New South Wales Auditor-General's Report
Financial Audit

Volume Three 2013
Focusing on New South Wales State Finances

audit office
OF NEW SOUTH WALES

The role of the Auditor-General

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

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

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

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

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

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

audit.nsw.gov.au

auditoffice OF NEW SOUTH WALES

AUDITOR-GENERAL NEW SOUTH WALES

GPO Box 12
Sydney NSW 2001

The Legislative Assembly
Parliament House
Sydney NSW 2000

The Legislative Council
Parliament House
Sydney NSW 2000

Pursuant to the *Public Finance and Audit Act 1983*,
I present Volume Three of my 2013 report.

A T Whitfield
Acting Auditor-General
October 2013

Contents

Executive Summary

Audit Result

The Total State Sector Accounts for the year ended 30 June 2013 received an unqualified independent auditor's opinion. This is the first time in over a decade the Total State Sector Accounts have not been qualified.

Budget Result

The Budget Result was a surplus of $239 million for the year ended 30 June 2013, $1.1 billion better than originally budgeted in June 2012. Revenues were less than one per cent above original budget and expenses were one per cent below.

The Budget Result was $613 million better than forecast in the 2013-14 Budget Papers published in June 2013.

Financial Analysis

Significant Transactions

The State received $5.0 billion from the lease of port operations in Sydney and Port Kembla. It used $767 million to repay associated borrowings. The State recorded a gain of $2.0 billion on the transaction.

Revenues and Expenses

Total revenues and expenses for the whole-of-government were $71.2 billion and $69.4 billion respectively. After the results from discontinued operations are included, the State's Net Operating Balance (Budget Result) was a $2.1 billion surplus. While the State's revenue and expenses exceed those reported by other states and territories, revenues and expenses per capita are lower than those in other jurisdictions.

After fair value adjustments to liabilities and other losses, the State recorded an Operating Result of $6.5 billion surplus.

Taxation revenues increased by 6.3 per cent overall, as a result of all sources of revenue increasing, with the exception of land tax. Commonwealth grants totalled $24.5 billion, $1.6 billion less than in 2011-12, and slightly less than expected.

Employee costs were 46 per cent of total expenditure, which is relatively consistent with previous years. The State employs approximately 11 per cent of all people employed in New South Wales.

Assets and Liabilities

The value of the State's assets was over $320 billion at 30 June 2013. The assets mostly comprise property, plant and equipment to provide or support service delivery. The value reflects $72.0 billion in capital expenditure over the past five years. Capital expenditure was $14.2 billion in 2012-13, which represents about 94 per cent of the budgeted amount. In addition to the infrastructure assets reflected in the Total State Sector Accounts, the State has over forty public private partnerships to deliver infrastructure and services.

The State's total liabilities are relatively steady, falling slightly to around $156 billion at 30 June 2013. Borrowings increased by $4.3 billion.

Fiscal Responsibility

Credit Rating

The State has maintained its AAA credit rating and outlooks from rating agencies have remained unchanged since October 2012.

Quality and Timeliness of Financial Reporting

The quality and timeliness of financial reporting across the NSW public sector have significantly improved.

The Treasurer has actively engaged with agency Chief Financial Officers and Audit and Risk Committee Chairs to communicate the importance of accurate and timely financial information at various forums.

Treasury Circular 13/01 'Mandatory early close procedures for 2013' expanded the scope and the range of procedures agencies needed to perform before year end.

Public Accounts Committee Recommendations

The three year timeframe for implementing the Committee's recommendations to improve the quality and timing of financial reporting has ended. Reassessment of the recommendations is required and further actions, if any, determined.

Agency Financial Statements in 2012-13

The number of errors has fallen since 2011-12, but opportunities for improved quality and timeliness of financial reporting still exist.

Significant Items

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

Fiscal Responsibility

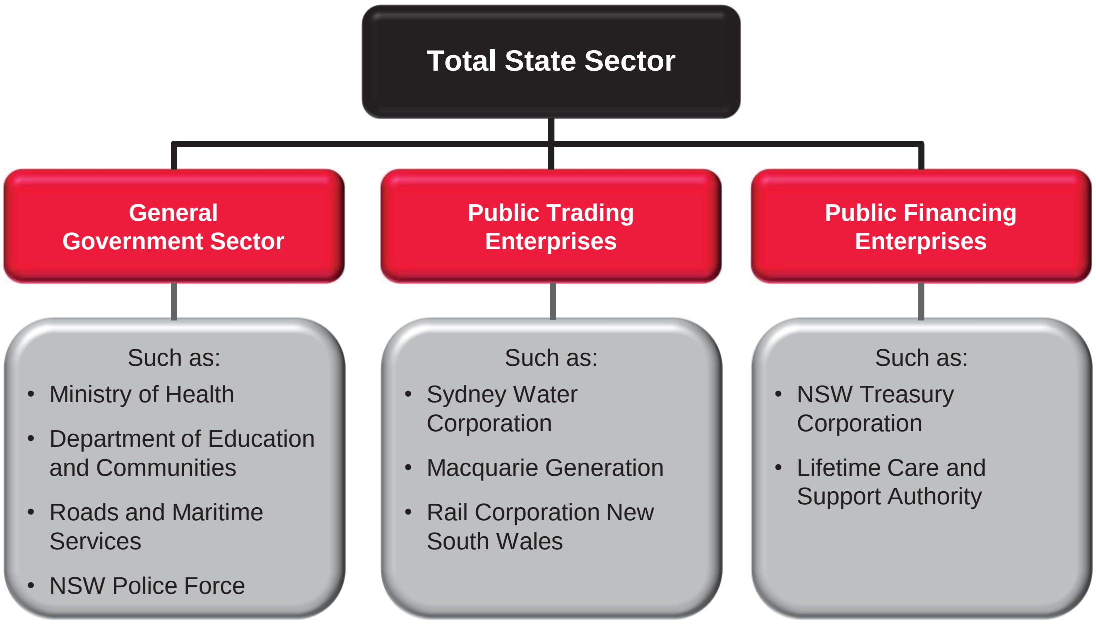
Quality and Timeliness of Agencies’ 2012-13 Financial Reporting

Audit Result

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

The General Government Sector and Total State Sector

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



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

Auditor's Opinion

The State received an unqualified auditor's opinion for the first time in over a decade

This is the first time in over a decade the General Government and Total State Sector Accounts received an unqualified auditor's opinion. This year's audit outcome evidences the Government's commitment to improve the quality of financial reporting across the NSW public sector.

Longstanding issues, and new matters arising in 2012 that gave rise to new qualifications, have been addressed sufficiently in the current year to enable removal of past qualifications from the independent auditor's report.

Resolution of Qualifications

Qualifications to the prior year's audit opinion on the Total State Sector Accounts that were resolved during the 2012-13 audit cycle are detailed below.

Building Valuations

My office obtained enough evidence supporting the value of education buildings and their depreciation expense

The State could not provide all the information needed to form an audit opinion on the value of certain buildings owned by the Department of Education and Communities (the Department) in 2011-12. As a result, an audit opinion could not be formed on whether buildings totalling $18.6 billion were correctly valued. This also meant an audit opinion could not be formed as to whether revaluation increments of $4.9 billion and depreciation expense of $380 million were correct. As a result, the audit opinion on the State's Net Operating Balance/Budget Result, Operating Result and Comprehensive Result was qualified for 2011-12.

During 2012-13, the Department performed another revaluation of its buildings. It used a new methodology which addressed the previous shortcomings. The Department also addressed limitations in evidence to support assumptions used within its methodology. This resulted in the Department being able to provide sufficient evidence to support the carrying value of its buildings and related depreciation expense.

The revaluation exercise resulted in a fall in the buildings' carrying values of $1.2 billion in 2012-13.

Further information will appear in Volume Five of the Auditor-General's 2013 Report to Parliament.

State Archives

Sufficent evidence has been obtained to support the existence and value of the State archives

As reported last year, sufficient information could not be obtained to form an audit opinion on the existence and value of archives recognised for the first time. The value of these archives was reported as $938 million.

These archives are managed by the State Records Authority. During 2012-13, the Authority performed a detailed stock-take and extensive review of the value of its archives. This has resulted in a revised valuation of $818 million. Audit testing of the Authority's evidence to support this value is not yet complete, but sufficient audit evidence has been obtained to confirm that any further adjustments will not materially impact the Total State Sector Accounts.

Further information will appear in a later Volume of the Auditor-General's 2013 Report to Parliament.

Land and Infrastructure Holdings

My office obtained enough evidence supporting the completeness of land and infrastructure holdings recognised

The State prepared its first consolidated financial report in 1996-97. The audit opinion on this financial report was qualified for various reasons, one of which was the completeness of land and infrastructure holdings. The financial reporting framework for preparing consolidated financial reports for the State has changed since 1996-97, but an audit qualification on the completeness of assets has consistently endured.[1]

The audit opinion on the 2011-12 Total State Sector Accounts was qualified because the State could not provide all the information needed to form an audit opinion on the value of land and related infrastructure assets that should be recognised in the financial statements. Volume Three of the Auditor-General's 2012 Report to Parliament noted this issue related to more than one agency within the sector. Significant effort has occurred over the past twelve months to resolve this qualification, including:

- further work on determining the control of Crown Reserves
- identifying land controlled by the Corporation Sole 'Minister Administering the *Environmental Planning and Assessment Act 1979*'
- implementing processes for including various small agencies.

1 Further information on the current financial reporting framework appears within Appendix 1 to this Volume.

Crown Land Reserves

There are over 30,000 Crown reserves in New South Wales, many held by Crown Land Reserve Trusts. Responsibility for administering the Crown Reserve System has passed between various government agencies in recent years and is currently with the Department of Trade and Investment, Regional Infrastructure and Services. Volume Six of the Auditor-General's 2012 Report to Parliament noted progress made by the Department to identify which Crown Land Reserve Trusts were controlled by the State, and hence which reserves should be recognised as assets in the Total State Sector Accounts. Further progress occurred in 2012-13 resulting in sufficient, appropriate evidence being obtained to confirm all controlled Trusts have been recognised by the State.

The State has confirmed land held by Trusts managed by NSW Government agencies are controlled by the State and, therefore, land held by Trusts managed by entities outside the State's control are not. For example, Crown Land Reserve Trusts managed by local governments, universities and religious organisations are not controlled by the State.

Improvements are still needed in the accuracy of information used to record the State's land holdings

While the State has provided sufficient appropriate evidence to support its assertion that all material controlled land has been recognised, opportunities remain to improve the recording of land. For example, the State has recognised approximately $100 million of land for which the agency owner is not yet determined. Examples of potential double counting of land need further investigation and more work is needed to ensure the integrity of Crown Reserves data.

Recommendation

Treasury should ensure remaining opportunities for improvement in the recording of land are actioned and explore new financial reporting issues arising.

The work done in 2012-13 raised a new financial reporting issue to resolve. Hundreds of Reserve Trusts exist that potentially may need to prepare financial statements in accordance with the *Public Finance and Audit Act 1983.* Work is required to determine the financial reporting obligations of these Trusts and then to ensure the obligations are met.

Volume Six of the Auditor-General's 2012 Report to Parliament reported that Livestock Health and Pest Authorities, not the State, controlled other Reserve Trust lands valued at $416 million. These Authorities will be abolished from 31 December 2013 and their functions merged with catchment management authorities, currently controlled by the State. A reassessment of whether the State controls these Reserve Trust lands is required as part of the 2013-14 financial reporting processes.

Corporation Sole 'Minister Administering the Environmental Planning and Assessment Act 1979'

Volume Six of the Auditor-General's 2012 Report to Parliament reported certain parcels of land in New South Wales may have been controlled by the Corporation, but not recognised at fair value in its financial statements. This impacted the State's ability to provide evidence all controlled land had been recognised in the Total State Sector Accounts.

During 2012-13, the Corporation identified and valued all controlled land resulting in the State recognising $475 million of land in the Total State Sector Accounts, previously recorded at one dollar. The Corporation has provided sufficient appropriate audit evidence to support this balance, which removes the limitation to concluding on the completeness of land and infrastructure assets.

Inclusion of Small Agencies

In 2012-13, Treasury implemented new processes to capture and recognise the transactions and balances of many individually small agencies not previously aggregated in the Total State Sector Accounts. As a result, net assets of $461 million have been added to the General Government Sector and $608 million to the Total State Sector. These assets mainly comprise property, plant and equipment

Revenues and expenses for these small agencies are still excluded, but the net impact of this omission is only around $25 million. These transactions will be captured via a movement in the net assets recognised next year.

These small agencies were not previously recognised on the basis their net assets represented less than 0.5 per cent of the State's total net assets. On their own, the impact of these smaller agencies may be negligible, but when added to the other matters discussed above, the cumulative impact was more significant. Treasury's new process helps reduce the risk that future issues around the completeness of assets is significant enough to impact future audit opinions.

Other Matters

Other matters noted during the course of the audit, but not significant enough to impact the Independent Auditor's Report, include:

Lifetime Care and Support Scheme

Uncertainty exists in the estimate of the State's liability for scheme participants' care and support services of $2.1 billion at 30 June 2013 ($1.8 billion at 30 June 2012) and the related expense of $176.2 million ($255.2 million). The liability and related expense are included in the Total State Sector Accounts, but are not part of the General Government Sector.

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

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

Home Warranty Insurance Liabilities

Uncertainty exists in the estimates of the State's home warranty insurance liabilities. These liabilities total $257 million at 30 June 2013 ($249 million). The uncertainty arises mainly due to variability in claim costs.

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

Financial Reporting and Internal Control Deficiencies

Previous Auditor-General's Reports to Parliament have reported on significant financial reporting issues and internal control deficiencies that have resulted in qualified audit opinions on agency financial statements.

The approach to auditing the Total State Sector Accounts includes performing audit procedures at a selection of the largest individual agencies. Where the intended reliance cannot be placed on the largest agencies to form audit conclusions, the audit of the Total State Sector Accounts can be delayed. This is because alternative audit procedures need to be designed and performed on transactions and balances at other smaller agencies to gain sufficient audit assurance.

Resolution of Other Matters

Besides the qualifications, some other matters reported in 2012 have been resolved in 2013.

Water Filtration Plants

As reported last year, the Total State Sector Accounts did not include a liability of $336 million for water filtration plants.

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

These arrangements effectively transfer to the Corporation substantially all the risks and benefits incidental to ownership of the plants. However, the Corporation considers these agreements to be service agreements for the filtration of water. It considers the agreements do not meet the definition of a finance lease as they do not convey the right for the Corporation to use the assets. However, the value of balances related to these leases has diminished to levels that, in my view, would not materially impact Sydney Water Corporation's financial statements.

Budget Result

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

Revenue ($60.1 billion)
- Taxation
- Commonwealth grants
- Dividends and income tax from PTEs
- Interest income

funds

Essential Services ($59.9 billion)
- Health
- Education
- Housing
- Transport

Net Operating Balance – Variance to Original Budget

The table below compares actual results for 2012-13 with the amounts budgeted in the 2012-13 Budget Papers published in June 2012.

The 2012-13 Budget Result was a $239 million surplus, $1.1 billion better than expected in June 2012

Financial Information

Year ended 30 June 2013	Actual $m	Budget $m	Difference $m	Difference % of Budget
Revenues				
Taxation	21,980	22,111	(131)	(0.6)
Commonwealth grants	24,466	24,696	(230)	(0.9)
Other grants and subsidies	941	698	243	34.8
Sale of goods and services	5,434	5,066	368	7.3
Interest	406	367	39	10.6
Dividend and income tax	2,648	2,367	281	11.9
Other dividends and distributions	595	546	49	9.0
Fines, regulatory fees and other	3,662	3,876	(214)	(5.5)
Total revenues	**60,131**	**59,727**	**404**	**0.7**
Expenses				
Employee related	26,195	26,541	(346)	(1.3)
Superannuation	2,188	2,547	(359)	(14.1)
Depreciation and amortisation	3,667	3,294	373	11.3
Interest	2,220	2,147	73	3.4
Other property	--	1	(1)	(100.0)
Other operating	14,245	14,197	48	0.3
Current grants and transfers	9,071	9,264	(193)	(2.1)
Capital grants and transfers	2,336	2,561	(225)	(8.8)
Total expenses	**59,923**	**60,552**	**(629)**	**(1.0)**
Discontinued operations	30	--	30	100.0
Net operating balance – surplus/(deficit)	**239**	**(824)**	**1,063**	**(129.0)**
Net borrowing	**2,168**	**3,473**	**1,305**	**(37.6)**

In accordance with normal budget practice, the 2012-13 Budget does not include the impact of business asset transactions. These are excluded on the basis the transactions are not complete at the time of preparing the Budget.

* Amounts in table may not add due to rounding.

