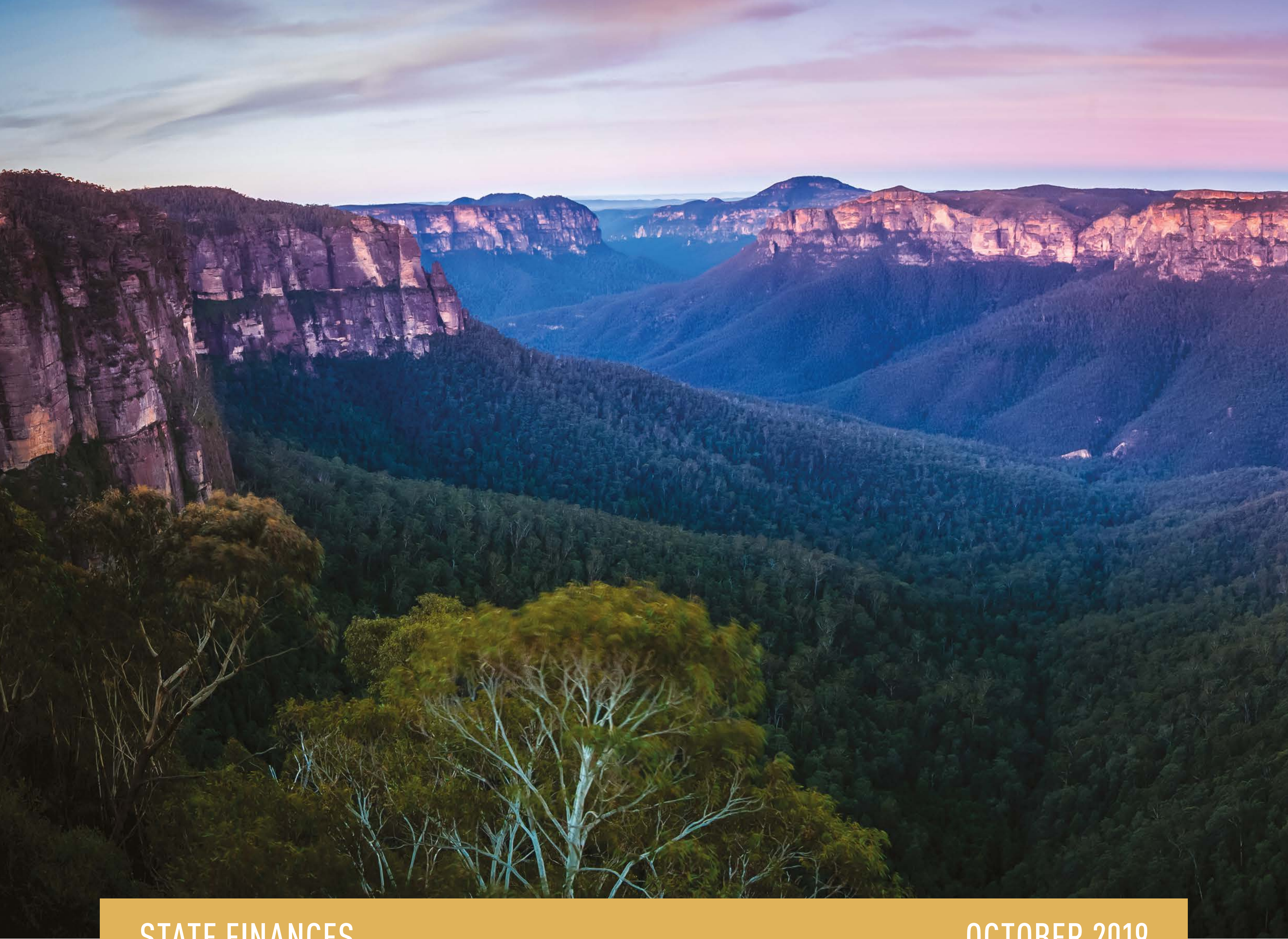


STATE FINANCES

OCTOBER 2019

Report on State Finances 2019

NEW SOUTH WALES AUDITOR-GENERAL'S REPORT

audit office OF NEW SOUTH WALES

Contents

Auditor-General's Introduction

Pursuant to the Public Finance and Audit Act 1983, I present my Report on State Finances 2019.

Strong financial management and transparent reporting are key elements of our system of government.

I am pleased to once again report that I issued an unmodified audit opinion on the State's consolidated financial statements.

The number of errors in agencies' 2018-19 financial statements fell to six compared to the 23 recorded in 2017-18. This reflects Treasury's focus on early close and the resolution of complex accounting matters before submission. Agency finance teams need to be consulted on major business decisions and commercial transactions to assess their accounting impacts at the time of their execution, rather than at the end of a financial year. This would improve the quality of financial reporting and avoid the need for extensions for agencies to submit their financial statements for audit.

To further increase transparency, a Key Audit Matters section was included in my Independent Auditor Report on the Total State Sector Accounts this year. This explains those matters considered most significant to the conduct of the audit and requiring significant management judgement.

Looking forward, certain factors have the potential to impact the accuracy and completeness of the Total State Sector Accounts in coming years. First, three new accounting standards are effective from 1 July 2019 and a fourth from 1 July 2020. Transitioning to new standards requires significant planning and resources to ensure the impacts are appropriately assessed and accounted for. Second, the Government Sector Finance Act 2018 will be implemented in stages over three years to 2020-21. This Act is intended to focus on performance, transparency, accountability, and efficiency of financial management in the government sector. I encourage agencies to build their awareness of this important reform and ensure their alignment with the principles of the Act.

I want to thank Treasury staff for the way they engaged with my staff in the conduct of the audit. Our partnership is critical to ensuring the quality of financial management and reporting.

Margaret Crawford
Auditor-General, 10 October 2019

Audit Result

Our audit opinion on the State's 2018-19 financial statements was unmodified. There were fewer reported errors but earlier resolution of accounting matters is still required.

Our audit opinion on the State's 2018-19 financial statements was unmodified.

This year, six errors exceeding $20 million were found in agencies' 2018-19 financial statements that make up the State's consolidated financial statements. The total value of these errors was $927 million compared to $3.8 billion in 2017-18. The errors identified in 2018-19 resulted from:

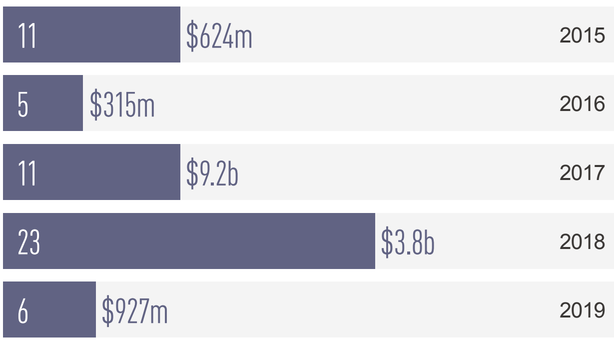
- incorrectly applying Australian Accounting Standards and Treasury Policies
- using inappropriate assumptions and inaccurate data
- incorrectly assessing the fair value of non-current physical assets.

The introduction of mandatory 'early close procedures' in 2011-12, saw the number of errors in agencies' financial statements fall progressively, to a low of five in 2015-16.

In 2016-17, Treasury narrowed the scope of its mandatory early close procedures to focus on non-current physical asset valuations and pro-forma financial statements. Following this, the number of significant errors increased to 23 in 2017-18, the highest number in six years and similar to the numbers identified before mandatory early close procedures were introduced.

In 2018-19, Treasury and agencies' refocussed their efforts around early close procedures and other year-end processes resulting in this year's lower error total of six.

Errors in agency financial statements exceeding $20m (2015-2019)



Exemptions from complying with Treasury's reporting timetable.

Whilst ensuring the quality of financial reporting is important, agencies should resolve issues earlier to avoid delaying and potentially compromising Treasury's reporting timetable.

Seven agencies received extensions of time to submit completed financial statements for audit. The seven agencies were:

- Crown Entity
- Department of Justice
- NSW Self Insurance Corporation
- Roads Retained Interest Pty Ltd
- Sydney Metro
- Sydney Olympic Park Authority
- Transport for NSW

The values of the combined financial statements of the seven entities granted extensions were far more significant to the State's consolidated financial statements than those granted extensions last year. The extensions were provided to facilitate resolution of complex accounting matters.

