



Tasmanian Audit Office

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10 July 2008

Senate Finance and Public Administration Committee
PO Box 6100
Parliament House
CANBERRA ACT 2600

Attention Stephen Palethorpe, Committee Secretary

Dear Sir

Other matters

I refer to my letter to you dated 11th June 2008 in which I noted that I would, on the Committee's behalf, follow-up two further matters:

1. Details on the levels of spending on capital as opposed to recurrent expenses.

When questioned by the Committee about the proper allocation of expenditure between recurrent and capital I indicated my confidence that audits conducted by my Office of financial reports had not identified material instances of misallocation. I noted further that the budget for expenditure on State roads may raise some doubt in this regard because "capital appropriation" reported on the Income Statement of the Department responsible for managing the State's roads included funds appropriated for both road maintenance and new road infrastructure. Despite this, I reconfirmed my view that actual expenditure on State roads was properly allocated for financial reporting purposes at both the departmental and General Government Sector levels.

The issue here seems to me to be distinguishing between expenditure on:

- The purchase of non-financial assets (normally property, plant and equipment) and
- Infrastructure investments.

These are not necessarily the same. Investment in infrastructure can, and does, include investment in social infrastructure, investment in works and services such as maintenance, and investment in capital assets.



To assist the Committee I attach the following two chapters from the State's 2006-07 Budget Paper No. 1 — Budget Overview 2006-07:

- Chapter 4 — Revenue and Expense Estimates, 2006-07. Particular attention should be given to page 62 which notes an amount of \$262m budgeted to be spent on the purchase of new non-financial assets in the General Government Sector. Actual expenditure in 2006-07 was \$233m. [\$293m is the 2005-06 outcome]
- Chapter 7 — Infrastructure investment. As expected, there is a degree of overlap with Chapter 4 because "Infrastructure" includes both expenditure on capital account (works and services funding) and expenditure from recurrent funding. However, the distinction in Chapter 7 is clearly articulated.

The Department of Infrastructure, Energy and Resources (DIER) is responsible for maintaining the State's road infrastructure and to assist the Committee I attach copies of:

- DIER's Income Statement for the financial year ended 30 June 2007 and
- My report to Parliament analysing DIER's financial performance for that year in which I explain the impact of its Capital Appropriation on its financial performance.

2. Details of superannuation and other off-balance sheet liabilities.

My understanding of the question put to me, and therefore of what I agreed to provide, related to the observations made to the Committee in the submission to it by the leader of the Tasmanian Liberal Party (the Submission) regarding funding the State's unfunded superannuation liability. I was provided with a copy of the Submission in which I paid particular attention to the section headed "The Abuse of Net Debt" and the subsets entitled Co-mingling the Superannuation Provision Account, Net Financial Liabilities the appropriate measure and Off-Balance Sheet Financing of State-owned Companies. I comment on each of these items separately below.

Co-mingling the Superannuation Provision Account

In summary, the Submission questions the calculation of net debt and, in particular, the impact on net debt of the current policy of entering into temporary debt repayments at each 30 June with such repayments including application of funds available in the Superannuation Provision Account (SPA). These comments apply only to the General Government Sector and it is noted that the SPA is an account within the Special Deposits & Trust Fund (SD&TF) details of which are reported, and audited, annually in the Public Account Statements. These statements also include details of the Temporary Debt Repayment Account.

Legality of the current arrangements

The current arrangement whereby at each 30 June temporary debt repayments are shown as netted off against the balance of the SD&TF commenced on 30 June 2003. Prior to this, the Department of Treasury and Finance (Treasury) undertook a temporary overnight borrowing with the amount borrowed placed on overnight deposit. This latter approach had the effect of grossing up debt and financial assets with no impact on net debt.

Prior to entering into these arrangements, Treasury sought and obtained legal confirmation that the proposed netting off arrangements did not contravene legislation. Confirmation that the proposal complied with legislation was also sought from the then Auditor-General who advised that he had no objections to or comments on the proposal if implemented in the manner described. Had I been asked the same question, based on the information provided, I would have concluded similarly.

Specific Concerns raised in the Submission

My reading of the Submission indicates to me that it argues that the netting referred to above:

- Understates net debt because
- The SPA (\$1.145 billion at 30 June 2007) is not available to repay debt and should not therefore be included in the netting arrangement. It argues that the SPA account is "specific purpose".

In responding to these matters, I have held discussions with Treasury and reviewed relevant audit working papers supporting my audit of the Public Account Statements. To assist the Committee, set out below is a summary of the impact of the temporary debt repayments and of the SPA since 30 June 2002. 2002 is included because that was the last occasion when the previous practice of entering into an overnight borrowing arrangement was entered into. All of the information in the summary is available from the Public Account Statements.

Statement 1 Public Account Balance and summary of the SPA

	2002 \$'000	2003 \$'000	2004 \$'000	2005 \$'000	2006 \$'000	2007 \$'000
Public Account						
SD&TF	905 282	1 133 077	1 446 193	1 539 679	1 783 242	1 889 092
Less Temporary Debt Repayments	-	698 123	822 330	973 086	1 203 160	1 170 233
Net balance	905 282	434 954	623 863	566 593	580 082	718 859
Superannuation Provision Account						
Balance b/f	355 485	465 191	590 390	710 891	845 031	1 052 323
Net receipts	109 706	125 199	120 501	134 140	207 292	92 962
Balance at y/e	465 191	590 390	710 891	845 031	1 052 323	1 145 285

What is the SPA?