The 2012-13 results are relatively consistent with the 2012-13 Budget. Total revenue was less than one per cent over budget and total expenses were one per cent less than budgeted. However, these small variances translate into large dollar amounts when applied to the State's revenues and expenses and the Budget Result, which was $1.1 billion better than expected.

Revenue

Taxation revenue was less than budgeted mainly due to lower than expected growth in land values, offset by higher than budgeted receipts from stamp duties. The higher stamp duties were mainly due to one-off receipts from the sale of government assets.

Commonwealth grants were less than budgeted mainly due to lower than expected health funding driven by changes to the calculation of the funding, and lower than anticipated funding for natural disasters driven by delays in finalising documentation for the Commonwealth. This was partially offset by the earlier than expected receipt of funding for rail and road projects.

Other grants exceeded budget, but this variance is attributable to an inaccuracy in the original budget rather than additional revenue. The inaccuracy is equally offset in grants expenditure having no net impact on the budget result.

The higher than expected sales revenue mainly relates to revised arrangements for the delivery of transport infrastructure and the recoupment of costs from transport entities outside the general government sector. These generally have an offsetting impact in expenses.

Dividends and taxes received from public trading enterprises exceeded budget due to higher than forecast profits in the State's electricity and water businesses. Dividends and taxes from the continuing electricity sector were $263 million higher than budgeted, driven by cost savings from the electricity distribution businesses. This was offset by a reclassification of dividends from discontinuing operations originally included in the Budget.

Fines, regulatory fees and other revenue was less than budgeted mainly due to lower than expected mining royalties offset by under-budgeting of revenue by agencies. Mining royalties were $560 million less than budget, driven by lower than expected coal prices, higher than expected exchange rates, and no revenue received from supplementary coal royalties.

Expenses

Employee related expenses were less than expected mainly due to delays in education expenditure in line with Commonwealth funding received and lower than expected redundancy payments.

Superannuation expenses were less than expected mainly due to revised discount rates used to calculate the interest expense on defined benefit superannuation liabilities.

Depreciation and amortisation exceeded budget due to higher than expected road infrastructure and school building asset values used to calculate depreciation expenses.

Other operating expenses were largely in line with budget. At a detailed level, the budget variances are more significant.

Higher than budgeted other operating expenses include:

- revised arrangements for the delivery of rail infrastructure ($275 million)
- functions transferred from transport entities outside the general government sector ($127 million)
- the expected cost to terminate the State's coal supply agreement with Origin Energy ($300 million).

Lower than budgeted other operating expenses include:

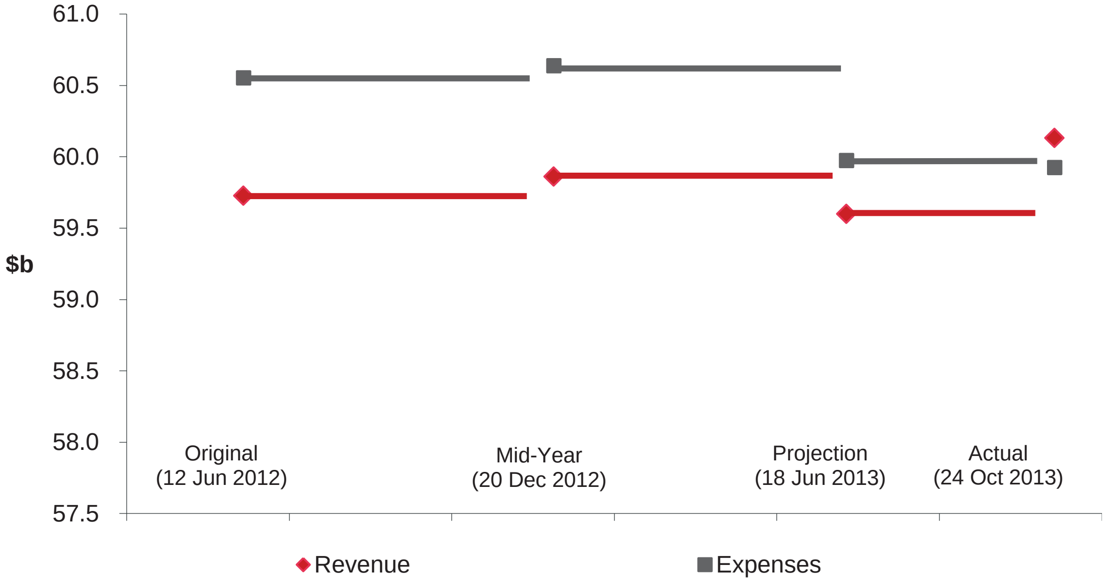
- delays to education and health expenditure in line with Commonwealth funding received ($334 million)
- reclassification of road maintenance expenditure as capital expenditure ($152 million)
- reduced public liability claim numbers and costs compared to budget ($185 million).

Grants and transfers were $418 million less than budget due to delays in education expenditure in line with Commonwealth funding received, and a number of smaller programs being underspent for 2012-13.

Changes to the Expected Budget Result during 2012-13

The 2012-13 Budget was announced in June 2012. All budgets are publicly revised twice each year. The first revision occurs in December as part of the mid-year review. The second occurs when handing down the following year's Budget, which occurred in June 2013. The graph below demonstrates how the State's expectations about its revenues and expenses changed for each of the revisions during 2012-13.

Changes to Budgeted Revenues and Expenses during 2012-13



The change in the expected Budget Result published in June 2013 and the final audited Budget Result in the 2012-13 Report on State Finances was around $600 million. The expected Budget Result is formulated using actual year to date information for the first ten months of the financial year and a projection for the final quarter. In any year, a variance between expectations published in June and the final result can be attributed to:

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

While it is appropriate for future policy changes not to be considered when formulating Budget Result expectations, variances from inaccurate year to date data or projections should be minimised. Variances that occurred during 2012-13 at the line item level are shown below.

Date information released	**31 October 2013**	**18 June 2013**		
Year ended 30 June 2013	**Actual $m**	**Projection $m**	**Difference $m**	**Difference % of Projection**
Revenues				
Taxation	21,980	21,783	197	0.9
Commonwealth grants	24,466	24,173	293	1.2
Other grants and subsidies	941	876	65	7.4
Sale of goods and services	5,434	5,519	(85)	(1.5)
Interest	406	429	(23)	(5.4)
Dividend and income tax	2,648	2,606	42	1.6
Other dividends and distributions	595	557	38	6.8
Fines, regulatory fees and other	3,662	3,656	6	0.2
Total revenues	**60,131**	**59,599**	**532**	**0.9**
Expenses				
Employee related	26,195	26,215	(20)	(0.1)
Superannuation	2,188	2,350	(162)	(6.9)
Depreciation and amortisation	3,667	3,586	81	2.3
Interest	2,220	2,249	(29)	(1.3)
Other property	--	--	--	--
Other operating	14,245	14,157	88	0.6
Current grants and transfers	9,071	9,060	11	0.1
Capital grants and transfers	2,336	2,357	(21)	(0.9)
Total expenses	**59,923**	**59,974**	**(51)**	**(0.1)**
Discontinued operations	30	--	30	100.0
Net operating balance – surplus/(deficit)	**239**	**(374)**	**613**	**(163.9)**
Net borrowing	**2,168**	**2,970**	**802**	**(27.0)**

* Amounts in table may not add due to rounding.

The additional taxation revenue is mainly due to stamp duties. Treasury advises the variance was caused by stronger than expected activity in the residential and commercial markets in the last few months of the financial year by around $170 million.

Treasury advises the additional Commonwealth grant revenue includes reclassifications of health revenue items from other revenue line items of around $135 million and money received under the Skills Reform Commonwealth agreement that was not expected to be signed before 30 June of around $55.0 million. Funding for the Northern Sydney Rail Freight project exceeded the State's expectations by around $40.0 million.

Treasury advises the lower than expected superannuation expenses were mainly due to current service costs of the State's defined benefit superannuation schemes and a higher than expected number of members taking pension benefits of around $75.0 million.

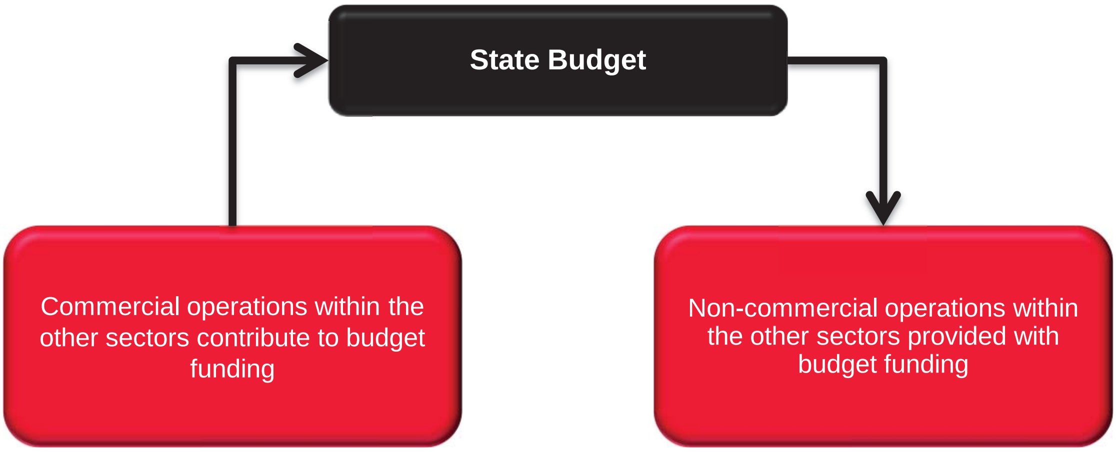
While other operating expenses were in line with projection, the variances are more significant at a detailed level. The projection did not include the expected cost to terminate the State's coal supply agreement with Origin Energy of $300 million. The expected cost was unknown at the time of preparing the projection. Offsetting this were moderate underspends in transport, roads, education, health, and central government services. Treasury advises the underspend was mainly driven by:

- lower than expected costs from re-negotiated private bus operator contracts
- capitalisation of road maintenance costs previously expected to be expensed
- lower payments out of the Climate Change Fund based on updated information from electricity distributors
- lower spending on Commonwealth funded education programs due to delayed receipts from the Commonwealth government.

The General Government Sector subsidised other public enterprises by a net $1.0 billion in 2012-13

Impact of other Sectors on the Budget Result

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



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

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

Year ended 30 June	2013 $m	2012 $m	2011 $m
Distributions from the other sectors	3,194	2,637	2,427
Contributions to the other sectors	4,197	4,056	4,291
Net expense	**1,003**	**1,419**	**1,864**

* Excludes distributions from asset sale/lease transactions as they are not included in the Budget Result.

Further information on the State's public trading enterprises appears in Appendix 2.

Assurance on estimates and forecasts in the 2013-14 Budget Papers

Engagement performed upon certain aspects of the 2013-14 Budget Papers

In November 2012, the Treasurer requested the Auditor-General, among other things, to 'undertake a review of the reasonableness of the estimates and forecasts in the 2013-14 Budget'. The Auditor-General performed this review in accordance with applicable assurance standards and qualified the conclusion on the estimates and forecasts. This section discusses this engagement.

A copy of the request by the Treasurer appears in Appendix 2 of Volume Ten of the 2012 Auditor-General's Report to Parliament. A copy of the Auditor-General's Independent Assurance Practitioner's Review Report and the engagement subject matter appears within Budget Paper 2 of the 2013-14 Budget Papers published at www.budget.nsw.gov.au.

The conclusion on estimates and forecasts within the 2013-14 Budget Papers was qualified

Engagement Outcome

The engagement resulted in a qualified conclusion. Those matters that caused the Auditor-General to qualify his conclusion on the estimates and forecasts in the 2012-13 Half-Yearly Review and his opinion the 2011-12 Total State Sector Accounts had not yet been resolved. While the Auditor-General observed progress towards resolving the matters, the matters were not resolved in time for the 2013-14 Budget. Details of resolution are reported within the Audit Result section earlier in this Volume.

Objective of the Engagement

The objective of the Auditor-General's review was to conclude whether anything had come to his attention that caused him to believe the estimated financial statements of the General Government Sector had not been prepared consistently with the basis of preparation and assumptions stated or the methodologies used to determine those assumptions are unreasonable. The conclusion is deliberately expressed in the negative form because it offers a limited level of assurance.

Limited Level of Assurance

Limited assurance is a lower level of assurance than that offered by an audit. The nature of the subject matter, being prospective financial information, has a high inherent risk, for which no amount of procedures can reduce risk to an acceptable level for an audit.

Prospective financial information relates to events and actions that have not yet occurred and may not occur. While evidence may be available to support the assumptions and underlying data upon which prospective financial information is based, such evidence is generally future oriented and therefore less certain in nature than evidence available to support historical financial information. Accordingly, no opinion can be expressed as to whether the forecasts will be achieved.

Professional Standards and Independence

The review was conducted in accordance with Australian Standards on Assurance Engagements, in particular ASAE 3000 'Assurance Engagements other than Audits or Reviews of Historical Financial Information', and relevant Australian Auditing Standards. These standards require the Auditor-General to comply with relevant ethical requirements relating to assurance engagements.

Financial Analysis of the General Government and Total State Sectors

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

Snapshot of the Total State Sector Accounts

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

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

Significant Transactions

Long-term Lease of Port Botany and Port Kembla

On 31 May 2013, the Government entered into long-term leases of Port Botany and Port Kembla. The State received gross proceeds of $5.0 billion from the transaction. It used $767 million of the proceeds to repay borrowings associated with the Port operations.

The State recorded a gain of $2.0 billion from the transaction. This is after $48.0 million in costs paid to complete the transaction.

The long-term leases allow the new operators to run the ports for 99 years. The State remains the legal owner of the port lands.

Post Year-end Sale of Electricity Generators

On 1 August 2013, the Government sold its shares in Eraring Energy. The business included Eraring and Shoalhaven power stations. The State will record proceeds of $659 million from the sale in 2013-14. It received net proceeds of $50.0 million after deducting the previously held Gentrader deposit liability.

As part of the sale, the State paid Origin Energy $300 million to cancel its obligation to supply coal to Origin, and to sell coal below the expected cost of production. The net cash settlement on 1 August 2013 was a payment to Origin of $250 million.

On 2 September 2013, the government entered into contracts selling Mt Piper and Wallerawang power stations. The State will record proceeds of $475 million from the sale in 2013-14. It received net proceeds of $160 million after deducting the Gentrader deposit liability.

The State will record the sales in 2013-14.

Significant Events

Economic Conditions

Volume Three of last year's Auditor-General's Report to Parliament noted the impact of global economic conditions. The State's net worth had fallen from $166 billion at 30 June 2011 to $146 billion at 30 June 2012, due mainly to growth in the State's unfunded superannuation liabilities. These liabilities increased by almost 50 per cent in 2011-12 to $50.9 billion, largely as a result of weak investment returns and low bond rates.

Some of the 2011-12 loss on unfunded superannuation liabilities reversed in 2012-13. This, together with increases in the value of some property, plant and equipment assets and realised gains in the port sector from new long-term leases discussed above, have been largely responsible for restoring the State's net worth to $166 billion.

Analysis of Operating Results

Financial Information

The General Government Sector Operating Result was a $1.7 billion surplus

The Total State Sector Operating Result was a $6.5 billion surplus

Abridged Statement of Comprehensive Income

Year ended 30 June	General Government		Total State Sector	
	2013 $m	2012* $m	2013 $m	2012* $m
Revenues				
Taxation, fees, fines and other	25,642	24,251	26,100	24,801
Grants and subsidies	25,407	26,743	25,241	26,554
Sales of goods and services	5,434	4,961	18,408	16,853
Interest, dividends, income tax equivalents and other distributions	3,649	3,050	1,480	1,649
Total revenues	**60,131**	**59,005**	**71,228**	**69,856**
Expenses				
Employee costs	28,383	28,540	31,998	32,553
Depreciation and amortisation	3,667	2,978	6,776	6,048
Interest	2,220	2,082	3,959	4,222
Grants and subsidies	11,407	11,383	7,203	7,293
Other	14,245	13,410	19,460	18,611
Total expenses	**59,923**	**58,394**	**69,396**	**68,727**
Discontinued operations	30	49	250	535
Net operating balance – surplus	**239**	**660**	**2,082**	**1,664**
Asset sale gains	151	12	2,086	261
Fair value adjustments to financial instruments	985	(526)	2,782	(5,054)
Other net gains/(losses)	332	(2,005)	(414)	(1,689)
Operating result – surplus/(deficit)	**1,706**	**(1,859)**	**6,535**	**(4,817)**
Revaluations	3,161	6,383	8,317	6,192
Actuarial gain/(loss) from superannuation	5,613	(19,407)	6,433	(21,574)
Net gain/(loss) on equity investments	11,201	(5,479)	--	--
Other net losses	(516)	(37)	(119)	(200)
Comprehensive result - total change in net worth before transactions with owners as owners	**21,166**	**(20,399)**	**21,166**	**(20,399)**

* 2012 amounts have been restated for changes made in accordance with Australian Accounting Standards.