Extensions of time can be avoided if finance teams are engaged earlier to assess the accounting impacts of business decisions and commercial transactions.
This will help ensure:

- appropriate and sufficient data is gathered
- high quality position papers are prepared
- the accounting impacts are fully considered
- issues are resolved in a timely manner
- the accounting treatments comply with accounting standard requirements
- Treasury, Audit & Risk Committees and the Audit Office are consulted on a timely basis.

Key Audit Findings

Correction of prior year's reported values.

Correction of earthwork assets ($2.1 billion)

Some of the State's earthworks were first valued in 2016-17. These included earth excavations and embankments for the Country Rail and Metropolitan Network created before the year 2000 and dating back to the early 1900s.

For many years, the State did not account for earthworks because it believed the value could not be reliably measured. In 2016-17, the State engaged an external valuer who identified a methodology showing the earthworks could be valued. That valuer performed a valuation using topography maps for the Country Rail Network (CRN) because information in this earthworks database was of poor quality and incomplete. The valuation resulted in the State recognising $7.5 billion of earthworks for the first time in 2016-17. This was disclosed as a prior period error.

Over the following years, the State improved the quality of the CRN earthworks database by engaging an engineering firm to perform more detailed earthworks surveys. The work involved the use of technology to survey most of the CRN lines.

In 2018-19, the State once again engaged an external valuer to assess the fair value of the CRN earthworks. The valuer determined that incorrect assumptions were used in the 2016-17 valuation. These primarily related to land elevations, which were corrected in the earthworks database and this resulted in a new fair value of $5.4 billion, $2.1 billion less than the previous valuation. The error reported in the 2017-18 value has been corrected in the 2018–2019 financial statements to reflect the revised value.

Previously reported value for earthworks reduced from $7.5 billion to $5.4 billion.

Correction of museum collection assets ($27 million)

The Australian Museum's collection assets were restated by $27 million to $800 million in 2017-18.

After the 2017-18 financial statements were published, the Australian Museum identified additional collection assets that were not included in the original valuation. This resulted in a $27 million error relating to collection asset values. As last year's valuation was based on an incomplete listing of collection assets, the 2017-18 value has been corrected in the 2018–19 financial statements to reflect the revised value.

Correction of lease liability ($46.2 million)

On 1 July 1995, the Department of Justice entered into a 25-year lease arrangement with an option to extend for a further 15 years.

The Department accounted for the arrangement as a finance lease by recognising a building asset and a corresponding finance lease liability for the period of 25 years. The Department depreciated the leased asset based on a useful life of 40 years.

As it was reasonably certain the Department would exercise the lease option at inception, it should have recognised a liability that reflected the entire 40 year lease period. To correct the prior year error and properly reflect the extended lease period, the Department of Justice increased the lease liability and decreased retained earnings by $46.2 million as at 1 July 2017.

Abuse Claims remain a significant contingent liability of the State

The State discloses a contingent liability in its financial statements when the possibility of settling the liability in the future is considered less than probable, but more likely than remote, or the amount of the obligation cannot be measured with sufficient reliability.

If the expected settlement subsequently becomes probable and reliably estimable, a provision is recognised.

The State has numerous contingent liabilities. Some are quantifiable while others are not. As contingent liabilities are potentially material future liabilities of the State, every effort should be made to quantify these as accurately as possible. They also need to be monitored closely to ensure that they are recognised and brought on balance sheet as they crystallise.

At 30 June 2019, NSW Self Insurance Corporation (SiCorp) could not reliably measure the claims liability arising from past incidences of abuse that occurred within NSW Government institutions which have not yet been reported. These are referred to as incurred but not reported claims (IBNR).

Since 1 July 2018, victims of child sexual abuse can opt to claim compensation through the National Redress Scheme, or to lodge a civil claim. Civil claims for incidents that occurred within NSW Government institutions may be covered by SiCorp. An estimate of an IBNR for child abuse claims within SiCorp will be impacted by the extent that victims claim compensation through redress as compared to civil claims.

Recent legislative changes have added further uncertainty to estimating the extent of IBNR claims. SiCorp requires more reliable data on the number of IBNR child abuse claims and the expected average size of the related payments. As such, the liabilities presented in the SiCorp and the State financial statements do not include an allowance for IBNR abuse claims.

As more information becomes available it may be possible for SiCorp to reasonably estimate the value of abuse claim liabilities. It is possible that such an estimate may be material to SiCorp and the State's financial statements.

TAFE update

In prior year's we reported on information system limitations at TAFE NSW, specifically relating to its student administration system. TAFE NSW continues to implement additional processes to verify the accuracy and completeness of revenue from student fees for the 2018-19 financial year.

In 2017-18 TAFE NSW started implementing a new student management system. Significant delays have occurred in implementing this system, mainly due to the complexity of integrating the vendor solution with the requirements of TAFE. TAFE will now bring the final commissioning and operation of the system in house. Final project delivery timeframes and estimated completion costs are being reviewed. Costs incurred to date amount to $67 million. The original budget for this new system is $89.4 million.

Light Rail settlement

The CBD and South East Light Rail is a new twelve kilometre light rail network for Sydney, currently under construction. Passenger trips are set to begin on the light rail by December between Circular Quay and Randwick. The second stage from Randwick to Kingsford is planned to open in March 2020. The original budget for construction work of $1.6 billion was revised to $2.1 billion in 2014.

The State Government has been in dispute with the firm responsible for delivering and operating the CBD and South East light rail project. In May 2019, the parties reached a Settlement Arrangement resulting in the State agreeing to pay a settlement amount of $576 million, which is in addition to the revised budget.

Transport has advised a final cost is still to be determined following project completion.

The Audit Office has commenced a follow up audit on the CBD South East Light Rail. This audit will consider whether recommendations of our previous audit have been implemented. We will also review the current status and budget of this project.

Sydney Metro Northwest project commissioning

The Sydney Metro North West officially opened in May 2019.

In constructing the metro, some assets were built to facilitate its operation. These included pavements, roadworks, and electricity and water connections.

When the project was completed, the assets and the responsibility for maintaining them transferred to third parties, primarily Councils and utility providers. In 2018-19, the State expensed (derecognised) the assets, valued at $306 million, because it no longer controlled them.

Financial Reporting by Crown Land Reserve Trusts

Approximately 700 reserve trusts, managed by Trust Boards, did not prepare the financial statements at 30 June 2019 as required by the Public Finance and Audit Act 1983.

These Crown reserves contain showgrounds, cemeteries, racecourses, local parks, and other community facilities and public areas. Some of the Crown reserves have independent streams of revenue from user charges.

In 2016-17, Treasury determined that NSW cemetery trusts and a holiday park reserve trust were controlled entities of the State. As such, the Public Finance and Audit Act 1983 requires them to prepare financial statements and have these audited by the Auditor-General.

In 2017–18, three reserve trusts accepted NSW Treasury's view, prepared financial statements and had them audited by the Auditor-General.

However, three cemetery reserve trusts continue to maintain they are not controlled by the State and therefore their financial statements are not audited by the Audit Office. These cemeteries shared their unaudited financial statements with Treasury so they could be incorporated into the State's financial statements. At 30 June 2019, the value of their combined assets and liabilities, which are not audited by the Audit Office, was $564 million.

The State included an additional $319 million in assets that relate to Crown land values of approximately 700 reserve trusts that did not prepare or submit financial statements.

We performed additional audit procedures to obtain some assurance over the value of these crown lands. The nature and extent of the limitations to the scope of these procedures was not significant enough to impact our audit opinion. Treasury should ensure these trusts comply with the requirements of the Public Finance and Audit Act.

Derecognition of investment in City West Housing

In 2017-18, the State had an equity investment of $680 million in a community housing provider, City West Housing Pty Limited (CWH).

During 2018-19, CWH amended its constitution to ensure alignment with its charitable status. The unintended impact of this change was that on windup the net assets would not be distributed to the State. The accounting implications to the State's investment was not considered by Treasury at the time of approving the amended constitution. Consequently, the State wrote off its $680 million investment in CWH in 2018-19.

It is important that accounting impacts of such changes are discussed and agreed upon early. At the time of approving the decision to change the constitution, all accounting implications should be made available and understood. Such information is relevant when approving decisions. The theme of what is relevant information will be explored further in our Performance Audit of 'Advice on Major Decisions'.

Machinery of Government changes

Machinery of government (MoG) changes refers to how the government reorganises agency structures and functions and realigns ministerial responsibilities.

Cluster changes

On 2 April 2019, the Government reorganised public sector agencies into eight clusters (ten in 2017-18) with effect from 1 July 2019.

Prior to 30 June 2019, two subsequent administrative arrangement orders were made to amend and finalise the MoG changes.