The SPA was established in July 1994 to provide for the superannuation benefits of defined benefit scheme members employed in departments and by some Statutory Authorities. These agencies and authorities are currently required to pay into the Superannuation Provision Account at a rate determined by the Treasurer, on the advice of the State Actuary. For most agencies and authorities, this rate is currently 11 per cent of salary. In addition, inner-Budget agencies are also required to pay into the SPA a 'gap' payment of two per cent of salary in respect of each permanent employee appointed after 15 May 1999, notwithstanding that these employees are not members of the Retirement Benefits Fund defined benefit scheme. The employer share of pensions and lump sum benefits payable to retiring Retirement Benefits Fund defined benefit scheme members in these agencies and authorities is reimbursed to the Retirement Benefits Fund Board from the SPA.

My observations

- The impact of the temporary debt repayments is transparently reported.
- Is the SPA a "specific purpose account" and therefore not available for application in the annual financial year end temporary debt repayment arrangement? I have confirmed that the SPA is not a "specific purpose account". The funds in the SPA are administered by Treasury and are available for application as part of the temporary debt repayment at each financial year end.
- Does the temporary debt repayment practice reduce net debt? In my view it does not. If the end-of-year borrowing practice was reintroduced, net debt would be the same although both financial assets and financial liabilities would increase by the same amount.
- Does the \$1.145bn set aside to fund the State's superannuation liability actually exist? In my view this is a reasonable question and I respond as follows:

- Is it intended that the funds in the SPA will actually be paid at some future date to the State's superannuation board? Current projections are that by approximately 2033 (see graph attached) on-going annual net receipts into the SPA will enable the balance in the SPA to equal the unfunded superannuation liability.. However, whilst at that time the liability might be fully funded, it is my understanding that the balance of the SPA may not be paid to the superannuation board but retained in the SD&TF with superannuation obligations continuing to be settled on an emerging costs basis. On this basis, the balance in the SPA will continue to be regarded as a controlled balance offsetable against financial liabilities in determining net debt.
- In at least one other Australian jurisdiction the same approach was adopted. However, in that jurisdiction, prior to 30 June 2007, the balance in its SPA equivalent was paid to its superannuation board. This had the obvious effect of increasing net debt but with no impact on net financial liabilities (see further discussion below on the relevance of the net financial liabilities measure). Therefore, if the SPA was "off-balance sheet", net debt would go up but net financial liabilities would reduce.

Overall conclusion

Making an overall conclusion is difficult when dealing with transactions and balances that involve such lengthy timeframes, as is the case with the SPA and its related unfunded superannuation liabilities. The unfunded balance is itself potentially subject to significant movements each year, being based on actuarial assessments taking into account changes in income tax legislation and various economic and other assumptions. In my view, the information reported is transparent, presents fairly the financial position of the State's Public Account and enables a reader to assess any impacts of the temporary debt repayment arrangements.

Net Financial Liabilities the appropriate measure

The Submission raises an interesting point. Net debt is one of the "headline" numbers invariably quoted publicly as a measure of a State's financial condition and in Tasmania's case it is included as one of a number of fiscal targets. This is not to say that the State ignores the importance of the net financial liabilities measure. On the contrary, net debt and net financial liabilities receive equal prominence on the face of the State's balance sheet each financial year end.

In my view, both measures are important and neither should be read in isolation. There is a risk with any indicator of financial performance or condition that it is read in isolation of other indicators when judging performance. Equally important is the need to understand the components making up the computation of the indicator and that this be consistent over time. The State's balance sheet spells out how the various measures are computed, enabling readers to assess financial performance and condition.

Off-Balance Sheet Financing of State-owned Companies

Audits conducted by my Office have not identified any off-balance sheet financing arrangements.

My initial assessment, in 2004, of the substance of the Basslink electricity inter-connector (Basslink) referred to in the Submission was that it was a finance lease. On this basis Basslink could have been accounted for as early as June 2004 as a significant asset and liability of Hydro-Electric Corporation (Hydro) and, therefore of the State. There would have been little impact on net equity. It does not, therefore, surprise me that others may also have concluded that the Basslink transaction was a finance lease.

However, independent expert advice obtained by me in 2004 persuaded me that the Basslink transaction was not a lease under Australian Accounting Standards (AAS). Consistent with AAS, full disclosure of the Basslink transaction was made in the Hydro and Whole of State Consolidated financial statements at both 30 June 2004 and 2005.

Changes to AAS arising from Australia's adoption of international financial reporting standards resulted in the Basslink transaction being recorded as a financial instrument with effect from 1 July 2004. This arose because an international standard dealing with accounting for financial instruments existed with there being, at that time, no equivalent standard in Australia.

As a result, in Hydro's financial report at 30 June 2006 the Basslink financial instrument was recorded as both a liability and an asset with comparative information at 30 June 2005 updated accordingly. This achieved what some commentators consider should have occurred from the outset. However, Hydro's and the State's, accounting treatment at both 30 June 2004 and 2005 was in accord with AAS at those dates.

Please do not hesitate to contact me should you require further information regarding the Committee's inquiry.

Yours faithfully



H M Blake

AUDITOR-GENERAL

Copy to:

Hon Will Hodgman, MP

Mr DW Challen, Secretary, Department of Treasury and Finance

Hon Michael Aird, Treasurer