Amounts in table may not add due to rounding.

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

Comparison with other Australian States and Territories

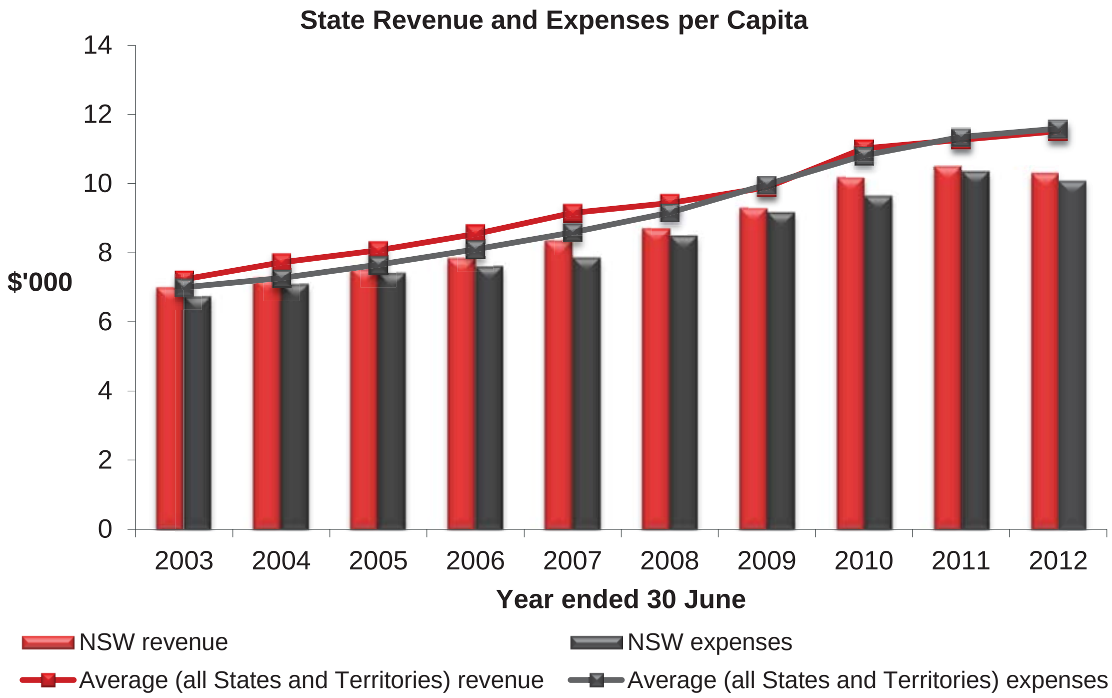
The State does not collect as much revenue per capita as the average of all states and territories. In turn, expenditure per capita is also less than the average. The table below shows information for 2011-12.

	New South Wales	Average (all states and territories)
Total revenue per capita ($)	10,314	11,517
Total expenses per capita ($)	10,087	11,590

Source: Australian Bureau of Statistics; amounts based on 2011-12 Total Public Sector Government Finance Statistics data.

Note: This analysis relies on publicly available information for all states and territories. The most current data available is for 2011-12.

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

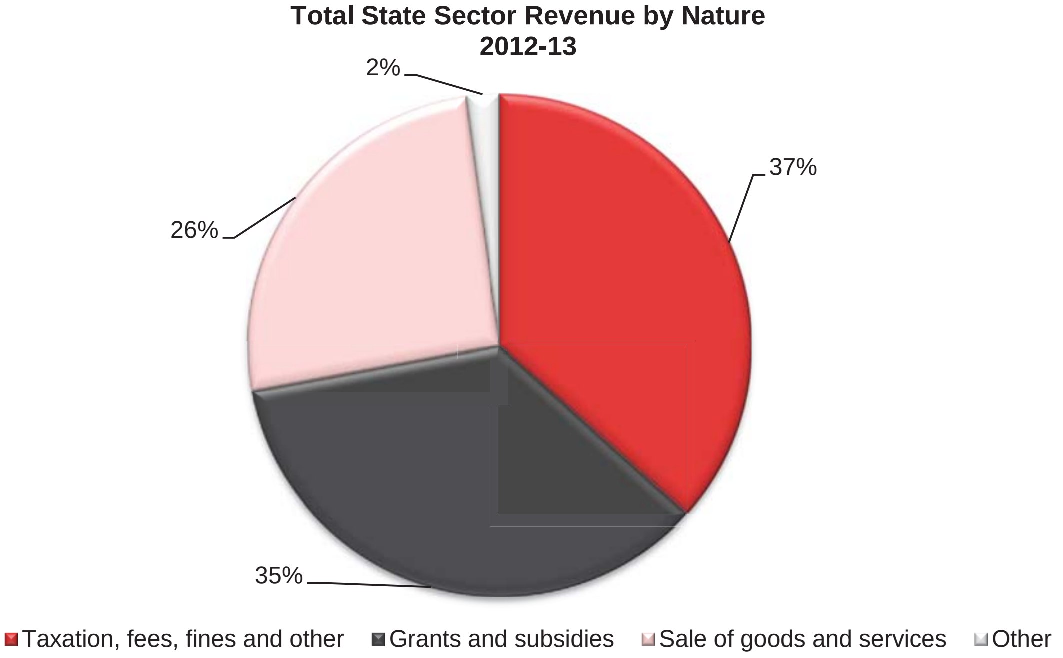


Source: Australian Bureau of Statistics; Total Public Sector Government Finance Statistics data.

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

Revenues

Total State Sector Revenue by Nature



Taxation, Fees, Fines and Other

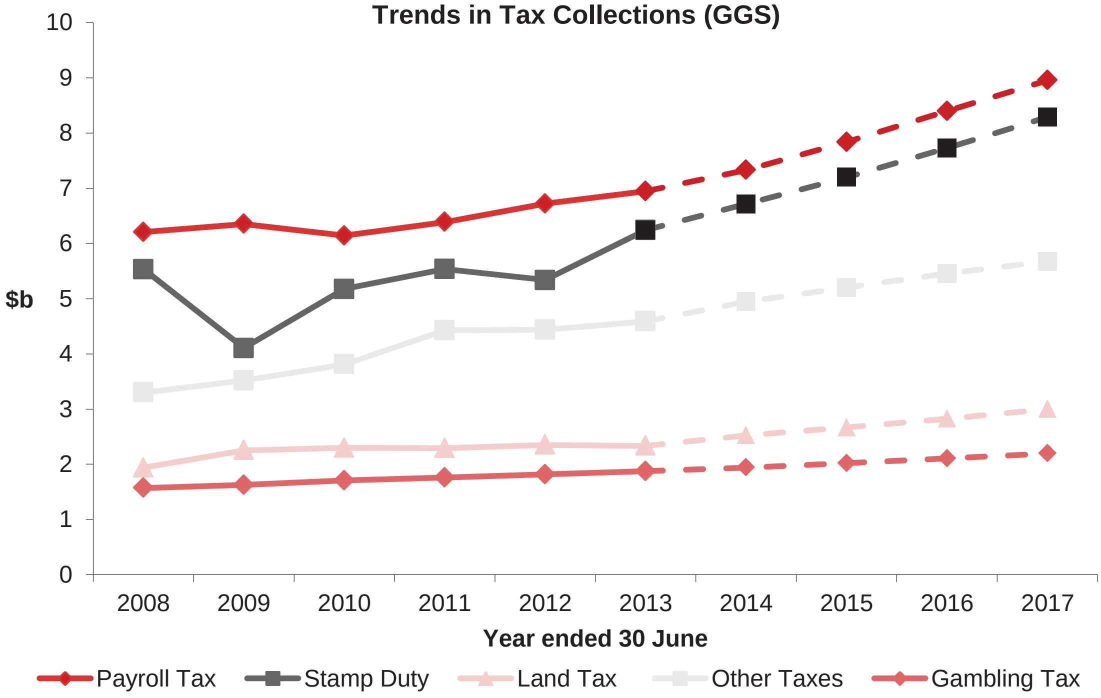
Taxation revenues grew by 6.3 per cent

Taxation, fees, fines and other revenue comprises $21.6 billion of taxation ($20.3 billion in 2011-12) and $4.5 billion of fees, fines and other ($4.5 billion).

Tax revenue for the Total State Sector increased by $1.3 billion (6.3 per cent) compared to 2011-12. All sources of tax revenue increased except for land tax, which fell slightly. Stamp duties increased by $904 million, reflecting improved economic conditions in New South Wales.

Over the last five years, total tax revenue increased from $16.9 billion to $21.6 billion, which represents average annual growth of 6.2 per cent.

The following chart shows tax collected between 2008 and 2013 and the Government's forecasts in the 2013-14 Budget Papers for General Government Sector tax collections over the next four years to 2017. The next published forecasts are expected in the 2013-14 Half Yearly Review to be released before 31 December 2013.



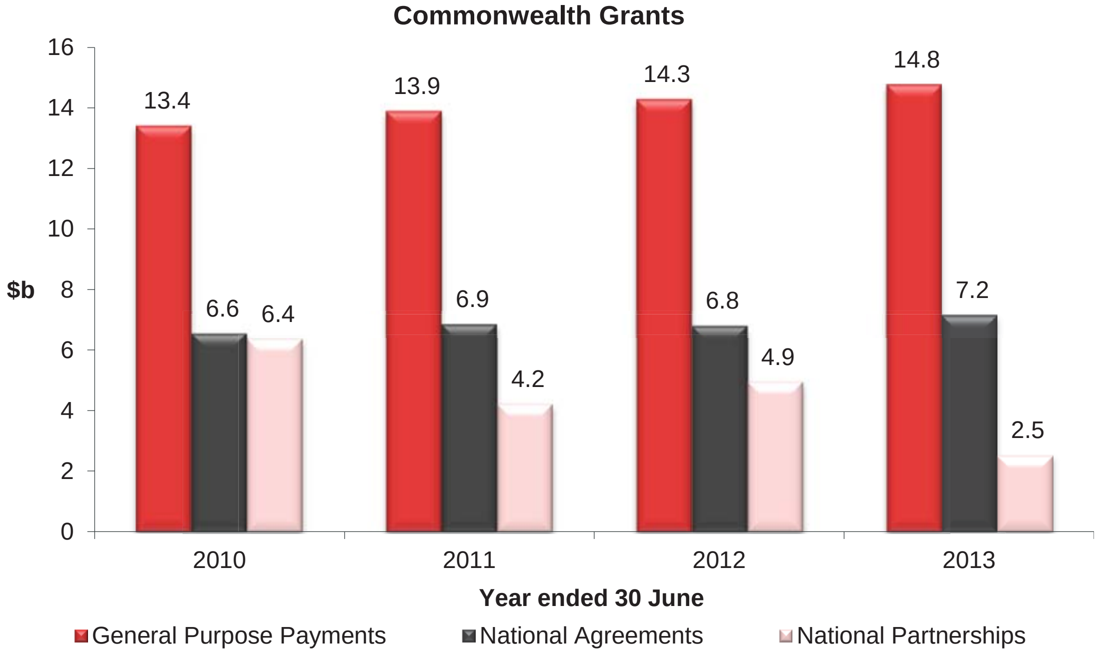
Fees, fines and other revenue include mining royalties of $1.3 billion ($1.5 billion).

Grants and Subsidies

The State received $24.5 billion in Australian Government grants, $1.6 billion less than last year

The State received $24.5 billion from the Australian Government in 2012-13, $1.6 billion less than in 2011-12 and slightly less than expected. The reduction was mainly due to lower capital grants from the Australian Government.

The money is provided to the State under various arrangements, which fall into three broad categories – general purpose payments, national agreements and national partnerships.



GST grants increased by $504 million in 2012-13

General Purpose Payments

Commonwealth General Purpose GST grants increased by $504 million from 2011-12. The increase reflects the State's marginal increase in its share of the total GST pool available for distribution to the states and territories and general economic growth. GST revenue was broadly in line with budget.

	New South Wales	Average (all states and territories)
GST revenue as a percentage of total revenue (%)	18.9	17.6
GST revenue per capita ($)	1,953	2,030

Source: Australian Bureau of Statistics; amounts based on 2011-12 Total Public Sector Government Finance Statistics data.

Note: This analysis relies on publicly available information for all states and territories. The most current data available is for 2011-12.

All states and territories' revenue is partly reliant on GST receipts. The State receives less GST per capita than average because the current GST distribution model is not solely based on a state's or territory's population.

National Agreements

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

In 2012-13, the State received $7.3 billion in National Agreement payments ($6.8 billion), including the following significant items:

National Agreements	Amount $m
Healthcare	4,251
Education	1,292
Skills and workforce development	452
Disability	414
Affordable housing	403

National Partnerships

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

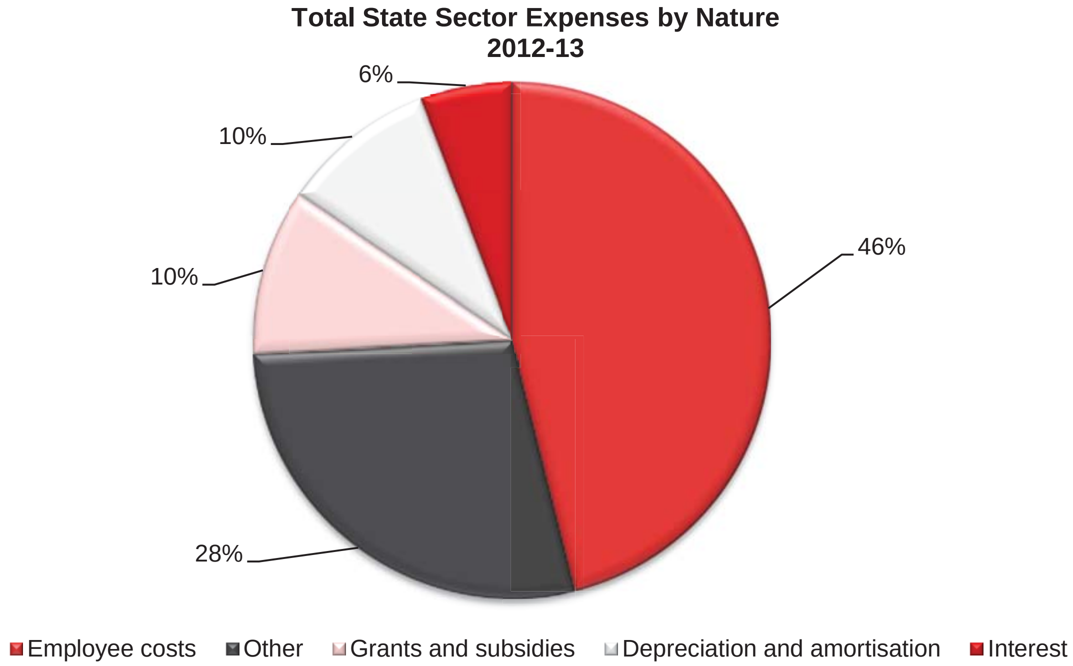
In 2012-13, the State received $2.5 billion in National Partnership Payments ($4.9 billion), including the following significant items:

National Partnerships	Amount $m
Transport	730
Education	531
Nation building plan for the future	421
Health and national health reform	434

The fall in National Partnership Payments is mainly due to decreases in Australian Government fiscal stimulus and transport funding.

Expenses

Total State Sector Expenses by Nature



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

Employee Costs

Total employee costs increased by approximately 1.5 per cent compared to the prior year. They increased in about half of all agencies and decreased in other half. Employee costs increased in health, education, and police agencies and decreased in transport, correctional, and electricity agencies.

The State spent $327 million on employee redundancies in 2012-13 ($258 million in 2011-12). A large portion of redundancies were in rail, health, education and central government agencies.

Employee costs include salary and wage costs of $26.8 billion ($26.1 billion in 2011-12), which exclude long service leave expenses of $894 million ($1.0 billion).

Superannuation costs within employee costs comprise $2.1 billion in defined contribution obligations ($2.0 billion) and net costs of defined benefit plans of $409 million ($1.5 billion). Employee costs do not include increases and decreases in superannuation liabilities resulting from changes to assumptions used to calculate these obligations (for example, movements in discount rates and other economic variables). These costs are reported in Other Economic Flows – Other Comprehensive Income.

The State employs approximately 402,000 people, around 11 per cent of all people employed in New South Wales. The size of the NSW public sector has increased 1.8 per cent annually over the five-year period to 2012, slightly more than the 1.5 per cent annual increase in people employed in New South Wales.