The key MoG changes included:

- abolishing the following five departments: Finance, Services and Innovation; Industry; Planning and Environment; Family and Communities; and Justice
- transferring their functions into three new Departments:
  - Department of Customer Service
  - Department of Planning, Industry and Environment
  - Department of Communities and Justice

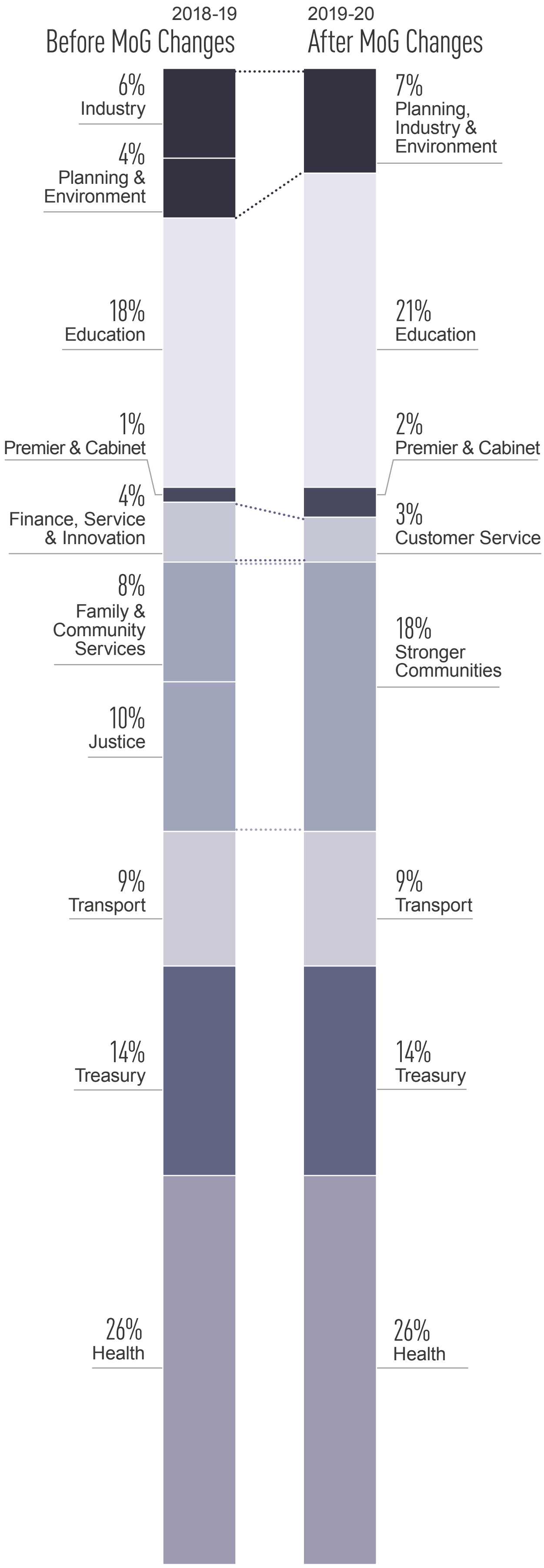
The State's consolidated financial statements at 30 June 2019 were not impacted by the changes, as they were effective from 1 July 2019.

The chart to the right shows the cluster arrangements before and after the MoG changes to the General Government Sector. It compares total budgeted expenses presented in the 2018-19 and 2019-20 Budget Papers[1].

Each cluster's share of the General Government Sector's (GGS) total expenditure remains relatively unchanged after the MoG changes. Further details on other functions transferred between clusters are detailed in the 2019-20 Budget Papers.

Of the clusters, Education is affected most by the MoG changes from the perspective of increased expenditure in the 2019-20 budget. This is because the TAFE Commission transferred into this cluster from the former Department of Industry on 1 July 2019, resulting in a corresponding decrease in the new Planning, Industry and Environment cluster's expenditure.

Cluster expenses



[1] The 2018-19 Budget Paper 3 (unaudited) and 2019-20 Budget Paper 3 (unaudited).

Machinery of Government risks

Significant MoG changes can disrupt government services and processes if risks are not identified early and promptly managed.

Risks and challenges for the State and agencies include:

- disruption to control environments due to staffing, process and system changes
- loss of corporate knowledge when key staff change
- impacts to service delivery due to unclear roles and responsibilities
- poorly defined services performed on behalf of other agencies during the transition
- effectively managing complex asset and liability transfers between agencies, including data migration and contracts
- ensuring governance arrangements are appropriate for the new structures
- tight timeframes to implement the changes effectively and maintain business as usual
- measuring the costs and benefits arising from the MoG changes.

It is essential that agencies update their delegation instruments from 1 July 2019 to reflect their new organisation structure and delegation limits.

Updating delegations will help ensure:

- incurring expenditure is authorised by appropriate staff
- compliance with the Government Sector Finance Act 2018 (GSF Act) and other relevant legislation.

When updating these instruments, agencies should take into account those funds controlled by a Minister, such as special deposit accounts. Agencies need to ensure Ministers' powers, if permitted by legislation, are appropriately delegated to allow them to legally act on a Minister's behalf and in accordance with the GSF Act and any other applicable legislation.

Our 2018-19 audit of the Social and Affordable Housing NSW Fund identified non-compliance with legislation, where a payment was made from the Fund without the required delegation from the Treasurer. The *Social and Affordable Housing NSW Fund Act 2016* (SAHF Act) requires the Treasurer to control and manage the Fund unless delegated under section 13 of the SAHF Act.

The risk of material misstatements in State and agency financial statements increases if the risks and challenges of MoG changes are not effectively managed and mitigated.

Post 30 June 2020, the Audit Office plans to conduct a performance audit on whether the 2019 Machinery of Government changes achieved their goals effectively and efficiently, and improved public sector administration.

The State is revising its outcomes-based budgeting performance measures to reflect the MoG changes.

The State's outcomes were revised and reallocated across the eight new government clusters. However, the related measures and indicators were excluded from the 2019-20 Budget Papers. Treasury plans to revise them to reflect the MoG changes and align them with the State's outcomes-based budgeting.

Outcomes based budgeting aims to drive better funding decisions to benefit the people of New South Wales. Outcomes based reporting is a key accountability measure to the public for the governments spend of tax dollars. The effectiveness of the reporting would be enhanced if Treasury obtained independent assurance to identify any gaps in transparency and accountability.

Post 30 June 2020, the Audit Office intends to conduct a performance audit to consider how well outcomes-based budgeting has been implemented and taken up by agencies, and whether agencies are positioned to maximise its benefits.

General Government Budget Result

$1.2 billion surplus, $0.2 billion below 2018-19 budget of $1.4 billion

The Total State Sector comprises 304 entities controlled by the NSW Government.

The General Government Sector, which comprises 212 entities, generally provides goods and services funded centrally by the State.

The non-General Government Sector, which comprises 92 Government businesses, generally provides goods and services, such as water, electricity and financial services that consumers pay for directly.

A principal measure of a Government's overall performance is its Net Operating Balance (Budget Result). This is the difference between the cost of General Government service delivery and the revenue earned to fund these sectors.

What changed from 2018 to 2019?

2017-2018	Change	2018-2019	
4.4b	3.2b (decrease)	1.2b	**2018-19 General Government Budget Result**

Change in revenues compared to 2017-18

Dividends and distributions

2017-2018	Change	2018-2019
3.7b	174m (increase)	3.9b

Due to:

- An increase of $354 million from income tax equivalents and dividends from other sectors. The increase comprised a final dividend of $148 million from Sydney Motorway Corporation before the WestConnex transaction and NSW Treasury Corporation dividend of $117 million, which was nil in the previous year.
- Decrease of $180 million in other dividends and distributions mainly due to the State selling its 58 per cent stake in Snowy Hydro in 2017-18. The State received a $154 million distribution from Snowy Hydro Ltd in that year.

Taxation

2017-2018	Change	2018-2019
31.3b	117m (increase)	31.4b

Due to:

- Increases in land tax of $481 million driven by land valuations used to calculate land tax assessments.
- Increases in payroll tax of $522 million, gambling and betting of $284 million and other taxes of $67 million.
- Stamp duty receipts were $1.2 billion lower largely due to weaker residential property prices and lower than expected residential transaction volumes. This was partially offset by one-off transfer duty payment of $555 million from the WestConnex transaction. This was paid by the Consortium when it acquired its 51 per cent stakeholder interest in WestConnex.

