 matters a day
- collected $90 million, at a cost of around $12 million.

Audit Approach

Auditing Standards

Australian Auditing Standards require that an auditor plan the audit work so that the audit will be performed in an effective manner. Matters to be considered in developing the audit plan include knowledge of the entity to be audited and understanding the internal control structure.

Top-Down Approach to Planning

The Audit Office approach is top down, examining matters and planning at the government-wide level before proceeding to detailed planning at the individual audit level. It begins by focussing on the Government's operations overall, how it is organised, how its important programs function and how the main transactions are directed, controlled and recorded. This understanding at the government-wide level provides the basis for an initial assessment of likely risk areas for financial misstatement, non-compliance with statutory requirements and performance audit issues. This enables the Office to focus quickly on those aspects of government operations that are significant to the audit.

Understanding Current Government Operations

The audit planning process begins with an understanding of current government operations in order to assess audit risks and other factors which may impact all or most of the audited organisations. We need to understand:

- any particular requirements which Parliament has imposed upon Executive Government
- current events and issues which may impact the Government's operations
- how Government is structured, its priorities and the manner in which it conducts its affairs.

This understanding of the Government's operations and of the effects of significant changes, trends and current events is essential in order to effectively assess inherent risks from an audit perspective.

The Government Control Structure

We also need to understand and assess effectiveness of the Government control structure established to ensure that:

- the Government's resources are managed effectively, efficiently and economically
- irregularities are prevented as far as is possible, and detected should they occur
- government assets are safeguarded from unauthorised use or disposition
- financial records and other relevant databases completely and accurately reflect the entire activities of government and permit the timely preparation of individual and consolidated State financial information.

This is accomplished by addressing each of the three elements of that control structure, namely the overall internal control environment, the information system and the controls procedures, as follows:

- *internal control environment* – encompasses the attitudes, abilities, perceptions and actions of those responsible for developing the policies and procedures which govern the operations of government organisations; the operating style and management philosophy within government and approach to such issues as risk management and the performance of structures and mechanisms used to control and monitor financial systems and reporting. The government control environment has a pervasive effect on all or most organisations in that it influences the attitudes of those organisations.

- *information system* – the systems, including information technology (IT) systems and the procedures and documents established to record and report all government transactions and to maintain accountability for assets, liabilities, revenues and expenditures (including those of government departments, statutory authorities and corporations, and other government agencies).

- *control procedures* - the specific policies and procedures established at the central government level for ensuring that business and accounting processes are in place and operating; processes such as reconciliation and approval checks over significant business and accounting processes covering appropriations, levies, taxes and other revenues, payment processing, payroll and significant assets and liabilities.

Statement of the Budget Result

AUDIT OPINION

The audit of the Statement of Budget Result for the year ended 30 June 2002 resulted in the issue of an unqualified Independent Audit Report.

FINANCIAL INFORMATION

Year ended 30 June	Actual 2002 $m	Budget 2002 $m	Actual 2001 $m
Taxation	**13,214**	12,090	13,333
Commonwealth grants	**15,033**	14,465	12,970
Other State revenues	**2,029**	2,008	2,124
Total State Revenues	**30,276**	28,563	28,427
Sale of goods and services	**2,374**	2,289	2,359
Other	**1,086**	966	1,270
Total Operating Revenue	**3,460**	3,255	3,629
Employee related	**14,718**	14,384	13,966
Other operating	**9,879**	9,143	8,884
Recurrent grants and subsidies	**4,920**	4,815	4,965
Capital grants and subsidies	**1,854**	1,399	1,547
Finance other	**860**	877	992
Total Expenses	**32,231**	30,618	30,354
GFS Net Operating Surplus	**1,505**	1,200	1,702
Less capital acquisitions	**(2,716)**	(2,596)	(2,536)
Plus depreciation	**1,538**	1,493	1,332
Plus asset sales and other	**168**	271	214
Budget Surplus	**495**	368	712

The surplus of $495 million in 2001-02, was $127 million higher than the Budget estimate. This was due to substantially higher than expected State taxation, Commonwealth grants and operating revenues, largely offset by higher than budgeted expenses and lower than budgeted asset sales.

EXPLANATION OF STATEMENT

The Statement of Budget Result is prepared using Government Finance Statistics data classification principles. GFS is a set of statistical standards for the presentation of public sector expenses, revenues and financing transactions on an accrual basis. It is based on standards developed by the International Monetary Fund and is similar in most (but not all) respects to the system advocated by the United Nations. In Australia, the GFS is used by the Australian Bureau of Statistics in its classification of public sector finances.

The GFS Net Operating Result shown in the Statement differs from the operating result shown in the accounting-based Statement of Financial Performance (discussed in the Overview of Financial Aggregates section of this Volume). The GFS result excludes valuation changes, such as non cash actuarial adjustments for superannuation, gains/losses from foreign exchange contracts and asset revaluations.

Excluding these differences, revenues and expenses are similar to those shown in the Overview of Financial Aggregates section. The commentary in that section would largely apply to the GFS based figures above.

THE AUDIT OFFICE OF NEW SOUTH WALES

THE AUDIT OFFICE MISSION

Assisting Parliament Improve the Accountability and Performance of the State

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