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

Analysis of the Financial Position

Abridged Statement of Financial Position

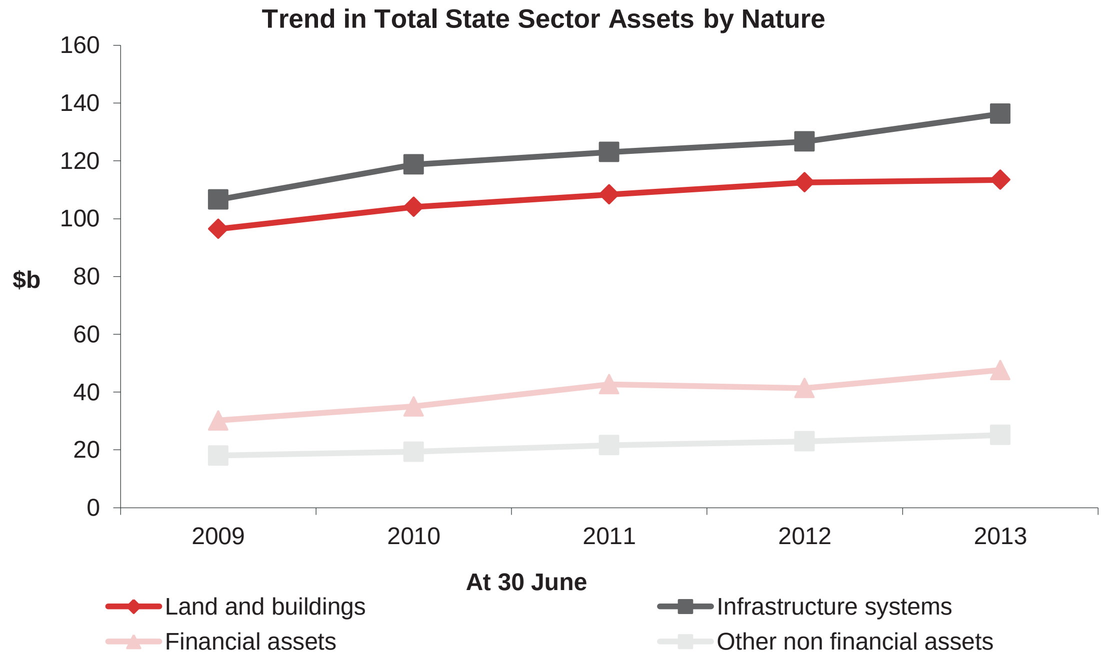
At 30 June	General Government		Total State Sector	
	2013 $m	2012 $m	2013 $m	2012 $m
Assets				
Cash and cash equivalents	8,967	6,576	12,110	9,975
Receivables and advances	13,184	12,151	6,663	6,355
Financial assets at fair value	9,071	7,235	24,492	20,777
Other investments	87,843	82,542	4,342	4,240
Property, plant and equipment	141,487	135,102	264,826	253,682
Other	4,648	4,098	10,068	8,479
Total assets	**265,200**	**247,705**	**322,500**	**303,508**
Liabilities				
Payables and deposits held	5,782	5,674	7,394	7,900
Borrowings and advances	29,785	27,641	77,327	73,098
Employee provisions	13,130	12,802	15,491	15,289
Superannuation provision	40,327	47,181	43,186	50,922
Other provisions	7,511	7,032	9,860	8,571
Other	1,989	1,864	2,565	2,217
Total liabilities	**98,523**	**102,194**	**155,823**	**157,997**
Total net worth	**166,677**	**145,511**	**166,677**	**145,511**

* 2012 amounts have been restated for changes made in accordance with Australian Accounting Standards.
Amounts in table may not add due to rounding.

The State has over $320 billion in assets, mostly property, plant and equipment

Assets

Total assets increased from $251 billion in 2009 to $323 billion in 2013 (28.3 per cent over four years), which equates to an average annual growth rate of 6.4 per cent. Around 65 per cent of this growth has occurred in property, plant and equipment, and about two-thirds of this occurred in infrastructure systems.

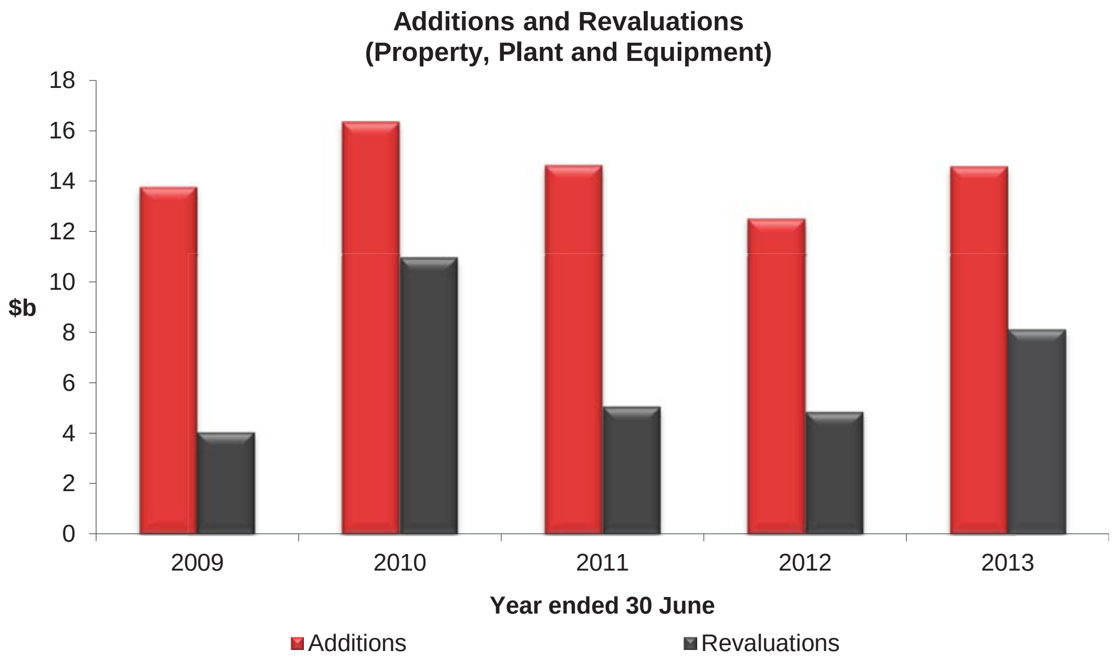


Property, Plant and Equipment

Property, plant and equipment assets represent 82 per cent of the State's total assets (84 per cent at 30 June 2012). The slight fall reflects the lease of some port operations, which have conversely increased cash and cash equivalents held by the State as a proportion of total assets.

Physical assets of land and buildings, infrastructure systems and plant and equipment are used to provide or support service delivery. The State measures these assets at fair value, usually represented by the cost to replace the remaining service potential of the asset. This is considered more useful information for government decision-making and is allowable under Australian Accounting Standards. Measuring at fair value means movements in carrying values year on year may be caused by revaluations of existing assets as well as the purchase or disposal of assets.

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



The State has spent around $72 billion on capital works over the past five years

Over the last five years, the State has spent $71.9 billion on capital works (an average of $14.4 billion per year). In 2012-13, additions to property, plant and equipment totalled $14.6 billion, partly funded by capital grants of $1.3 billion from the Australian Government. The largest single area of capital expenditure is transport and communication, representing over 40 per cent in 2012-13.

Major asset revaluations in 2012-13 included:

- roads infrastructure and earthworks, which increased values by $4.2 billion
- electricity network assets, which increased values by $2.9 billion
- residential property portfolio, which increased values by $2.0 billion
- schools and TAFE buildings, which decreased values by $1.2 billion.

Maintenance Spending and Depreciation

The State spent $4.1 billion in 2012-13 ($4.4 billion in 2011-12) maintaining its property, plant and equipment. This includes relevant employee costs. Expenditure on asset maintenance is equivalent to 1.9 per cent (2.2 per cent) of the State's property, plant and equipment (excluding land) and represents 5.9 per cent (6.5 per cent) of total expenses. In comparison, depreciation of the State's property, plant and equipment represents 9.8 per cent (8.8 per cent) of total expenses.

The State recorded depreciation and amortisation expenses of $6.8 billion in 2012-13 ($6.0 billion). Additions to property, plant and equipment and intangible assets were $15.5 billion ($13.3 billion). The expenses as a proportion of additions were 43.8 per cent in 2012-13 (45.4 per cent).This is higher than the five year average of 39.4 per cent.

Major Capital Projects

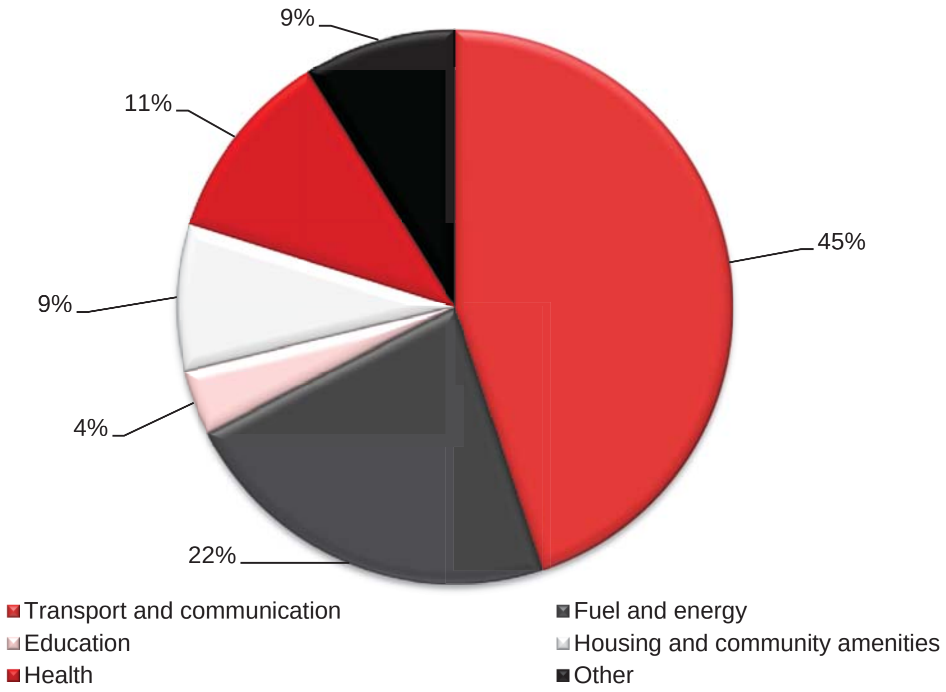
In the 2012-13 Infrastructure Statement the Treasurer announced capital expenditure of $61.8 billion over the four years to 2015-16.The Government publishes its capital infrastructure plans for current and forward estimates periods in Budget Paper 4: Infrastructure Statement.

The Government's 2012-13 capital infrastructure plan included around 700 major capital projects estimated to cost $15.0 billion. The State spent $14.2 billion (94.2 per cent) of the infrastructure budget in 2012-13 ($13.1 billion in 2011-12). Treasury advises the reasons for the $870 million Budget underspend include:

- $1.0 billion underspend for electricity generation, transmission and distribution infrastructure mainly because of revised capital programs and the impact of subdued energy demand forecasts
- $133 million underspend for water infrastructure mainly because of project delays and procurement savings
- $593 million overspend for health infrastructure mainly due to earlier recognition of the Royal North Shore Hospital Acute Services Building in 2012-13 rather than in 2013-14
- $212 million overspend for road infrastructure mainly due to a change in treating road resurfacing maintenance as capital expenditure
- $120 million overspend for transport infrastructure relates to a number of projects including:
  - rail rollingstock subject to finance lease arrangements ($286 million higher)
  - South West Rail Link ($140 million higher)
  - Opal integrated ticketing ($60.0 million lower)
  - Waratah rollingstock enabling works ($45.0 million lower)
  - bus acquisitions ($38.0 million lower)
  - bus depots ($32.0 million lower)
  - Lidcombe to Granville rail line resignalling ($32.0 million lower)
  - train station upgrades ($22.0 million lower).

Further information on major capital projects will appear in later volumes of the Auditor-General's Report to Parliament.

Total State Sector Infrastructure Investment by Policy Area 2012-13



Source: Treasury, unaudited.

Public Private Partnerships

The State has over 40 public private partnerships to provide facilities and services

The State controlled $265 billion of property, plant and equipment assets at 30 June 2013 ($254 billion). Of this, $136 billion ($127 billion) relates to infrastructure systems. Infrastructure can also be provided via mechanisms other than State owned, financed and operated arrangements.

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

The State currently has over 40 active PPPs covering a wide range of government services. A summary of active PPPs appears in Appendix 3.

The Treasury advises the following PPPs are proposed:

Proposed PPP	Nature of proposed PPP
North West Rail Link-Operations, Trains and Systems component	Manage the Operations, Trains and Systems component of the heavy rail project between Rouse Hill and Epping (North West Rail Link).
Sydney CBD and South East Light Rail	Construct and operate a light rail service from Circular Quay to Kingsford and Randwick via Surry Hills, including around 20 light rail stops, major transport interchanges, and pedestrianisation of approximately one kilometre of George Street.
Northern Beaches Hospital	Deliver and provide clinical services at a new 432-bed hospital in the Northern Beaches
F3-M2 Link	The NSW Government received an unsolicited proposal from Transurban to construct an 8km tunnel link between the F3 and M2 motorways.

Other Assets

Cash and Cash Equivalents

The State had around $12.1 billion cash and cash equivalents at 30 June 2013 ($10.0 billion at 30 June 2012). The increase was mainly due to proceeds from the long-term leases of Port Botany and Port Kembla.

Financial Assets at Fair Value

Financial assets held at fair value increased by $3.7 billion to $24.5 billion during 2012-13, due to stronger investment returns and new investments made.

This asset category mainly comprises financial investments held by the State, such as listed equities and bonds. These investments are made by New South Wales Treasury Corporation (TCorp) on behalf of agencies.

Other Investments

The State has around $4.3 billion invested directly in entities outside the NSW public sector. Ownership of these entities is generally shared with other Australian jurisdictions, such as Snowy Hydro Limited ($3.3 billion) and joint ventures operated through the Murray-Darling Basin Authority ($806 million).

Receivables

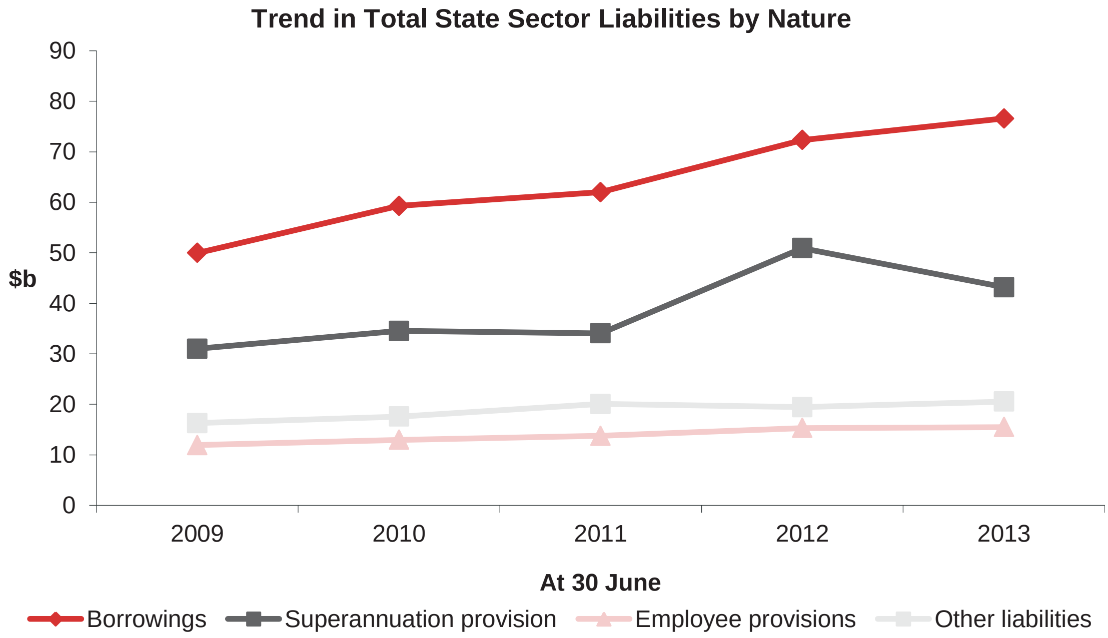
The State had receivables of around $6.6 billion at 30 June 2013 ($6.1 billion). During 2012-13, the State received nearly $77.0 billion cash from the collection of receivables.

The State generally collects most of what it is owed because the statutory nature of charges generally results in high recoverability. The table below shows details of doubtful debts at year end and debt write-offs during the year.

Year ended 30 June	2013	2012	2011	2010
Total receivables at 30 June ($m)	6,575	6,086	7,076	6,975
Allowance for doubtful debts at 30 June ($m)	352	184	313	200
Allowance for doubtful debts (% of total receivables) at 30 June	5.4	3.0	4.4	2.9
Debtors written off ($m)*	83	126	82	48
Debtors written off (% of total receivables)	1.3	2.1	1.2	0.7

* Excludes a one-off $311 million tax debt write-off in 2011-12.