Grants & Subsidies

2017-2018	Change	2018-2019
31.9b	10m (decrease)	31.8b

Includes:

- Decrease of $48 million in Commonwealth General Purpose payments due to a smaller GST pool collected by the Australian Government.
- Decrease of $392 million in national partnerships payments mainly due to the reprofiling of Australian Government transport contributions.
- Increase of $380 million in specific purpose payments received from the Australian Government, mainly due to an amendment to health activity level assumptions.
- Increase of $50 million in other grants and payments.

General Government Budget Result (Cont.)

Sale of Goods and Services

2017-2018	Change	2018-2019
8.5b	482m	9.0b

Includes:

- Higher fee for services received by Transport NSW within the General Government to deliver infrastructure projects on behalf of RailCorp.
- This revenue is offset by a corresponding increase in other operating expenses within the General Government.

2017-2018	Change	2018-2019
5.3b	254m	5.5b

Other revenues:

- Increase of $330 million in royalties from mining.
- Decrease $67 million in interest income mainly due to lower interest rates.

Change in expenses compared to 2017-18

Grants & Subsidies

2017-2018	Change	2018-2019
13.9b	837m	14.7b

Due to:

- A $274 million increase to the Human Services sector, primarily Commonwealth National Health funding in response to increase in volume of patient services.
- A $126 million increase to the Education and Training sector driven by Vocational education initiatives and grants to non-government schools for essential infrastructure.

Employee Costs

2017-2018	Change	2018-2019
36.1b	1.5b	37.6b

Due to:

- Annual salaries and wages increase ($725 million). Information from the NSW Government relating to the increase of employees was not available at the time of writing this report.
- Higher than expected workers' compensation insurance claims resulting from the latest actuarial valuation.
- Increase in employee liabilities due to a lower discount rate in 2018-19 compared to last year. The discount rate at 30 June 2019 was 1.32 per cent (2.65 per cent in 2017-18).

Other operating expenses

2017-2018	Change	2018-2019
19.7b	1.5b	21.1b

Includes:

- Increase of $1.1 billion mainly due to higher supplies and services expenditure by three clusters;
  - Health ($253 million) mainly higher activity resulting in increases visiting medical officer costs, medical and surgical supplies and information management expenses.
  - Transport ($616 million) relating to delivery of capital works by Transport on behalf of RailCorp including:
    - New intercity fleet project
    - Sydney Growth Trains project
    - Transport Access Program.
  - Education ($213 million) mainly minor computing equipment costs and cloud based teaching tools.
- Increase of $156 million in insurance claims.
- Increase of $181 million in contractor fees mainly related to the new entity Sydney metro, established from 1 July 2018.

2017-2018	Change	2018-2019
6.6b	381m	7.0b

Other expenses:

- Increased mainly due to higher depreciation and amortisation costs of $381 million, driven by increased asset values either through additions or valuations during the year.

Fiscal Responsibility

The State maintained its AAA credit rating.

The object of the Fiscal Responsibility Act 2012 is to maintain the State's AAA credit rating.

The Government manages NSW's finances in accordance with the Fiscal Responsibility Act 2012 (the Act).

The Act establishes the framework for fiscal responsibility and the strategy to protect the State's AAA credit rating and service delivery to the people of NSW.

The legislation sets out targets and principles for financial management to achieve this.

New South Wales has credit ratings of AAA/Stable from Standard & Poor's and Aaa/Stable from Moody's Investors Service.

The fiscal targets for achieving this objective are:

General Government annual expenditure growth is lower than long term average revenue growth.

General Government expenditure grew by 5.5 per cent in 2018-19 (5.1 per cent in 2017-18 based on restated balances). This was slightly below the long-term revenue growth rate of 5.6 per cent.

Eliminating unfunded superannuation liabilities by 2030.

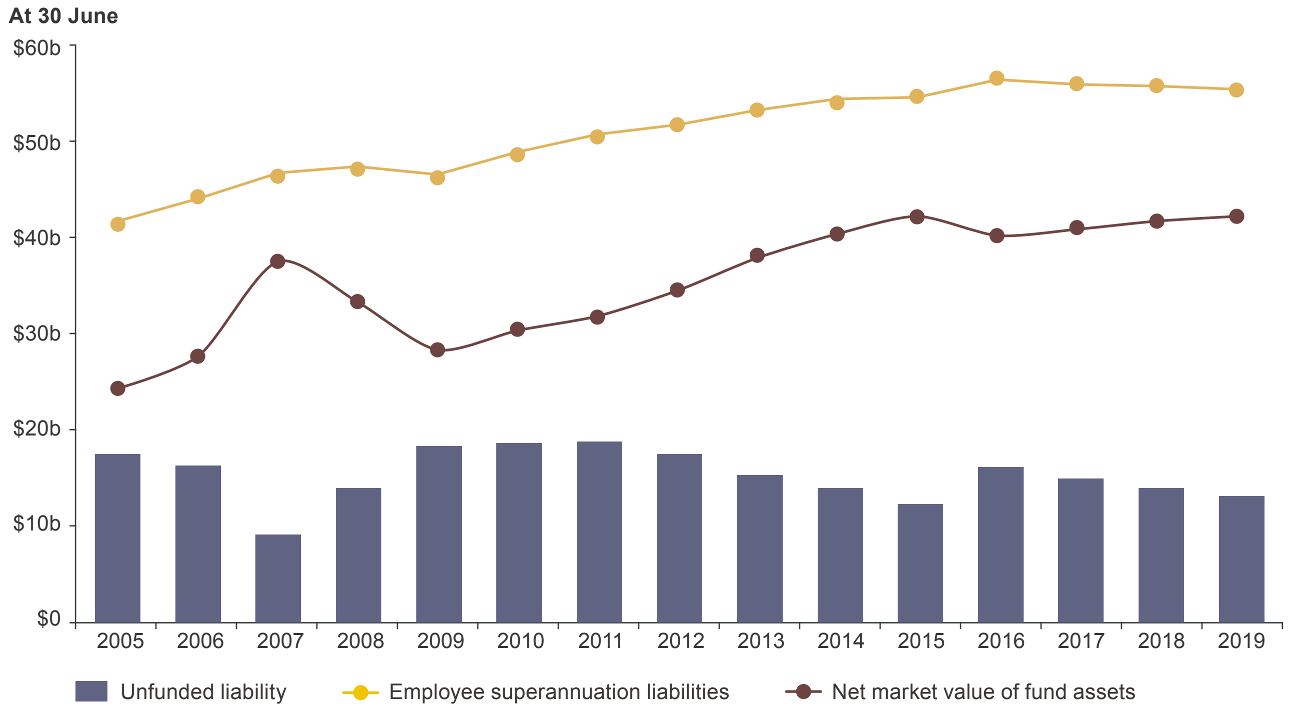
The Act sets a target to eliminate unfunded superannuation liabilities by 2030.

The State's funding plan is to contribute amounts escalated by five per cent each year so the schemes will be fully funded by 2030. In 2018-19, the State made employer contributions of $1.73 billion ($1.67 billion in 2017-18), an increase of $64 million or 3.8 per cent ($52 million or 3.2 per cent in 2017-18). This was under the five per cent target by $19.5 million.

For fiscal responsibility purposes, the State uses AASB 1056: Superannuation Entities. This accounting standard discounts superannuation liabilities using the expected return from the assets backing the liability.

Using this method, the State's unfunded superannuation liability was $13.2 billion at 30 June 2019 ($14.0 billion).

Superannuation Funding Position Since Inception of the Act - AASB 1056 Valuation



Fiscal Responsibility (Cont.)

The unfunded superannuation liability in the State's financial statements is $70.7 billion at 30 June 2019.

This is because it uses a different measurement basis than AASB 1056. In financial statements, accounting standards (AASB 119 Employee Benefits) require the State to discount liabilities using the Government bond rate.

As a result, the two approaches produce different results. In the current economic environment, AASB 119 produces a higher liability because of the low interest rate environment and the impact this has on discount rates.

	Recorded in financial statements of the State:	Fiscal reporting:
	AASB 119 Employee Benefits	**AASB 1056** Superannuation Entities
Purpose	Financial Statements for Employer	Financial Statements of Superannuation Funds
State's Superannuation Unfunded Liability	$70.7 billion	$13.2 billion
Discount rate	1.32 per cent	5.5 – 7.4 per cent
Discount rate used	Government bond rate	Expected return on assets backing the liability

Review of the Fiscal Responsibility Act 2012

Our 2017-18 Report on State Finances highlighted the five-year review of the State's compliance with the Fiscal Responsibility Act was overdue. The Treasurer's review was tabled during 2018-19 on 22 November 2018. The review found that the Government had maintained responsible fiscal management since 2012 because the:

- State's AAA rating had been maintained
- expenditure growth rate was less than target
- elimination of the State's unfunded superannuation liability by 2030 was on track.