Liabilities



Borrowings

State borrowings increased by $4.3 billion during 2012-13

The State had borrowings of $76.6 billion at 30 June 2013, an increase of $4.3 billion (5.9 per cent) during 2012-13. The increase includes around $4.2 billion of new borrowings, used to fund capital projects and operating cash flows.

The movement in borrowings also includes changes in the value of existing borrowings. Most of the State's borrowings are in the form of bonds, which are measured at fair value. The fair value of bonds is influenced by the cash rate set by the Reserve Bank of Australia and supply and demand of bonds. Generally, when the cash rate goes up, bond rates also increase, which causes the value of bonds to go down. Bond rates fell significantly towards the end of the 2011-12 financial year and the State recorded an unrealised loss of around $5.0 billion from fair value movements. An increase in bond rates in 2012-13 reversed some of this movement, with the State recording a reduction in the fair value of existing borrowings by around $1.2 billion.

Interest on borrowings for the 2012-13 year was $3.5 billion ($3.8 billion), which represents 4.6 per cent (5.2 per cent) of the year end borrowings balance and 4.9 per cent of total annual revenue (5.4 per cent).

During the year, the State issued $30.7 million ($19.2 million) in Waratah Bonds, which are included in borrowings.

Borrowings also include liabilities under finance leases of $4.2 billion ($2.8 billion). The increase in finance lease liabilities includes new hospital and rail rollingstock finance leases.

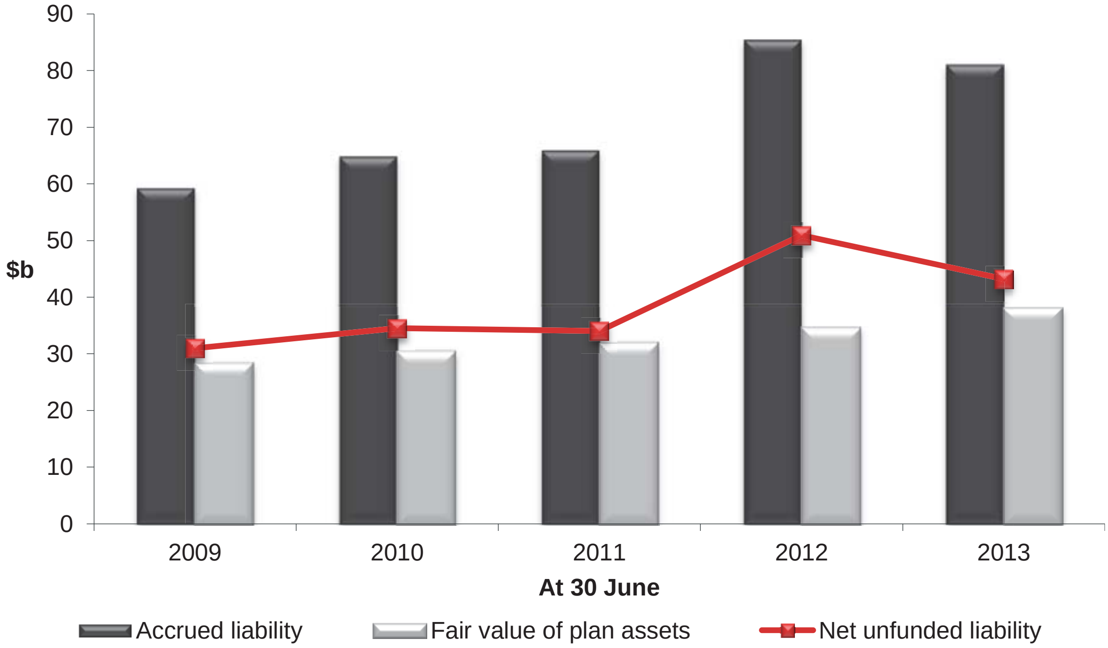
Superannuation Provisions

Superannuation liabilities decreased by $7.7 billion during 2012-13, a 15.2 per cent decrease from 2011-12

The State's superannuation liability of $43.2 billion represents obligations for past and present employees, less the value of assets set aside to meet those obligations. Superannuation liabilities decreased $7.7 billion (15.2 per cent) during 2012-13.

This decrease arose largely due to the recovery of economic conditions in Australia. Returns on the assets offsetting liabilities (plan assets) have been higher than expected and liabilities have decreased as a result of higher bond rates.

Trend in Unfunded Superannuation Liability



Higher than Expected Investment Returns

Superannuation investments that offset the liabilities performed better than expected during 2012-13. The investments earned 17.1 per cent in 2012-13 compared to the return expected by the Government of between 8.1 – 8.6 per cent. The higher investment returns meant there were $2.8 billion more investments available to reduce superannuation liabilities.

Higher Bond Rates

Superannuation liabilities are discounted using government bond rates. These bond rates increased during 2012-13 from 3.1 per cent to 3.8 per cent. The increase caused superannuation liabilities to decrease by around $3.4 billion.

Superannuation liabilities are very sensitive to changes in the government bond rate. A one per cent change in the bond rate affects the liability by over $8.0 billion.

Contributions

The State makes annual contributions to plan assets with a view to eliminating unfunded liabilities by 2030. Annual contributions in 2012-13 were $1.5 billion ($1.5 billion).

In 2011-12, the State made additional contributions of $4.6 billion funded from the proceeds of previous asset sale transactions and borrowings.

Further information on superannuation obligations will appear in Volume Seven of the 2013 Auditor-General's Report to Parliament.

Employee Provisions

The State's employee-related liabilities of $15.5 billion includes annual leave and long service leave owed to public sector employees. It also includes $3.6 billion ($3.3 billion) outstanding workers' compensation claims from public sector employees.

Employee provisions increased $202 million during 2012-13 mainly due to increases in outstanding workers' compensation liabilities.

Other Liabilities

The State had other liabilities and provisions of $20.5 billion at 30 June 2013. These liabilities increased $1.1 billion during 2012-13. The increase includes recognition of the State's obligations to fund a portion of superannuation liabilities related to NSW universities. The increase also includes the State's obligation to compensate Origin Energy for terminating its Cobbora coal supply agreement and its obligations to compensate victims of crime.

Fiscal Responsibility

Governments across Australia have legislation aimed at promoting sound financial management, or fiscal responsibility in budgeting.

It is generally accepted that balancing immediate community needs with longer term needs is necessary for intergenerational equity. The next generation should not pay for the previous generation. However, each government will set different criteria as to how this balance will be achieved and therefore what is meant by the term fiscal responsibility. The NSW Government has set out its criteria in the *Fiscal Responsibility Act 2012*.

Fiscal Responsibility Legislation

The *Fiscal Responsibility Act 2012* sets the overall goal for the management of government finances, being maintenance of the State's AAA credit rating. The purpose of holding onto the AAA credit rating is to limit the cost of and ensure the broadest access to borrowing, and to maintain confidence so economic activity and employment is sustained. The legislation also sets out targets and principles for financial management.

Since this is the first year of the current Act's application, key aspects of the legislation are summarised below.

Object	Maintain the AAA credit rating.
Purpose	• limit borrowing costs • access to a broad source of borrowings • maintain business and consumer confidence, to sustain economic activity and employment
Fiscal targets	• annual growth in General Government expenses is less than long-term average General Government revenue growth • eliminate unfunded superannuation liability by 2030
Principles of sound financial management	Responsible and sustainable spending, taxation and infrastructure investment, including: • align growth in expenses and revenue • stable and predictable taxation policies • infrastructure investment that provides highest community benefit. Effective financial and asset management, including sound policies and processes for: • performance management and reporting • asset maintenance and enhancement • funding decisions • risk management practices. Achieving intergenerational equity, including ensuring that: • policy decisions consider the effects on future generations • the current generation funds the cost of its services.

New South Wales maintained its AAA credit rating during 2012-13

AAA Credit Rating

New South Wales has credit ratings of AAA/negative from Standard & Poor's and Aaa/Stable from Moody's Investors Service. In March 2013, Fitch Ratings affirmed the State's AAA credit rating and announced it would no longer provide ratings for the State. In May 2013, Moody's affirmed its Aaa rating and stable outlook, noting New South Wales is well placed compared to most Australian states and territories. Most recently in October 2013, Standard & Poor's affirmed its AAA rating and its unchanged negative outlook.

Ratings agencies consider a variety of factors and apply judgment when determining the State's rating. These factors include such items as:

- prevailing economic conditions
- budgetary performance and flexibility
- the ability to service borrowings
- liquidity of the balance sheet.

When reporting ratings, rating agencies cite some of the State's current attributes they consider relevant to a decision to maintain a AAA rating. These include, in no particular order:

- a diversified economy
- moderate budgetary flexibility and performance
- a commitment to reduce expenditure growth
- escalating but manageable debt burden, including large unfunded superannuation liabilities
- a large infrastructure program
- strong liquidity and access to capital markets
- large grant payments from the Australian Government and likelihood of support from that Government, should acute liquidity stress occur.

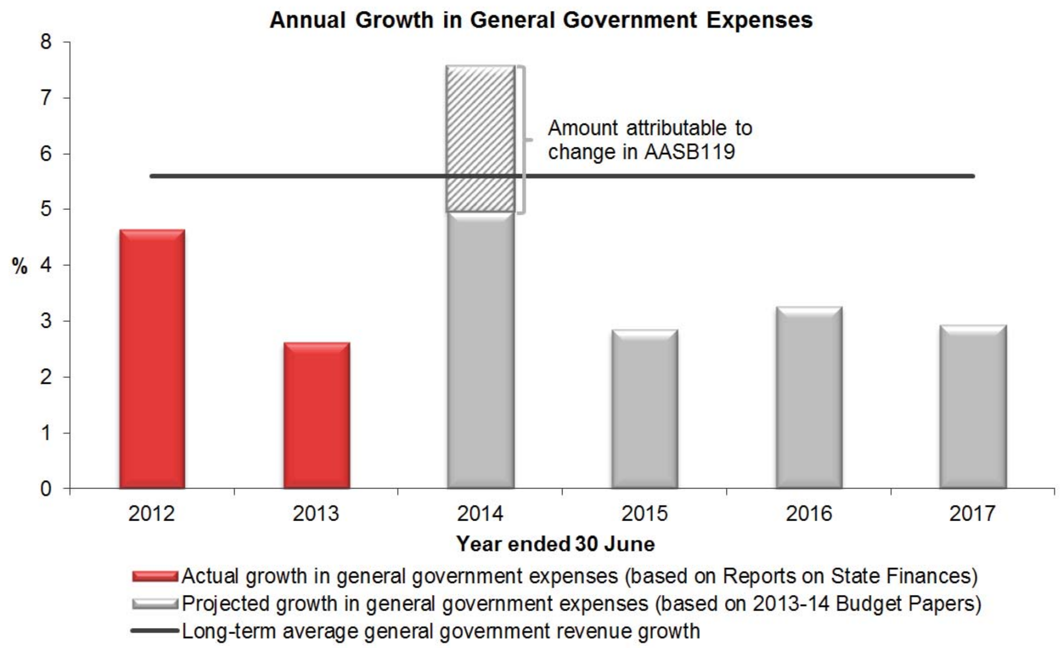
Overriding the factors used to assess New South Wales' credit rating is the Australian credit rating. The states and territories cannot have ratings higher than the Australian Government.

Ratings agencies may update their formal opinions at any time, if they perceive material changes in credit-worthiness have occurred. A risk to the AAA rating, as reported by Moody's and Standard & Poor's, is if there is a weakening resolve to implement budgetary measures that will reduce the size of recurring deficits and the pace of growth in debt.

General Government Expenditure Growth

The *Fiscal Responsibility Act 2012* sets a target for General Government expenditure growth. This growth cannot exceed the State's long-term average General Government revenue growth. The legislation prescribes the long-term revenue growth rate as 5.6 per cent. This rate equals an estimate of growth over the past fourteen years published in the 2011-12 Long Term Fiscal Pressures Report. This report is released every five years and examines the impact on the State's finances of the ageing of the population and long-term cost pressures available on Treasury's website.

The graph below illustrates this target has been achieved for 2012-13. In the 2013-14 Budget Papers, the Government predicts it will achieve this target in coming years, with the exception of 2013-14. In 2013-14, expenditure growth is impacted by a change in the classification of certain superannuation expenditure arising from new requirements within Australian Accounting Standards (changes to AASB 119 'Employee Benefits'). This is a one-off change that has no impact on cash payments or underlying liabilities.



Eliminating Unfunded Superannuation Liabilities

The government predicts unfunded superannuation liabilities of $43.2 billion will be eliminated by 2030

The *Fiscal Responsibility Act 2012* sets a target of eliminating the total net employer liabilities of the State under defined benefit superannuation schemes by 2030. The State's net superannuation liability was $43.2 billion at 30 June 2013 ($50.9 billion at 30 June 2012), almost all of which is in the General Government Sector.

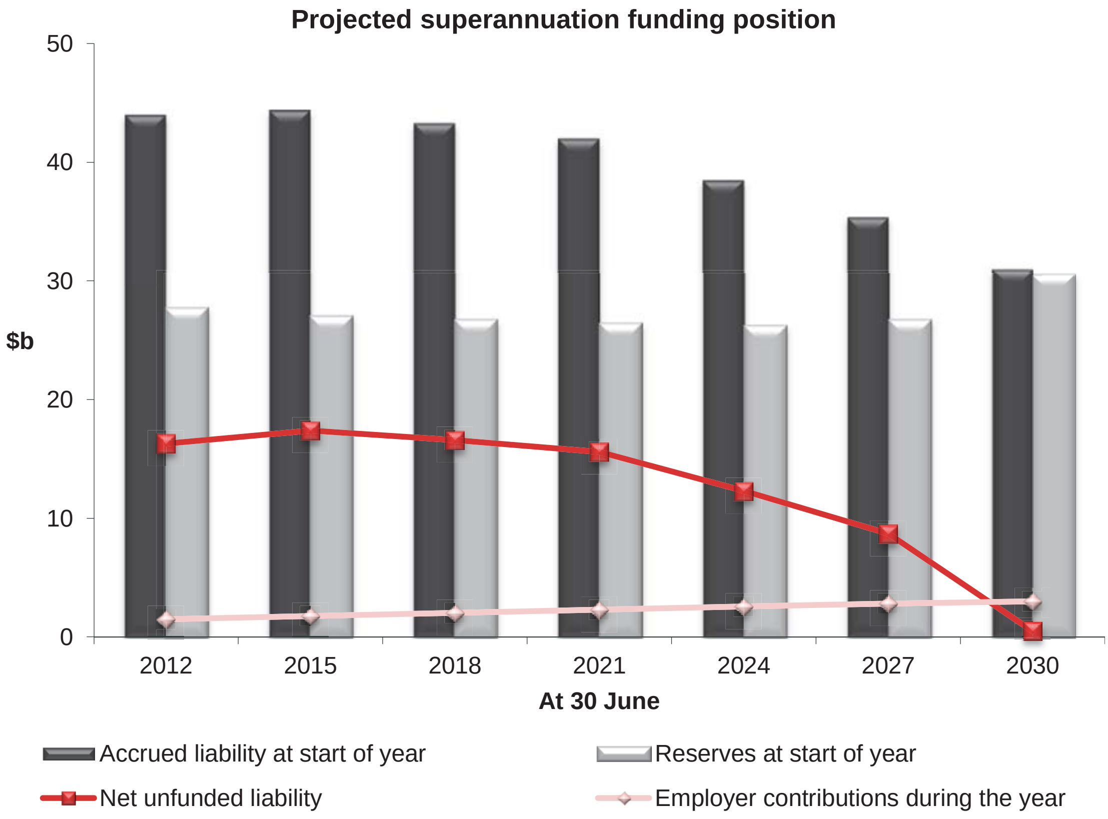
With the exception of the Judges' Pension Scheme, the State's defined benefit superannuation schemes are closed to new members. At 30 June 2013, less than 50,000 NSW public sector employees are members of defined benefit superannuation schemes. However, the schemes have over 130,000 members including past employees.

The measurement of the State's liability is affected by economic conditions. The movements in the graph on page 31 show the impact of weak investment returns and a low discount rate on the liability in 2012. The liability has reduced significantly in the current year mainly as a result of strong investment returns.

Notwithstanding volatility in the net liability in recent years, the government predicts the 2030 target will be achieved. The State's funding plan is to contribute amounts that escalate by five per cent per annum such that the schemes will be fully funded by 2030.

In accordance with this plan, the State contributed $1.5 billion towards plan assets, which offset gross liabilities, in 2012-13. This amount is largely consistent with average usual contributions over the past five years. In 2011-12, in addition to its usual contribution, the State put in an extra $4.6 billion, bringing total contributions for that year to $6.0 billion. This one-off amount will have the impact of reducing future necessary contributions.