The review assessed the revenue growth rate and determined that it should remain at 5.6 per cent.

The State's Revenues

State revenues fell $604 million to $86.1 billion in 2018-19.

In the prior years, revenue growth was underpinned by cyclical increases in land tax, payroll tax and one-off large stamp duty receipts from the lease of the State's electricity network assets. In 2018-19, the State's revenue fell by $604 million to $86.1 billion ($86.7 million in 2017-18).

Taxation Revenue remained relatively stable

Taxation revenue only grew slightly, mainly due to:

- a $517 million increase in payroll tax from NSW wages growth
- a $469 million increase in land tax from growth in land values
- offset by a $1.2 billion decrease in stamp duty due to lower than expected growth in the property market. This decrease would have been higher had the State not received $555 million in stamp duty from the new 51 per cent owner of WestConnex.

The gap between payroll tax and stamp duty reduced significantly in 2018-19. Stamp duty still remains the largest source of revenue for the State at $9.2 billion, only $42 million above payroll tax.

Australian Government grants and subsidies

The State received $31.8 billion in grants and subsidies from the Australian Government, $158 million less than the previous year. This was due to falls in Other grants and subsidies of $98 million and GST revenues of $48 million.

GST revenues fell due to weaker growth in national consumption expenditure and a smaller GST pool. The GST pool represents funds made available by the Commonwealth for transfer to the States as untied financial assistance. The allocation of GST is determined by the Commonwealth, not the State.

A $392 million decrease in National Partnership Payments was offset by a $380 million increase in Specific Purpose Payments.

In 2018-19, sales of goods and services fell $395 million mainly due to the sale of WestConnex.

Other dividends and distributions fell by $122 million due to lower distributions from associates. This reflected weaker performance in the electricity sector (Ausgrid and Endeavour) resulting in lower distributions paid to the State following changes in the Electricity Network Service Providers regulatory environment and the sale of Snowy Hydro Pty Ltd in 2017-18.

Fines, Regulatory Fees and Other revenues increased by $242 million largely from mineral royalties. The increase was attributed to strong demand across Asian markets for coal exports, which the State expects will continue to experience steady growth.

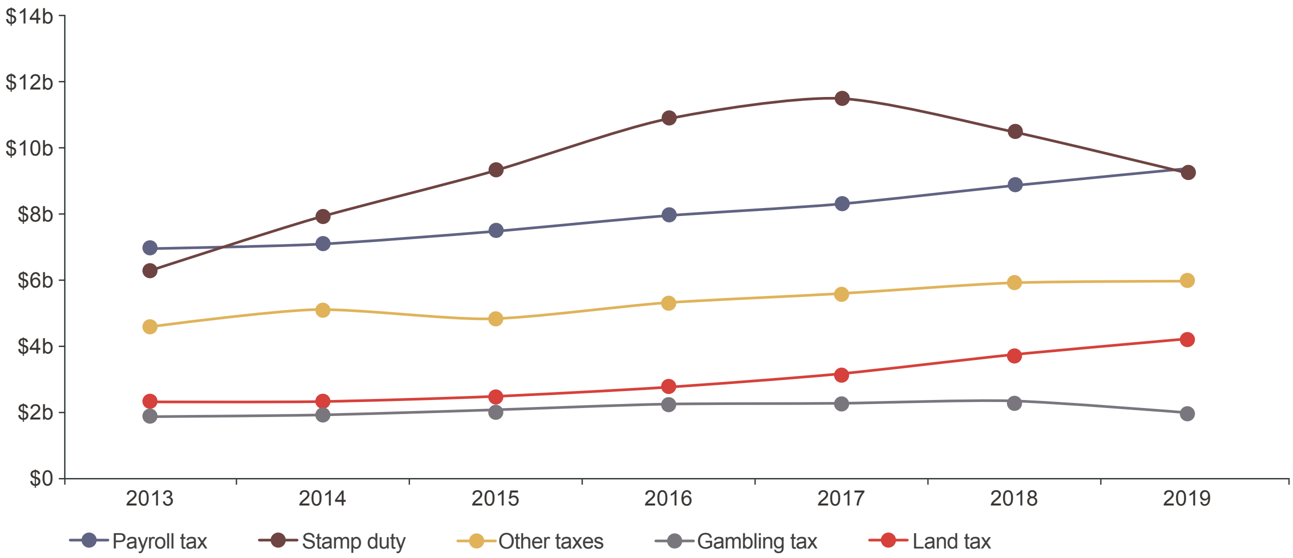
$	86.7b	▼ 0.6	86.1b	**Total Revenue**

Key revenues include:

2017-2018	Change %	2018-2019	
36.3b	▲ 1.1	36.7b	**Taxation, Fees, Fines, and Other**
31.9b	▼ 0.3	31.8b	**Grants & Subsidies**
15.2b	▼ 2.6	14.8b	**Sales of Goods and Services**

Trends in Tax Collection (General Government Sector)

Year ended 30 June



SOURCE: **2013 - 2019**: Tax collection balances (audited).

The State's Expenses

Expenses increased $4 billion to $87.9 billion in 2018-19.

Overall, the State's expenses increased 4.8 per cent in 2018-19 compared to 2017-18. Most of the increase was due to higher employee expenses, operating costs and grants and subsidies.

Employee expenses, including superannuation, increased by 3.9 per cent to $40.3 billion.

Salaries and wages increased to $40.3 billion in 2018-19 from $38.8 billion 2017-18. This was mainly due to salary and wage increases. The Government wages policy aims to limit growth in employee remuneration and other employee related costs to no more than 2.5 per cent per annum.

Operating expenses increased 6.1 per cent from 2017-18.

Within operating expenses, payments for supplies, services and other expenses increased due to:

- increased operating costs associated with the commencement of the new Sydney Metro
- higher operating activity levels experienced in the Health sector resulting in higher visiting medical officer costs, surgical supplies and information management costs
- higher school operating expenses in Education, mainly relating to teaching cloud tools and purchase of computer equipment

Health costs remain the highest expense of the State.

The following clusters have the highest expenses as a percentage of total government expenses:

- Health - 25.8 per cent (24.6 per cent in 2017-18)
- Education - 20 per cent (18.5 per cent)
- Transport - 14.7 per cent (17.6 per cent).

Other, mainly relates to Economic Affairs, Housing and Community, Recreation and Culture functions of the State.

Transport expenses have decreased in 2018-19 mainly due to the sale of WestConnex. This is partially offset by costs associated with the new Sydney Metro, which commenced operations from 1 July 2018. The graph highlights annual expenditure by function in 2018-19 compared to 2017-18.

Grants and subsidies increased by $782 million to $11.7 billion.

This was mainly due to:

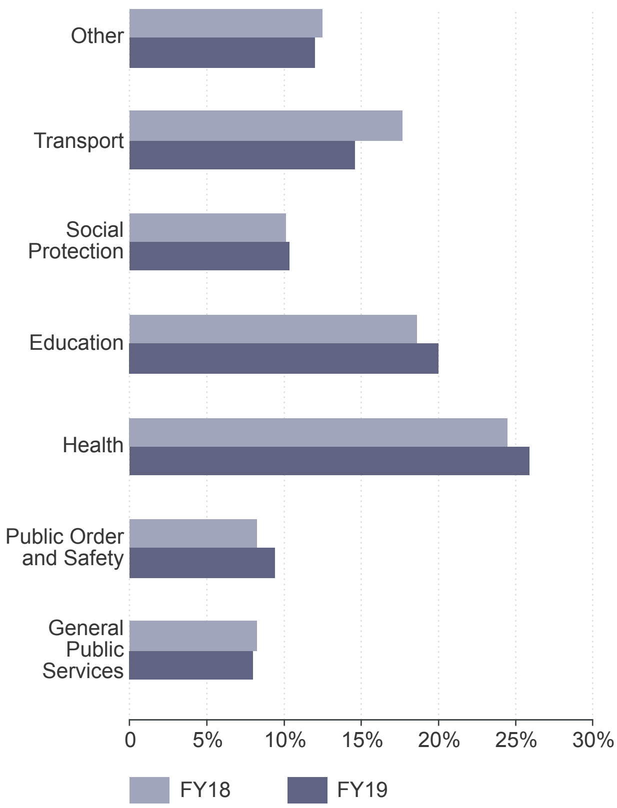
- the $239 million Emergency Drought Relief Package
- a $226 million increase in funding to the Human Services sector to deliver key election commitments, including 5,000 more nurses and midwives
- $123 million in funding for sporting facilities and creating NSW Centres of Excellence.