The graph below reflects the State's current funding plan, as advised by Treasury. This funding plan is broadly consistent with the latest actuarial review of schemes that comprise the bulk of the State's liability conducted in 2012. The graph demonstrates expectations about the General Government Sector funding position over time.



Source: The Treasury, unaudited.

The liability levels in the graph above do not reflect levels recorded in the Total State Sector Accounts. This is due to the measurement basis applied for financial reporting purposes varying from the basis applied by superannuation schemes. When assessing whether a superannuation scheme is fully funded, it is generally accepted practice to measure liabilities this way. More information about the different bases of measurement will appear in Volume Seven of the 2013 Auditor-General's Report to Parliament.

Compliance

Budget Papers

The *Fiscal Responsibility Act 2012* required the 2013-14 Budget Papers to include:

- a statement of the Government's fiscal strategy to maintain the AAA credit rating of the State of New South Wales
- a report on the Government's performance on maintaining the credit rating and against the targets and principles in the Act
- the reasons for any departure from that object and those targets and principles, together with the action planned to achieve that object and those targets and principles within the forward years of the budget
- an assessment of the impact of the measures in the budget on the State's long-term fiscal gap.

Budget Paper 2 of the 2013-14 Budget Papers addressed these requirements. The Government's fiscal strategy statement affirmed its commitment to maintain the AAA credit rating and noted this had been achieved.

As noted in last year's Auditor-General's Report to Parliament, expenditure growth is readily assessable and the Budget Papers report this target has been achieved. They also report the current plan to fund superannuation liabilities will achieve the 2030 target.

The Government states it has adhered to the principles within the legislation, but as reported last year, the principles are high level and the *Fiscal Responsibility Act 2012* does not include standards of performance in all instances. Accordingly, an assessment of 'adherence' may be subjective. Finally, the Budget Papers state measures within the 2013-14 Budget reduce the long-term fiscal gap, and articulate further detail within Budget Paper 2.

Comparison of Financial Position with Other Australian States and Territories

As noted earlier in this Volume, the State's finances can be compared to other Australian states and territories using a variety of financial indicators. The following table shows how New South Wales compares on key financial management measures for 2011-12.

Measure	New South Wales	Average (all states and territories)
Net borrowing as a percentage of GSP (%)	1.1	1.9
Net financial liabilities as a percentage of GSP (%)	26.0	22.8
Net debt as a percentage of GSP (%)	9.5	6.7

Source: Australian Bureau of Statistics; amounts based on 2011-12 Total Public Sector Government Finance Statistics data.

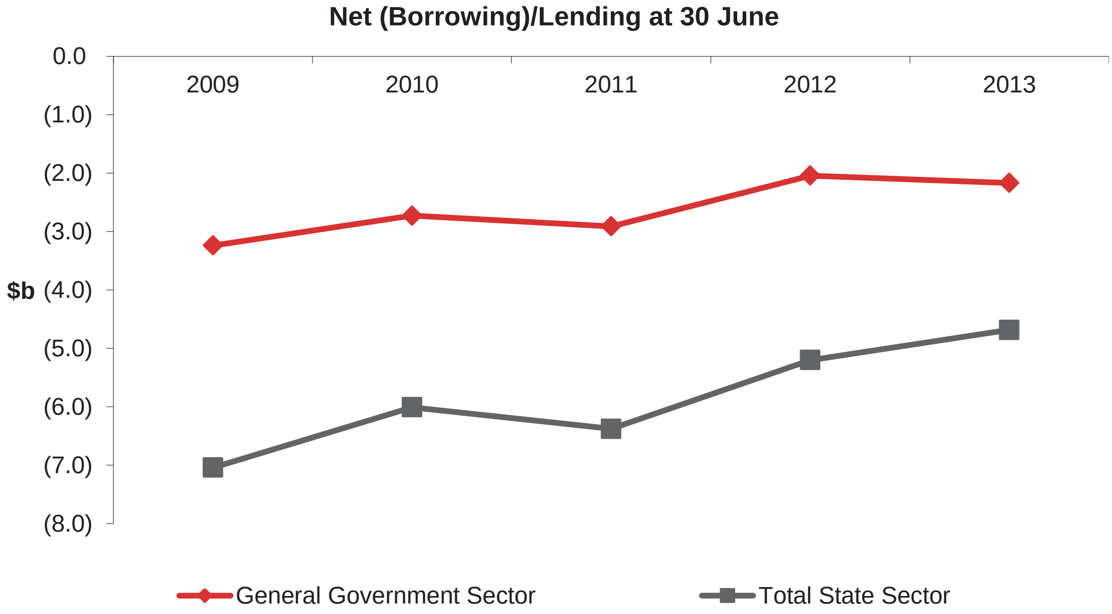
Note: This analysis relies on publicly available information for all states and territories. The most current data available is from 2011-12.

GSP: Gross State Product.

The following graph show trends in net borrowing over time. Subsequent graphs show trends in the financial management measures listed above for New South Wales compared with the average of all jurisdictions. As above, analysis relies on publicly available information for all states and territories and the most current data available is from 2011-12.

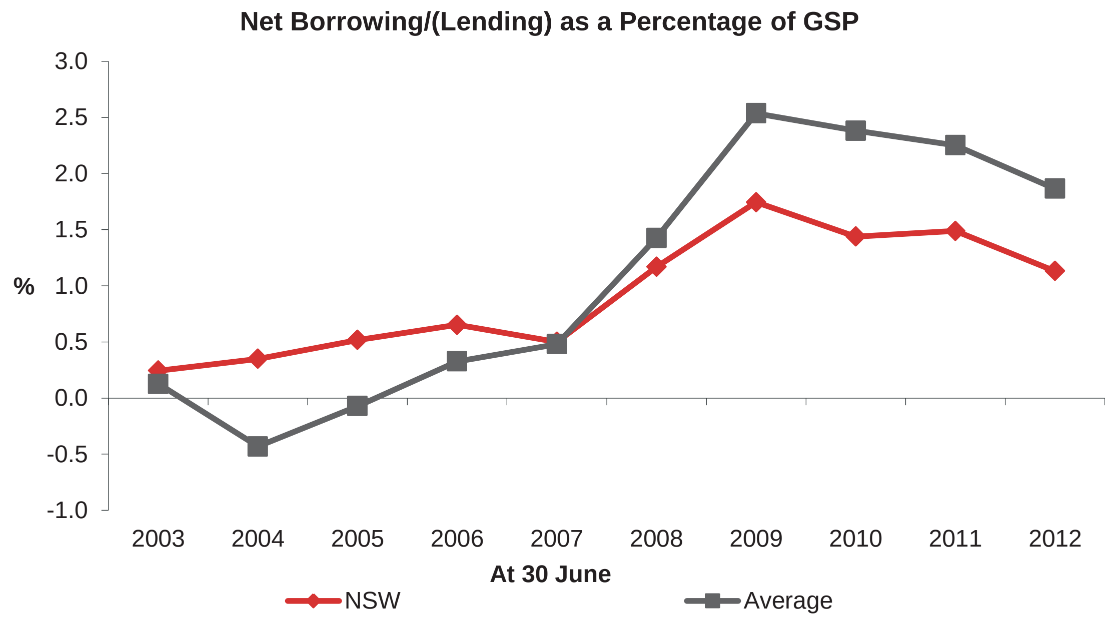
Net Borrowing

The net borrowing/lending result for a financial year reflects the extent to which capital spending was financed from operating surplus or from borrowings. The State has recorded net borrowings in recent years at both the General Government Sector and whole of sector levels. This indicates capital spending has been sourced from borrowings as well as surpluses.



Source: Australian Bureau of Statistics; amounts based on 2011-12 Total Public Sector Government Finance Statistics data.

Most jurisdictions have also recorded net borrowings in recent years and the State's net borrowing as a percentage of Gross State Product (GSP) has been lower than the average of all states and territories since 2007.



Source: Australian Bureau of Statistics; amounts based on 2011-12 Total Public Sector Government Finance Statistics data.

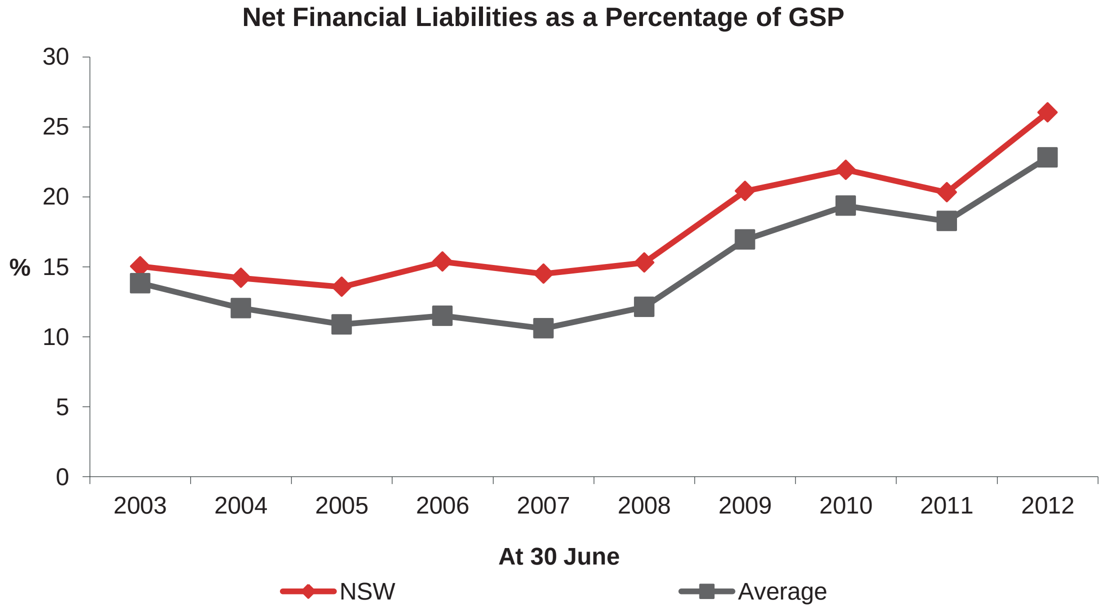
Based on data to 30 June 2012, the State had not borrowed as much money as a proportion of GSP to fund its spending as other states and territories. Given the State's lower net borrowing in 2012-13, it is reasonable to expect there will be no significant adverse change in the State's performance compared to average for the current year.

Net borrowing is calculated as the net operating balance (revenue from transactions minus expenses from transactions) less the net acquisition of non-financial assets. The State's net borrowing for 2012-13 was $4.7 billion ($5.2 billion for 2011-12).

Net Financial Liabilities

Net financial liabilities decreased to $108 billion at 30 June 2013

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



Source: Australian Bureau of Statistics; amounts based on 2011-12 Total Public Sector Government Finance Statistics data.

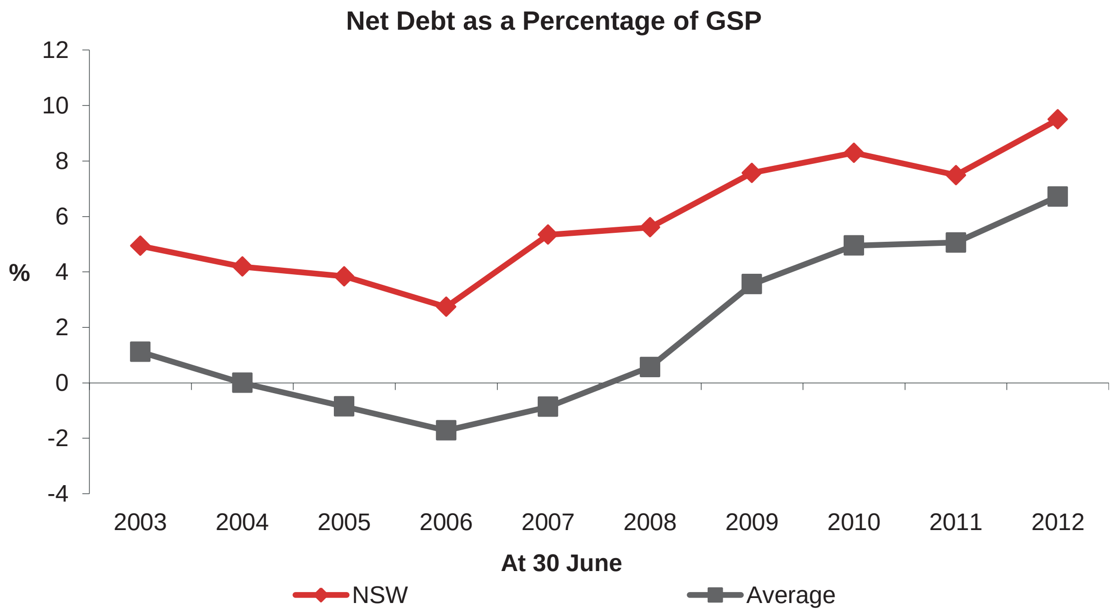
The graph above shows an overall upward trend to 2011-12. In 2012-13, the State's net financial liabilities decreased by about seven per cent to about $108 billion. This reflects the reduction in unfunded superannuation liabilities discussed earlier in this volume. If GSP is stable or increased in 2012-13, this will result in a fall in the above measure.

Net Debt

Net debt decreased to $41.6 billion at 30 June 2013

Historically, the State's net financial liabilities have not been significantly higher than average. However, the State's net debt as a percentage of GSP is higher than the average due to comparatively higher levels of net borrowing in the earlier part of last decade.

Net debt, essentially borrowings less cash and liquid financial assets, was $41.6 billion at 30 June 2013 ($43.7 billion).



Source: Australian Bureau of Statistics; amounts based on 2011-12 Total Public Sector Government Finance Statistics data.

As reported last year, the deterioration in the State's net debt in 2011-12 could have led to a widening in the gap between New South Wales and other jurisdictions. It is now clear the deterioration was common across other states and territories.

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

Quality and Timeliness of Agencies' 2012-13 Financial Reporting

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

Accurate and timely financial reporting is one aspect of sound financial management. In 2012, the NSW Commission of Audit, in its Interim Report on Public Sector Management, expressed surprise at the low importance attached to financial management across the NSW public sector. The Commission pointed to systemic weaknesses in financial management including poor reporting due to poor systems and a lack of capability. This need for improvement had been previously highlighted by the Public Accounts Committee.

This section of the report discusses progress towards improving the quality and timeliness of financial reporting across the NSW public sector.

There has been significant improvement in the accuracy and timeliness of financial reporting and audit processes

Action Taken to Improve the Accuracy and Timeliness of Financial Information

The quality and timeliness of financial reporting across the NSW public sector have significantly improved.

Last year's report to Parliament recommended Treasury take steps to further improve the accuracy and timeliness of information it uses to prepare whole-of-government financial reports. Treasury continues to implement a range of measures to improve public sector financial reporting. The Treasurer has actively engaged with agency Chief Financial Officers and Audit and Risk Committee Chairs to communicate the importance of accurate and timely financial information at various forums.

This is the third year Treasury has required agencies perform 'early close procedures'. Treasury Circular 13/01 'Mandatory early close procedures for 2013' expanded the scope and the range of procedures agencies needed to perform before year end. The early close procedures are designed to bring forward traditional year-end activities to reduce reporting timeframes and the number of errors by resolving financial reporting issues on a timely basis.

Treasury's timetable allowed less time for financial reporting and audit in 2013 than in previous years. Agency timetables were reduced by a few days and the Audit Office was asked to complete the audit process within eight weeks compared to nine weeks in 2012 and ten weeks in 2011.

In 2013, almost three times as many audits were completed by a comparable date in 2011, as a result of changes in timetable and early close procedures

As a result the Audit Office issued 175 opinions by 23 September 2013 compared to 165 by 2 October 2012 and 67 by 2 October 2011. Observations on agencies' early close procedures are discussed later in this section.

Treasury also implemented measures to improve forecasting accuracy in 2012-13. These measures include monthly forums with cluster Chief Financial Officers, presentations by Treasury staff at various finance and accountancy professional forums, and a greater emphasis in training agency and Treasury staff on ensuring quality of projections.

The Treasurer's request for the Auditor-General to review the estimates and forecasts in the 2012-13 Half Yearly Budget Review and 2013-14 Budget Papers was also aimed at improving overall quality.

The number of errors in agency financial statements decreased, but agencies still need to focus on quality control in financial reporting

Quality of Agencies' Financial Statements

The nature and extent of errors in agencies' financial statements provides valuable insight into the quality of financial reporting. Agencies' financial statements and other financial information are used to prepare the Total State Sector Accounts. Agencies' 2012-13 financial statements submitted for audit and used for whole-of-government financial reporting contained 15 errors each exceeding $20.0 million compared to 30 such errors in 2011-12.