$ 83.9b	4.8	87.9b	**Total Expenses**

Key expenses include:

2017-2018	Change %	2018-2019	
38.8b	3.9	40.3b	**Employee Expenses**
23.3b	6.4	24.8b	**Operating Costs**
10.9b	7.3	11.7b	**Grants & Subsidies**
7.6b	5.3	8.0b	**Depreciation**
4.7b	=	4.7b	**Superannuation Expense**

Expenses & related assets by function



The State's Assets

Assets grew by $26.7 billion to $468 billion in 2018-19.

Overall, the States total assets increased by $26.7 billion to $468 billion in 2018-19. This is a 6.0 per cent increase compared to 2017-18. Most of this was due to increases in carrying value of the State's physical assets and investments.

Valuing the State's physical assets

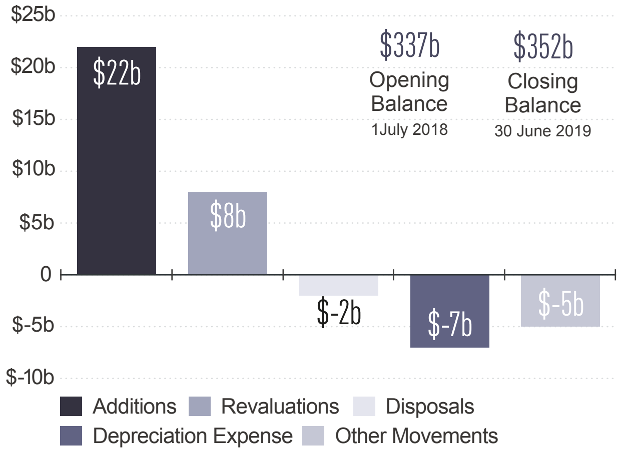
The State's physical assets were valued at $352 billion at 30 June 2019.

The State's physical assets include land and buildings ($166 billion) and infrastructure ($168 billion). The value of the State's physical assets at 30 June 2018 was restated from $339 billion to $337 billion. The restatement was required to correct errors in the fair value of earthworks previously reported at $7.5 billion and subsequently corrected to $5.4 billion.

Our audits assess the reasonableness and appropriateness of assumptions used to value physical assets. This includes obtaining an understanding of the valuation methodologies used and judgements made. We also review the completeness of asset registers and the mathematical accuracy of valuation models.

Net movements between years include additions, disposals, depreciation and valuations. **The State's physical assets increased by $15.2 billion compared to 2017-18.**

Movement in the State's Physical Assets



In 2018-19, asset additions totalled $22 billion, and were mainly due to land, building and infrastructure related spends by:

- Roads & Maritime Service ($5.5 billion)
- Sydney Metro ($3.7 billion)
- Health ($2.2 billion)
- Department of Education ($1.6 billion).

Revaluations of physical assets added a further $8 billion to the value of the State's physical assets. This was mainly driven by a $4 billion valuation increase in RMS' infrastructure assets and a $1.8 billion increase in the valuation of the Health sector's land and building assets. This was offset by disposals valued at $2.1 billion and depreciation of $7.1 billion.

In 2018-19, the State's financial assets increased by $11.4 billion.

The significant increase was primarily due to increases in equity investments relating to:

- the State selling 51 per cent of its controlling stake in the WestConnex Group to the Sydney Transport Partners consortium for $9.3 billion, including stamp duty. It now holds a 49 per cent interest in the associate, WestConnex
- $4.0 billion increase in TCorpIM Fund Trust investments in equity securities, Total State Sector equity investments (equity security investments totalled $24 billion at 30 June 2019). This increase was mainly due to the establishment of the NSW Generations fund

The increase in financial assets was partly offset by a $5.0 billion reduction in cash and cash equivalents as a result of ongoing investment activities in the State's major infrastructure projects.

The top five projects funded by the State during 2018-19 include:

- Sydney Metro City and Southwest ($1.8 billion)
- Pacific Highway - Woolgoolga to Ballina ($1.3 billion)
- Westmead Hospital redevelopment ($264 million)

In addition a number of major projects were completed in 2018-19. These included:

- North West Metro
- Newcastle Light Rail
- Broken Hill water pipeline
- Northern Beaches Hospital
- Western Sydney Stadium.

$	441b	6.1	468b	Total Assets

Key assets include:

	2017-2018	Change %	2018-2019	
Physical Assets				
	158.2b	6.1	167.9b	Infrastructure
	161.6b	2.9	166.3b	Land and Buildings
Financial Assets				
	26.4b	38.3	36.5b	Equity Investments
	20.5b	19.5	16.5b	Cash and Receivables
	42.1b	12.6	47.4b	Investments and Placements

The State's liabilities

Liabilities increased $28.6 billion to $217.5 billion in 2018-19.

The State relies on actuarial assessments to value its liabilities

Nearly half of the State's liabilities relate to its employees. They include unfunded superannuation and employee benefits, such as long service and recreation leave.

Valuing these obligations involves complex estimation techniques and significant judgements. Small changes in assumptions can materially impact balances in the financial statements, such as a lower discount rate.

Superannuation obligations rose by $14.3 billion.

The State's $70.7 billion unfunded superannuation liability represents obligations to past and present employees less the value of assets set aside to meet those obligations. The unfunded superannuation liability rose by $14.3 billion from $56.4 billion at 30 June 2018 to $70.7 billion at 30 June 2019. This was mainly due to a lower discount rate.

Borrowings totalled $79.9 billion at 30 June 2019.

The State's borrowings of $79.9 billion at 30 June 2019 were $8.6 billion higher than they were at 30 June 2018.

TCorp issues bonds to raise funds for NSW Government agencies. These are actively traded in financial markets, which provides price transparency and liquidity to public sector borrowers and institutional investors. All TCorp bonds are guaranteed by the NSW Government.

The Government manages its debt liabilities through its balance sheet management strategy. The strategy extends to TCorp, which applies an active risk management strategy to the Government's debt portfolio.

General Government Sector debt has been restructured by replacing shorter-term debt with longer-term debt. This lengthens the portfolio to match liabilities with the funding requirements for infrastructure assets.

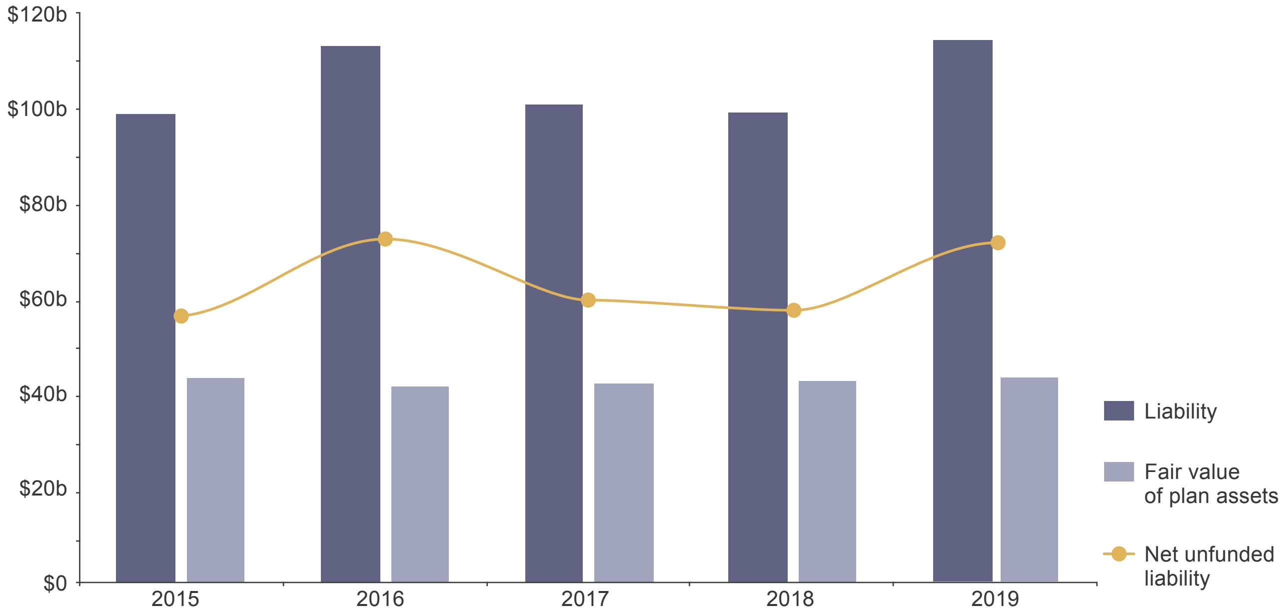
$	189b	15.1	218b	**Total Liabilities**

Key liabilities include:

2017-2018	Change %	2018-2019	
56.4b	25.3	70.7b	**Unfunded Superannuation**
19.1b	15.2	22.0b	**Other Employee Benefits**
71.3b	12.1	79.9b	**Borrowings**

Trend in unfunded superannuation liability

At 30 June



In Focus

Transitioning to Government Sector Finance Act 2018

In November 2018, NSW Parliament passed legislative reforms to the financial management of the public sector. These will have a significant impact on the agencies we audit. Under the reforms, legislation governing financial management, reporting and audit is now separated into two Acts.