	Number of errors	
	2012-13	2011-12
$20 - $50 million	7	15
$50 - $100 million	3	6
$100 million - $1 billion	5	7
Greater than $1 billion	--	2
Total errors greater than $20 million	**15**	**30***

* Comparative information has been updated to align with this year's reporting convention.

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

In addition to the errors reported above, agencies still reported financial information that required reclassification. For example, assets and liabilities reported as non-current when they were current or items presented in a way that is not consistent with the relevant accounting framework.

While these reclassifications have no net impact on agency assets or results, they can have other consequences, such as errors in the Total State Sector Accounts consolidation process. The reclassifications suggest improved quality control review processes and/or better knowledge of the relevant accounting framework maybe needed in some agencies.

Errors and reclassifications are identified in two ways. Some are identified by agency staff after submitting the financial statements for audit and others are identified through the audit process. Regardless, agency processes need to aim to minimise errors and reclassifications.

2012-13 Early Close Procedures

Agencies are on the right track with early close procedures

Agencies have been broadly successful in performing early close procedures and addressed most of their obligations. While there is room to improve agencies' early close procedures in some areas and in some agencies, overall, agencies are on the right track.

It is important agencies are well prepared for any future refinements of early close procedures and can plan for the 2014 timetable. Last year's Report to Parliament recommended Treasury issue its 2013 reporting timetable and any related early close procedures requirements no later than 31 December 2012. Treasury issued its 2013 timetable and requirements on 25 January 2013, a three week improvement on the previous year. Treasury advises it plans to issue the 2014 timetable and related requirements before the end of the 2013 calendar year.

Key Findings and Observations

Most agencies reconciled key account balances, performed monthly accruals and prepared pro-forma financial statements. Most agencies involved management review of monthly reconciliations and reports and included meaningful variance analysis in their monthly reports.

Opportunities for improvement in some agencies include:

- compiling adequate working papers to support early revaluations of property, plant and equipment ready for timely audit review
- ensuring sufficient documentation supporting management's proposed treatment for accounting issues, including documentation of judgements and assumptions exercised by management
- resolving all significant accounting issues as part of early close, or documenting a clear path towards their timely resolution
- preparing a documented action plan to facilitate resolution of issues.

Agencies will not always be in a position to fully resolve significant and complex accounting issues as part of early close procedures. Where full resolution is not achievable, it is important agencies document a clear path towards timely resolution and ensure appropriate stakeholders, including Treasury, are kept informed. This documentation should set out the issue, the current status, the key aspects needing resolution, and who is responsible for the expected deliverables, outcomes or outputs. Having this documented will help maintain a focus on achieving timely resolution.

Requirements

Agencies had to perform the following annual early close procedures:

- prepare pro-forma financial statements
- management review and endorsement of the pro-forma financial statements and supporting work papers
- identify and resolve one-off, complex or significant accounting issues, including changes to accounting policies and estimations
- conduct asset revaluations
- review prior year auditor's reports to ensure issues were being actioned and resolved
- review service groups, including the validity of apportioning transactions and balances between service groups.

Agencies also had to perform the following monthly procedures:

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

Timing of Agencies' Financial Statements

The *Public Finance and Audit Act 1983* allows agencies six weeks from the end of the financial year to submit their financial statements for audit. However, to facilitate preparation of the Total State Sector Accounts, Treasury determines an earlier reporting timetable for larger agencies. Building on last year, Treasury's 2012-13 timetable was earlier than in previous years.

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

In 2012-13, the 27 largest agencies needed to submit the financial statements and other relevant information to Treasury by 25 July 2013. Treasury advises 16 of these agencies met this deadline, about 60 per cent, with the balance submitting their financial statements or other relevant information between one and eleven days late.

The next 32 agencies had a due date of 26 July 2013. Treasury advises 21 agencies met this timeframe, about 65 per cent. Treasury advises all except one of the remaining agencies submitted their financial statements or other relevant information between one and seven days late.

About a further 72 agencies were required to submit financial statements and other information by 29 July 2013. Of these, Treasury advises about 60 per cent of the agencies met this timeframe, with a further 20 per cent submitting one day late.

Almost all of the further 165 or so agencies making up the Total State Sector submitted their financial statements for audit by the six week statutory deadline.

Public Accounts Committee Recommendations

The deadline for implementation of the Public Accounts Committee's recommendations has passed

Recommendation

The Premier and Treasurer should assess the status of implementing the Public Accounts Committee recommendations relating to the quality and timeliness of financial reporting and confirm action required.

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

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

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

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

No.	Public Accounts Committee's recommendations made in October 2010	Summary of government response at April 2011	Current status of progress towards implementing responses October 2013
1	The Treasurer require all agencies to conduct a hard close of their accounts at 31 March from 2011	After relevant consultation, Treasury concluded a full hard close was impracticable, and instead started implementing a series of 'early close procedures' for larger agencies. This involved conducting some aspects of year-end financial reporting processes before year-end	Early close procedures are now standard across almost all agencies. For 2013 financial reporting, Treasury mandated agencies perform expanded 'early close procedures'
2	The Treasurer propose amendments to the *Public Finance and Audit Act 1983* requiring chief financial officers to certify their financial reporting systems	Treasury requested all chief financial officers to express an opinion as to the effectiveness of internal controls over financial information prepared by their agencies by 15 April 2011	Treasury writes to agencies on an annual basis setting out requirements for certifications, but there has been no legislative change in this respect
3	The Premier ensure that accountability for accurate and timely financial reporting is included in all chief executive officers' performance agreements	Recommendation to be incorporated as part of a broader reform of accountability of chief executive officers	The performance development framework published by the Public Service Commission on 1 July 2013 includes mandatory financial management performance objectives for executives
4	The Treasurer develop and implement a program to bring forward the deadline for the tabling of annual reports in Parliament to three months after the end of the financial year by 2013 at the latest	'Early close procedures' will facilitate earlier tabling of annual reports	Annual reporting timetables have not changed since the date of the recommendation
5	The Treasurer consider proposing amendments to prescribe minimum qualifications of chief financial officers in the *Public Finance and Audit Act 1983*	Premier's Circular 99-69 'Qualifications for Senior Financial Management and Accounting Positions' is still current and the government believed this issue could be managed more flexibly through current arrangements rather than legislative amendment	Minimum qualification requirements have not changed since the date of the recommendation

The Public Accounts Committeee's recommendations need re-assessment

The Public Accounts Committee set a three-year timeframe for the Government to implement its recommendations. The table above shows there has been mixed success over the three years in implementing the recommendations. This is in part due to developments across the sector, such as Treasury's financial management reforms, referred to as its Transformation Project and the Public Service Commission's capability framework.

It is appropriate for the Public Accounts Committee's recommendations to be reassessed in light of these planned reforms and residual action confirmed.

The current status of each of the recommendations is discussed in more detail in the following pages.

Early Close Procedures

The Treasury issued TC 13/01 ‘Mandatory early close procedures for 2013’ in January 2013. The circular aims to improve the quality of agencies’ annual financial statements by requiring agencies perform early close procedures.

The 2013 circular’s requirements build on similar circulars issued in 2012 and 2011. For example, the 2013 circular extended the extent of early close procedures smaller agencies had to perform. Also, unlike prior years, the 2013 circular was also mandatory for State owned corporations.

Certification of Financial Systems

Treasury continues to develop its certification requirements. Starting in 2011, Treasury asked agency chief financial officers (CFOs) to formally assert their agency had effective systems and processes to generate the financial information required by Treasury. Treasury asked about 130 agencies to make this certification, which covers in excess of 95 per cent of the transactions and balances within the NSW public sector. Most CFOs provided these assertions.

Building on 2011 processes, Treasury again wrote to CEOs requesting formal CFO certifications in 2012 and about 85 per cent of agencies complied within four months of year-end. In 2013, Treasury requested formal CFO certifications at year-end and supplemented these with Chief Executive Officer certification requirements over data submitted for use in 2013-14 Budget Paper preparation.

Treasury is currently working on further detailed guidance underpinning CFO certifications and expects this to be available later in 2013.

Accountability of Chief Executive Officers

Until 1 July 2013, the response to the Public Accounts Committee’s recommendation about making CEOs accountable for accurate and timely financial reporting was limited to principal departments. With the release of the Public Service Commission’s Public Sector Performance Development Framework, the situation has recently changed. This Framework applies to public sector employees, but excluding those within State owned corporations. It includes mandatory performance objectives for Directors-General and Chief Executive Officers in respect of financial management, including addressing financial reporting. Chief Financial Officers are also captured by these mandatory performance objectives.

Earlier Tabling of Annual Reports

The Public Accounts Committee recommended the Treasurer develop and implement a program to bring forward the deadline for tabling annual reports. As reported in previous years, there are still opportunities to improve the timeliness of agency annual reports.

Legislation requires agencies to provide annual reports to relevant ministers within four months of the financial year-end and ministers to table those reports in Parliament within one month of receipt. The Government’s response to the Public Accounts Committee’s recommendation noted that amendment of the *Public Finance and Audit Act 1983*, the *Annual Reports (Statutory Bodies) Act 1984* and the *Annual Reports (Departments) Act 1985* would be required. However, such changes have not occurred.

Audited financial statements are included in agency annual reports. In its Circular 13/01, Treasury states early close procedures will facilitate earlier tabling of annual reports. This measure alone is unlikely to bring about significant change in annual reporting timeliness.

Treasury advises it proposes to address annual report tabling timeframes as part of its planned financial management reforms.

Minimum Qualifications for Chief Financial Officers

As reported last year, it is crucial Chief Financial Officers have the proper skills and capabilities to meet the challenges of being part of agencies' leadership group. Minimum qualifications are one way to ensure this occurs. However, there have been no changes in the relevant requirements since the Public Accounts Committee made its recommendation.

Volume Three of the 2012 Auditor-General's Report to Parliament detailed concerns about reliance on Premier's Department Circular 99-69 'Qualifications for Senior Financial Management and Accounting Positions', which are still relevant. These concerns included its limited application, exemptions for existing officers taking on new roles and a narrow focus that did not consider the broad range of skills required to effectively deliver strategic financial management.

Also reported last year, agency Chief Financial Officers need a broad skill set and identification of relevant competencies as well as minimum qualifications would be beneficial. The Public Service Commission has developed a capability framework, which will be relevant to future developments in this area of financial management capability. Of note is that the Commission has identified strategic financial management as the capability requiring the most development across the sector. The Commission's framework includes consideration of occupation specific capability and finance is one such occupation that will be separately addressed. My office understands work has commenced in this area.

Treasury advises review of the form and content of prescribing minimum qualification requirements is included in its planned financial management reforms.

Other Governance Matters

Public Accounts Committee Follow-Up of Recommendations

In 2012-13, the Public Accounts Committee held inquiries to follow up recommendations made in Auditor-General's Reports to Parliament. In determining which financial audit recommendations to follow up, the committee focused on 'repeat recommendations'.

The Committee has released its report from its inquiries following up recommendations arising from performance audits during the period October 2011 to March 2012. it is currently drafting its report on its follow up of 2012 financial audit recommendations.

The Committee has commenced an inquiry into recommendations arising from performance audits during the period April 2012 to August 2012.

Reports arising from the Committee's inquiries will be available on Parliament's website once released. The Committee's interest in following up recommendations is welcomed.

Internal Audit and Risk Management in Agencies

Background to Treasury's Policy

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

During 2012-13, Treasury made changes to relevant material on its website to help agencies understand and apply the requirements of TPP 09-5. This includes adding frequently asked questions, provision of standard documentation in readily usable formats and rearranging materials by topic area.

Audit and Risk Committees

One of the six core requirements is for agencies to establish and maintain an audit and risk committee. Another core requirement is that the committee must have a majority of independent members and an independent chair. Treasury is developing a good practice guide for audit and risk committees with the aim of:

- clarifying committee member roles and responsibilities
- promoting greater consistency of committee operations across the NSW public sector
- providing practical guidance by way of templates
- providing useful materials for member induction.

Treasury expects the guide to be released later in 2013.

Annual Attestations

TPP 09-5 requires agencies to annually attest compliance with the six core requirements and provide this to Treasury by 31 August. Agencies also need to report compliance in their annual reports. Treasury advises 85 per cent of a possible 130 entities submitted an internal audit and risk management attestation for the 2011-2012 financial year. It is currently following up 2012-13 attestations and advises approximately fifteen per cent are outstanding.

Other Governance Developments

Guidelines for Boards and Committees

The Department of Premier and Cabinet released new guidelines for boards and committees in July 2013. The guidelines apply to all NSW Government boards and committees with governing and/or advisory functions that have at least one member who is external to government. The guidelines are given effect via Premier's Memorandum 2013-06 'NSW Government Boards and Committees Guidelines'.

The guidelines are designed to:

- help agency staff establish and operate boards and committees
- give guidance on government oversight and accountabilities between boards and committees and the related agency
- clarify roles and responsibilities of members
- improve transparency, integrity and accountability of boards and committees.

The guidelines replace four previous Department of Premier and Cabinet publications. Consolidating the relevant requirements promotes understanding by users and hopefully better outcomes. An opportunity exists to improve the effectiveness of the guidelines by including a reference to Treasury's Policy and Guidelines Paper 09-05 'Internal Audit and Risk Management Policy for the NSW Public Sector'.

The new guidelines briefly address internal audit and risk management arrangements and note that some agencies will need to comply with Treasury's requirements for audit and risk management. However, instead of referring to TPP 09-5, users are referred to Treasury's Policy and Guidelines Paper 09-02 'Commercial Policy Framework: Guidelines for Boards of Government Businesses' (TPP 09-2). TPP 09-2 only contains limited material and refers users to an outdated Treasury policy that was superseded by TPP 09-5. A clear link to TPP09-5 within the guidelines would direct users to the most relevant resources and requirements.

Governance Framework for Major Transactions

The Department of Premier and Cabinet released a new framework for transactions with a non-government entity that results in either:

- a payment or benefit to the government exceeding a net present value of $10.0 million
- establishing or maintaining an exclusive or right for more than five years.

Under the framework, such transactions will be overseen by a separate oversight committee chaired by Treasury and which reports to the Cabinet Standing Committee on Expenditure Review through the Treasurer. This oversight is designed to ensure the best financial result alongside the desired service outcomes.

Released in July 2013, the framework applies to all agencies except State owned corporations and captures transactions that involve the sale/lease/licensing of physical or financial assets.

Appendix 1: Financial Statements

Statement of Comprehensive Income

Year ended 30 June	General Government 2013 $m	General Government 2012 $m	Total State Sector 2013 $m	Total State Sector 2012 $m
Revenues				
Taxation	21,980	20,660	21,571	20,287
Grants and subsidies	25,407	26,743	25,241	26,554
Sales of goods and services	5,434	4,961	18,408	16,853
Interest	406	552	814	1,203
Dividends and income tax equivalents	2,648	2,088	--	--
Other dividends and distributions	595	410	666	446
Fines, regulatory fees and other	3,662	3,591	4,529	4,514
Total revenues	**60,131**	**59,005**	**71,228**	**69,856**
Expenses				
Employee costs	28,383	28,540	31,998	32,553
Depreciation and amortisation	3,667	2,978	6,776	6,048
Interest	2,220	2,082	3,959	4,222
Grants and subsidies	11,407	11,383	7,203	7,293
Other	14,245	13,410	19,460	18,611
Total expenses	**59,923**	**58,394**	**69,396**	**68,727**
Transactions from discontinuing operations	**30**	**49**	**250**	**535**
Net operating balance – surplus	**239**	**660**	**2,082**	**1,664**
Other economic flows – included in the operating result				
Gain/(loss) from liabilities	445	(1,074)	494	(1,133)
Other net gains/(losses)	331	(815)	4,042	(5,391)
Share of earnings from associates (excluding dividends)	(137)	(23)	(137)	(23)
Dividends from asset sale proceeds	151	12	--	--
Deferred income tax expense/(benefit) from other sectors	634	(727)	--	--
Other gains	44	108	38	109
Discontinuing operations	--	--	17	(44)
Operating result – surplus/(deficit)	**1,706**	**(1,859)**	**6,535**	**(4,817)**
Other economic flows – other comprehensive income				
Revaluations	3,020	5,837	8,176	5,646
Share of earnings from associates from revaluations	141	546	141	546
Actuarial gain/(loss) from superannuation	5,613	(19,407)	6,433	(21,574)
Net gain/(loss) on equity investments	11,109	(5,617)	--	--
Net gain on discontinued equity investments	92	138	--	--
Net gain/(loss) on financial instruments	(3)	3	91	(97)
Other losses	(513)	(40)	(210)	(103)

Year ended 30 June	General Government		Total State Sector	
	2013 $m	2012 $m	2013 $m	2012 $m
Comprehensive result - total change in net worth before transactions with owners as owners	**21,166**	**(20,399)**	**21,166**	**(20,399)**
Key fiscal aggregates				
Comprehensive result - total change in net worth before transactions with owners as owners	**21,166**	**(20,399)**	**21,166**	**(20,399)**
Less: net other economic flows	(20,927)	21,060	(19,084)	22,063
Net operating balance – surplus	**239**	**660**	**2,082**	**1,664**
Less: net acquisition of non-financial assets				
Purchases of non-financial assets	7,163	5,782	12,586	12,747
Sales of non-financial assets	(1,023)	(384)	(1,300)	(641)
Less: depreciation	(3,667)	(2,978)	(6,776)	(6,048)
Plus: changes in inventories	(17)	7	50	22
Plus: other movements in non-financial assets	(50)	276	2,206	785
Equals total net acquisitions of non-financial assets	**2,407**	**2,704**	**6,767**	**6,866**
Net borrowing at 30 June	**2,168**	**2,043**	**4,684**	**5,201**

* 2012 amounts have been restated for changes made in accordance with Australian Accounting Standards. Amounts in table may not add due to rounding.