The newly enacted Government Sector Finance Act 2018 (GSF Act), containing the new framework for government sector financial and resource management, commenced in stages from 1 December 2018.

On 1 December 2018, certain provisions of the GSF Act commenced, including key concepts, roles and responsibilities, authorisation of expenditure, financial services and arrangements, performance information, information sharing and delegations. From 1 July 2019, further provisions commenced including those related to budget, appropriations and special deposit accounts and certain types of expenditure. The reporting arrangements commence progressively over three years to 2020–21.

Legislative arrangements for the Auditor-General and the Public Accounts Committee contained in the Public Finance and Audit Act 1983 (PF&A Act) will remain, with the PF&A Act to be renamed the Government Sector Audit Act 1983 (GSA Act). The existing provisions remain largely unchanged by the reform, except for the principal objects which specifically recognise that the Auditor-General is an independent and accountable statutory officer.

Risks and challenges for agencies include:

- building awareness of the impacts of the new reforms
- assessing internal control environments for alignment with the GSF Act principles
- reviewing expenditure processes (including financial delegations)
- ensuring financial arrangements (such as entering into borrowings and contracts) are appropriately approved
- assessing the impact of the new banking arrangements, effective from 1 April 2019
- preparing for the new legislative financial and performance reporting framework.

When the financial arrangement provisions were enacted from 1 December 2018, the GSF Regulation requires all agencies to have a financial arrangement approval to enter into operating and finance leases. Previously under the Public Authorities (Financial Arrangements) Act 1989 agencies were only required to obtain the Treasurer's approval to become a lessee under a finance lease.

During 2019, the Public Finance and Audit Amendment (Financial Reporting and Auditing Exclusions) Regulation 2019 (the Regulation) was issued, which relieved 57 agencies from PF&A Act financial reporting requirements for the year ended 30 June 2019. These agencies were mainly special purpose service entities (staff agencies) and dormant agencies.

For reporting relief under the GSF Act, NSW Treasury in consultation with stakeholders, is determining the entities that will be eligible for financial reporting relief for the 2019-20 financial year and beyond.

Certain entities, such as Crown Reserve Trusts and a few Cemeteries, do not submit financial statements for audit, but are not subject to reporting exemptions. These entities are not complying with the Public Finance and Audit Act as they are required to prepare financial statements. Treasury should ensure all entities comply with the Act.

Restart NSW

Restart NSW was established in 2011 to fund the State's major infrastructure projects.

Restart NSW funds Rebuilding NSW, the Government's 10-year plan to invest $23 billion in new infrastructure. Its infrastructure projects, including Sydney Metro City and Southwest and WestConnex are primarily funded by proceeds from the Government's asset recycling program. The Restart fund had a balance of $19.0 billion at 30 June 2019 ($21.1 billion).

The fund made $5.6 billion in payments towards infrastructure projects in 2018-19. The projects mainly related to transport including Sydney Metro, WestConnex, Parramatta Light Rail, and an equity contribution to Rail Corporation NSW.

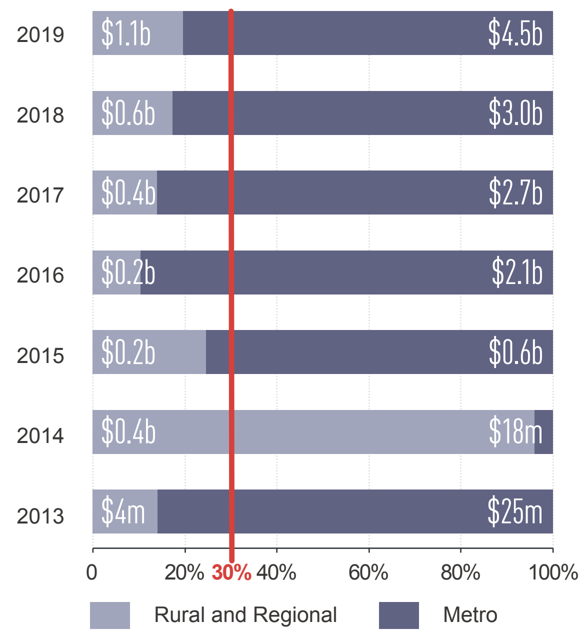
The Restart NSW Fund Act 2011 requires the fund to report on the percentage of payments directed to rural and regional infrastructure projects and whether this represents at least 30 per cent of the total payments from the fund.

The Fund directed 19.6 per cent of payments towards rural and regional infrastructure projects in 2018-19. This represents less than 30 per cent of total payments.

Payments directed towards rural and regional infrastructure projects since inception of Restart represents 18.9 per cent of total payments from the fund.

The table on the right shows the percentage of payments directed to rural and regional infrastructure each year since 2013.

Rural and Regional vs Metro



NSW Generations Funds

NSW Generation Funds - two new funds established in 2018 to support debt retirement and fund community focused initiatives.

The NSW Generation (Debt retirement) Fund had a balance of $10.9 billion at 30 June 2019. The State deposited $10 billion into the Fund mainly from the proceeds of the WestConnex transaction.

There have been no community focused payments from this Fund since its inception on 27 June 2018.

Investment performance was 9.6 per cent, which was in line with target earnings of 9.5 per cent. This resulted in a return of $0.9 billion to the State.

The NSW Generations (Community Services and Facilities) Fund closing balance was $27.7 million at 30 June 2019. The Fund made no payments towards community focused initiatives during its first reporting period commencing 27 June 2017. The Fund's payments amounted to $0.4 million which were primarily Director fees and administration costs. Payments from the fund were made in accordance with the NSW Generations Fund Act 2018.

Asset Transactions

The State sold 51 per cent of its controlling interest in Sydney Motorway Corporation (WestConnex).

On 31 August 2018, the Government announced the sale of 51 per cent of WestConnex to Sydney Transport Partners for $9.3 billion, including $555 million in stamp duty. Of the proceeds, $7.0 billion was directed to the NSW Generations Fund. The NSW Generations Funds Act 2018 requires that these funds can only be directed towards repayment of the State's debt.

The State recognised its remaining 49 per cent equity interest in WestConnex in a new entity, Roads Retained Interest Pty Ltd, established on 1 June 2018. The fair value of the State's remaining equity interest was $6.4 billion at 30 June 2019. All distributions received are directed to the NSW Generations Fund.

Key Audit Matters

A Key Audit Matters (KAM) section was included in the State's Independent Auditor's Report the first time this year.

KAMs are those matters considered of most significance to the audit. A separate opinion is not issued on these matters. KAMs adds value to users by providing broader insights, increased transparency and helps them understand areas of significant management judgement in the State's financial statements.

This year KAM's will be piloted for twenty of the State's significant agencies, including all principal departments. While a KAM Independent Auditor's Report will not be issued for the significant agencies this year, the pilot helps to communicate the key matters and our audit approach. A KAM Independent Auditor's Report will be issued from 2019–20 onwards.

The key audit matters included in the State's Independent Auditors report related to the following risks:

- fair valuing property, plant and equipment
- valuation of outstanding claim liabilities
- valuation of defined benefits superannuation and long service leave liabilities
- taxation revenue
- valuation of financial instruments
- disclosure of contingent liabilities

Looking forward

Implementing the requirements of new accounting standards will be challenging.

Risks to the quality and timeliness of financial reporting

The State and its agencies will be implementing the requirements of new accounting standards shortly. These are likely to have a major impact on the financial positions and operating results of agencies across the sector.

Accounting standards require agencies to assess and disclose where possible, the impact of the new standards in their 2018-19 financial statements.

Our review found agencies needed to do more work on their impact assessments to minimise the risk of errors in the financial statement disclosures. Some agencies disclosed that the new standards would not have a material impact on their reported financial position and performance, but had little evidence to support this.

Each agency is unique and implementing the new standards is not straight forward as many new principles apply. Management judgement is needed to interpret how the principles apply to each agency. As a result, agencies face the following risks and challenges:

- having the required technical skills in house
- having accurate data to assess the impacts
- correctly and consistently interpreting the new requirements
- adequately planning and preparing for their application
- implementing new systems to capture the information needed to meet the new reporting obligations.

To help agencies implement the new standards consistently across the sector, Treasury:

- issued guidance to agencies
- prepared position papers on proposed accounting treatments
- provided briefing sessions to agencies
- mandated which option in the new standards agencies had to adopt on transition.

Key dates

30 JUNE 2019	30 JUNE 2020	30 JUNE 2021
AASB 9 'Financial Instruments' AASB 15 'Revenue from Contracts with Customers (for-profit agencies) COMPLETE	AASB 16 "Leases' AASB 15 'Revenue from Contracts with Customers' (not for profit agencies) AASB 1058 'Income of Not-for-Profit Entities'	AASB 1059 'Service Concession Arrangements: Grantors'

AASB 9 'Financial Instruments' was implemented in 2018-19. The standard introduced:

- a simplified model for classifying and valuing financial instruments
- a new method for calculating impairment (decreases in asset values).

Applying the new method for calculating impairment in 2018-19 did not result in a significant change to impairment losses recognised by the State.

AASB 15 'Revenue from Contracts with Customers' will change the timing and pattern of recognising revenue and increase financial reporting disclosures.

'For-profit' agencies implemented AASB 15 in 2018-19, and the impact on these agencies was minimal. The State will be impacted more in 2019-20 when the new requirements apply to not-for-profit agencies.

Treasury expects AASB 15 will mainly impact the recognition of revenue from non-intellectual property licences. The new standard requires revenue from licences with no performance obligations to be recognised at commencement of the licence rather than progressively over the licence period.

The impact of AASB 15 is expected to increase the State's net worth by $396 million at 1 July 2019.

AASB 1058 'Income of Not-for-Profit Entities' provides guidance to not-for-profit entities to help them account for:

- transactions conducted on non-commercial terms
- the receipt of volunteer services.

Treasury expects this standard to mainly defer recognising revenue from certain capital grants so it aligns with the periods over which the assets are constructed. This will increase unearned income liabilities and decrease grant and subsidy expenses.

The impact of AASB 1058 is expected to reduce the State's net worth by $493 million at 1 July 2019.

AASB 16 'Leases' will change the way lessees recognise, account for and report operating leases in their financial statements.

With a few exceptions, such as low value and short-term leased assets, agencies will have to recognise future lease payments as an asset, because they represent the lessee's right to use that asset (i.e. a right-of-use asset), and a corresponding lease liability.

At 1 July 2019, the new leasing standard is expected to increase the State's total assets by $4.7 billion and total liabilities by $4.7 billion and reduce operating result by $106.5 million.

AASB 1059 'Service Concession Arrangements: Grantors' provides guidance for public sector entities (grantors) who enter into service concession arrangements with private sector operators for the delivery of public services. These agencies will need to recognise previously unrecorded service concession assets and liabilities in their financial statements.

The State has not quantified the estimated future impact of AASB 1059 in its 30 June 2019 financial statements.

Preparing well in advance is key for agencies to effectively transition to the new standards.

The table below shows the key points to consider in the transition.

Assess	Prepare	Implement
Develop a detailed project plan and identify key team members	Engage with key stakeholders, communicate the project plan	Continuous engagement with stakeholders
Identify key financial statement line items and complex transactions affected by the new standards	Determine staff training needs, schedule in advance and develop training material Seek external guidance from Accounting Professionals, if required	Execute staff training
Perform gap analysis between current and new recognition principles for revenue, leases and service concessions	Consider and determine what processes need to change to collect relevant data before implementing new standards	Clearly documented key judgements made when applying the new standards
Determine transition options and practical applications	Assess completeness of contract registers and nature of contracts with customers, grant and lease agreements, arrangements with private sector operators	
Determine availability and populations of information/data to support these balances Review capability of current IT systems to capture relevant information. Manual processes may be needed to accumulate the relevant data	Identify system enhancements or new software solutions to capture information for increased reporting obligations	Capture contract information/data Integrate contract information/data into systems, update processes and controls Implement and test completeness and accuracy of data and calculations. Ensure system is operating effectively and fully integrated in agency's operations Adjust opening balances to reflect impact of new standards
	Revise accounting policies and guidelines to align with the new standards	Communicate new policies and guidelines
	Review and update accounting disclosures	Socialise the updated accounting disclosures with your auditors.
	Identify impacts on key performance indicators and whether metrics need to change	Revise KPI's and internal reporting

Appendices

Appendix One - Prescribed Entities

Section 45 of the Public Finance and Audit Act 1983 requires the Auditor-General to perform audits of the financial statements of entities prescribed for the purposes of that section.

The following were prescribed entities as at 30 June 2019:

Entity/Fund	Latest financial statements audited	Type of audit opinion issued
Agricultural Scientific Collections Trust	30 June 2019	Unmodified
AustLII Foundation Limited	31 December 2018	Unmodified
Belgenny Farm Agricultural Heritage Centre Trust	30 June 2019	Unmodified
The Brett Whiteley Foundation	30 June 2019	Unmodified
Buroba Pty Ltd	30 June 2018*	Unmodified
C. B. Alexander Foundation	30 June 2018	Unmodified
City West Housing Pty Ltd	30 June 2019	Unmodified
The Commissioner for Uniform Legal Services Regulation	30 June 2019	N/A[a]
Cowra Japanese Garden Maintenance Foundation Limited	31 March 2019	Unmodified
Cowra Japanese Garden Trust	31 March 2019	Unmodified
Crown Employees (NSW Fire Brigades Firefighting Staff Death and Disability) Superannuation Fund	30 June 2019	Unmodified
Eif Pty Limited	30 June 2019	Unmodified
Energy Investment Fund	30 June 2019	Unmodified
Central Coast Council Water Supply Authority (formerly Gosford City and Wyong City Council Water Supply Authorities)	30 June 2018	Unmodified
Home Building Compensation Fund	30 June 2019	Unmodified
The funds for the time being under the management of the New South Wales Treasury Corporation, as trustee	30 June 2019	Unmodified
The Illawarra Health and Medical Research Institute Limited	30 June 2019	Unmodified
The Legal Services Council	30 June 2019	Unmodified
Macquarie University Professorial Superannuation Scheme	30 June 2019	Unmodified
Planning Ministerial Corporation	30 June 2019	Unmodified
Corporation Sole 'Minister administering the Heritage Act 1977' (a corporation)	30 June 2019	Unmodified
National Art School	31 December 2018	Unmodified
NSW Fire Brigades Superannuation Pty Limited	30 June 2019	Unmodified
Parliamentary Contributory Superannuation Fund	30 June 2019	Unmodified
Sydney Education Broadcasting Limited	31 December 2018	Unmodified
The superannuation fund amalgamated under the Superannuation Administration Act 1991 and continued to be amalgamated under the Superannuation Administration	30 June 2019	Unmodified
Act 1996 (known as the SAS Trustee Corporation Pooled Fund)	30 June 2019	Unmodified
The trustees for the time being of each superannuation scheme established by a trust deed as referred to in section 127 of the Superannuation Administration Act 1996	30 June 2019	Unmodified
The Art Gallery of New South Wales Foundation	30 June 2019	Unmodified
Trustee of the Home Purchase Assistance Fund	30 June 2019	Unmodified
Trustees of the Farrer Memorial Research Scholarship Fund	31 December 2018	Unmodified
United States Studies Centre	31 December 2018	Unmodified
Universities Admissions Centre (NSW and ACT) Pty Limited	30 June 2018	Unmodified
University of Sydney Professorial Superannuation System	31 December 2018	Unmodified
Valley Commerce Pty Ltd	30 June 2018*	Unmodified

[a]Included as part of the Legal Services Council.
*Entities exempt from preparing financial statements at 30 June 2019.

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Our insights inform and challenge government to improve outcomes for citizens.

OUR PURPOSE

To help parliament hold government accountable for its use of public resources.

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Pride in purpose

Curious and open minded

Valuing people

Contagious integrity

Courage

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