Statement of Financial Position

At 30 June	General Government		Total State Sector	
	2013 $m	2012 $m	2013 $m	2012 $m
Assets				
Financial assets				
Cash and cash equivalents	8,967	6,576	12,110	9,975
Receivables	6,492	6,012	6,223	5,902
Tax equivalents receivable	472	470	--	--
Financial assets at fair value	9,071	7,235	24,492	20,777
Advances paid	913	936	440	453
Deferred tax equivalents asset	5,307	4,733	--	--
Equity investments	87,843	82,542	4,342	4,240
Total financial assets	**119,065**	**108,504**	**47,608**	**41,347**
Non financial assets				
Inventories	271	284	1,468	1,451
Forestry stock and other biological assets	7	8	715	746
Assets classified as held for sale	235	432	1,499	504
Investment properties	125	169	562	749
Property, plant and equipment	141,487	135,102	264,826	253,682
Intangibles	2,062	1,710	3,688	3,251
Other	1,948	1,495	2,136	1,778
Total non financial assets	**146,135**	**139,201**	**274,893**	**262,161**
Total assets	**265,200**	**247,705**	**322,500**	**303,508**
Liabilities				
Deposits held	1,072	1,233	1,289	1,847
Payables	4,689	4,423	6,105	6,053
Tax equivalents payable	21	18	--	--
Liabilities directly associated with assets held for sale	--	--	182	--
Borrowing and derivatives at fair value	12	16	72,314	69,444
Borrowings at amortised cost	29,048	26,870	4,287	2,899
Advances received	725	755	726	755
Employee provisions	13,130	12,802	15,491	15,289
Superannuation provision	40,327	47,181	43,186	50,922
Deferred tax equivalent provision	634	780	--	--
Other provisions	6,877	6,252	9,860	8,571
Other	1,989	1,864	2,383	2,217
Total liabilities	**98,523**	**102,194**	**155,823**	**157,997**
Net assets	**166,677**	**145,511**	**166,677**	**145,511**

At 30 June	General Government		Total State Sector	
	2013 $m	2012 $m	2013 $m	2012 $m
Net worth				
Accumulated funds	22,012	10,650	58,214	44,904
Reserves	144,665	134,861	108,462	100,607
Total net worth	**166,677**	**145,511**	**166,677**	**145,511**
Other fiscal aggregates				
Net debt	**11,907**	**14,127**	**41,574**	**43,740**
Net financial liabilities	**62,963**	**71,996**	**108,216**	**116,650**

* 2012 amounts have been restated for changes made in accordance with Australian Accounting Standards. Amounts in table may not add due to rounding.

Applicable Accounting Framework

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

AASB 1049 is designed to provide users with information:

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

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

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

Appendix 2: Snapshot of the Public Trading Enterprise Sector

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

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

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

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

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

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

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

Highlights

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

- PTEs hold a significant proportion of State assets and liabilities. Over 90 per cent of PTE assets are property, plant and equipment used in delivery of services
- electricity PTEs have the highest asset levels, are the most geared and contribute the most money back to the General Government Sector through dividends, government guarantee fees and tax equivalent payments
- port PTE assets and liabilities fell in 2012-13 after the long-term lease of Port Botany and Port Kembla and repayment of associated debt. Current year port PTE returns reflect one-off gains on the sale of operations
- transport PTEs need significant contributions from the General Government Sector to meet their costs despite generating revenues from customers.

	Commercial Operations										Non-Commercial Operations			
	Electricity		Water		Ports		Sporting and Recreation		Other		Social Housing		Transport	
	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013	2012
Total assets ($m)	41,589	37,373	19,422	19,111	1,043	3,062	3,532	3,627	4,819	4,196	34,955	33,078	29,318	29,553
Total liabilities ($m)	30,239	28,522	10,874	10,552	361	1,282	145	156	1,462	1,550	981	975	4,401	3,651
Net assets ($m)	11,350	8,851	8,548	8,559	682	1,780	3,387	3,470	3,358	2,647	33,974	32,103	24,917	25,902
Total property, plant and equipment ($m)	35,516	31,430	18,695	18,371	820	2,528	3,341	3,456	2,322	1,787	34,512	32,816	27,954	28,170
Total capital expenditure ($m)	3,101	3,525	817	915	182	188	127	76	126	61	267	372	1,659	2,051
Total borrowings ($m)	20,339	19,554	7,640	7,154	67	723	45	52	262	268	227	220	2,166	957
Ratio of borrowings to net assets	1.8	2.2	0.9	0.8	0.1	0.4	--	--	0.1	0.1	--	--	0.1	--
Total revenue ($m) [a]	8,792	7,488	3,010	2,908	216	184	407	354	936	756	1,035	1,027	5,388	5,313
Total expenses ($m) [a]	7,209	6,779	2,388	2,378	191	170	232	312	1,141	958	1,075	1,039	4,493	4,670
Total net gains/(losses) ($m) [a][b]	(44)	323	(137)	60	2,127	(11)	(36)	(5)	298	166	(42)	(46)	(221)	(560)
Total surplus/(deficit) after tax ($m) [a][b]	1,539	1,032	485	589	2,152	3	139	36	94	(37)	(81)	(58)	674	82
Return on average equity (%)[c]	15.2	10.7	5.7	6.7	174.8	--	4.0	1.1	3.1	(1.3)	(0.2)	(0.2)	2.7	0.3
Contributions from the general government sector ($m))	199	133	53	48	--	--	238	125	42	33	132	204	3,588	3,457
Contributions to the general government sector ($m) [d]	2,209	1,821	783	592	[f] 104	67	1	1	148	88	--	--	--	9
Net return on investment (%)[e]	19.9	17.4	8.5	6.2	8.5	3.9	(6.9)	(3.6)	3.6	2.0	(0.4)	(0.6)	(14.1)	(13.2)

a From continuing operations. 2012 amounts have been restated for changes made in accordance with Australian Accounting Standards.

b Includes net proceeds from major asset sale/lease transactions.

c Return on average equity is calculated by presenting the total surplus from continuing operations (after tax), as a percentage of average net assets held in those operations over the year.

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

e Net return on investment is calculated by presenting the dividends received from operations (less any contributions made by the state), as a percentage of average net assets held in those operations over the year.

f Excludes the distribution of net proceeds from the long-term lease of Port Botany and Port Kembla. Net proceeds were paid directly to Restart NSW (within the general government sector).

Note – transactions between the PTE sector categories have been eliminated. Amounts in table may not add due to rounding.

Appendix 3: Summary of Public Private Partnerships

The State currently uses four broad types of Public Private Partnership arrangements:

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

PPP	PPP commencement [(a)]	PPP term (years)
Purchase arrangements with deferred payments		
Royal North Shore Hospital (RNSH) Redevelopment – Stage 2	2011	26
Bathurst, Orange & Associated Health Services	2011	24
Bonnyrigg Living Communities Project	2010	25
Newcastle Mater Hospital Redevelopment	2009	25
Long Bay Prison and Forensic Hospitals	2008	26
Eleven new schools (New Schools Project 2)	2007–2010	29
Nine new schools (New Schools Project 1)	2004–2005	29
Finance lease arrangements		
Rollingstock Maintenance Facility	2012	32
Electric Passenger Rollingstock Replacement	2011	33
Colongra Gas Pipeline and Storage Facility	2009	18
Parramatta Police Headquarters	2004	20
Hawkesbury Hospital	1996	18
Blue Mountains Sewage Transfer Tunnel	1996	32
Macarthur Water Treatment Plant	1995	35
Sydney Harbour Tunnel	1992	30
Build (Own) Operate Transfer (BOT or BOOT) arrangements		
The Sydney International Convention, Exhibition and Entertainment Centre Precinct	(b)	25
M5 Motorway Widening	(c)	(c)
M2 Motorway Widening	2013	(d)
Lane Cove Tunnel	2007	30
Westlink M7 (Western Sydney Orbital) Motorway	2005	31
Cross City Tunnel	2005	30
Airport Line Stations	2000	30

PPP	PPP commencement [a]	PPP term (years)
St George Hospital Car Park	1999	25
Eastern Distributor Motorway	1999	49
Stadium Australia	1999	32
Sydney SuperDome	1999	31
Randwick Hospital Car Park	1998	25
M2 Motorway	1997	49
Sydney Hospital Car Park	1995	25
Opera House Car Park	1993	50
M4 Motorway Service Centres	1993	25
M5 Motorway	1992	31
Build Own Operate (BOO) arrangements		
Rosehill Camellia Recycled Water Project	2011	20
Pindari Mini Hydro Power Station	2001	[e] 30
Woronora Water Treatment Plant	1997	23
Prospect Water Treatment Plant	1996	31
Illawarra Water Treatment Plant	1996	23
Burrendong Mini Hydro Power Station	1996	[e] 30
Copeton Mini Hydro Power Station	1995	[e] 30
Liverpool Hospital Car Park	1994	19
Glenbawn Mini Hydro Power Station	1994	[e] 30
Wyangala Mini Hydro Power Station	1991	[e] 30
Other		
Chatswood Transport Interchange	2008	[e] 47
Parramatta Transport Interchange	2006	23

Source: The Treasury (unaudited).

a Public Private Partnership commencement is the year the project was ready for operation.

b The Sydney International Convention, Exhibition and Entertainment Centre Precinct project is currently in its pre-construction phase. Construction is expected to take three years (estimated completion in 2016).

c The original M5 project commenced in 1992. The M5 Motorway widening project is currently in its construction phase. Construction extends the previous M5 Motor term by around three years (ending in 2026).

d The M2 Motorway widening project extends the original M2 Motorway term by four years (ending in 2046).

e Excludes options to extend PPP term.

Appendix 4: Legal Opinions Provided by the Attorney General or Crown Solicitor

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

I have received two such legal opinions since my last report in Volume Three 2012, which was released on 31 October 2012.

The first opinion relates to whether a decision by the NSW Aboriginal Land Council to purchase $1 million of shares in Social Enterprise Funding Australia Ltd complies with section 149(5) of the *Aboriginal Land Rights Act 1983* and, in particular, the 'prudent person test' in section 14A of the *Trustee Act 1925*. The legal opinion was jointly prepared for the Minister for Aboriginal Affairs.

The second opinion relates to whether the secrecy provisions in the PF&A Act prevented me from providing information requested by the NSW Environment Protection Authority. Sections of the opinion have been obscured. The opinion specifically refers to an active investigation by the NSW Environment Protection Authority and disclosure may compromise its investigation.

CROWN SOLICITOR
NEW SOUTH WALES

Advice

Whether NSWALC investment in SEFA in breach of the Act

Contents

Prepared for: AAR 008 Aboriginal Affairs/ AUD 018 Audit Office
Date: 16 November 2012
Client ref: Ross Pearson/ Steven Martin
CSO ref: 201203344 T01 Michael Dalla-Pozza

201203344 Advice 1 D2012/520297

1. Summary of advice

1.1 I am asked to advise the Auditor General and the Minister for Aboriginal Affairs jointly as to whether a decision by the New South Wales Aboriginal Land Council ("the NSWALC") to purchase $1,000,000 of shares in Social Enterprise Funding Australia Ltd ("SEFA") complies with s. 149(5) of the *Aboriginal Land Rights Act 1983* ("the *ALR Act*") and, in particular, the "prudent person test" in s. 14A of the *Trustee Act 1925* ("the *Trustee Act*"). I am asked to provide my views in light of an opinion provided by Ms Pritchard of Senior Counsel.

1.2 Whilst it is ultimately a matter for the Auditor General, I think that his preliminary conclusion that the investment did not comply with the prudent person test was legally available to him. In particular, I disagree with Ms Pritchard SC's construction of s. 149(5) of the *ALR Act* and think that considerations she raises at [67] of her opinion are irrelevant to the obligations imposed by s. 149(5).

1.3 I note that I have not been asked to advise specifically as to whether a report made by the Auditor General which contained those findings would survive a challenge brought by the NSWALC (there may be other relevant considerations, for example, whether the Auditor General has discharged any duty he might have to give procedural fairness to the NSWALC).

1.4 Please note this is a summary of the central issues and conclusions in my advice. Other relevant or significant matters may be contained in the advice.

2. Background

2.1 On 5 November 2012, I advised Aboriginal Affairs in relation to a letter written to the Minister for Aboriginal Affairs by the Auditor General dated 17 October 2012 in which he raised a preliminary concern about the investment by the NSWALC in SEFA (CS Reference: 201203248).

2.2 On 9 November 2012, the Auditor General asked me to advise in relation to these issues. He has instructed me with:

1. A letter written by the NSWALC to the Minister for Aboriginal Affairs dated 6 November 2012;
2. An opinion provided by Ms Pritchard SC of 6 November 2012.

2.3 On 14 November 2012, Aboriginal Affairs requested that I reconsider my earlier advice in light of Ms Pritchard SC's opinion.

2.4 Both Aboriginal Affairs and the Auditor General are content for me to provide advice to them jointly.

2.5 The circumstances which led to the Auditor General writing his letter of 17 October 2012 are set out below. (At the outset, I note that I will draw on some materials referred to by Ms Pritchard SC in her opinion which I have not seen. I have assumed this information to be accurate).

2.6 The Auditor General has performed an audit of the NSWALC. It appears that, as a result of the audit, the Auditor General became concerned about a decision made by the NSWALC on 21 July 2011 to purchase $1,000,000 shares in SEFA. This concern prompted the Deputy Auditor General to write his letter of 17 October to the Minister.

2.7 In that letter, the Deputy Auditor General raised the fact that the NSWALC had become a shareholder in SEFA to the value of $1,000,000 representing a shareholding in the company of 46.7 percent. The Deputy Auditor General said that he "understood" SEFA to be "a start-up venture with uncertainty over its likelihood to provide any return on investment for a number of years" and there to be "a lack of marketability with investments of this nature". He concluded: "[b]ased on the information we have before us, it is our view that the investment in SEFA fails the prudent person test and may therefore not be in accordance with the requirements of the [ALR] Act".

2.8 In her opinion, Ms Pritchard SC provides additional information about SEFA and the process by which the NSWALC resolved to purchase the shares.

2.9 According to Ms Pritchard SC, which my own researches have corroborated, SEFA is a public company limited by shares which provides sustainable loans for social enterprises. It receives funding from the Commonwealth Government.

2.10 In her opinion, Ms Pritchard SC refers to the submission made by the Council of the NSWALC supporting the investment and the minutes of the meeting at which the NSWALC resolved to purchase the shares. Apparently, these documents relevantly indicate that:

- The Council of the NSWALC thought that the primary objective of the investment was to "provide sustainable loans for Local Aboriginal Land Councils or for individuals for enterprise development and that [investing in SEFA]... was an opportunity to address needs and deliver services to the community". Therefore, the proposal was not for "a standard investment proposal" because the outcome was "not purely profit but the provision of services through a completely new structure to NSWALC's constituents";

- The Council raised with the NSWALC the "poor success rate for start-up rates for companies". I have assumed that this is a reference to companies set up as a result of the loans made to them by SEFA;

- The Council advised the NSWALC that "it is not likely that any dividends would be paid on shares for at least the first few years of the venture, regardless of the success of operations";
- The proposal to invest in SEFA had not gone through either the investment or finance committee of the NSWALC for in-depth consideration, evidently because of time constraints;
- The payment was classed as an investment and not a budget item. The reason for this was that, were it a budget item, it would have been necessary for the NSWALC to make cuts to other expenditure.

2.11 In response to the Auditor General's letter, the NSWALC obtained an advice from Ms Pritchard SC who concluded that the SEFA investment did not breach the prudent person rule. On 6 November 2012, the NSWALC wrote to the Minister for Aboriginal Affairs expressing its disagreement with the Auditor General's letter and alleging, amongst other things, that it was "based on error of law and should not be maintained".

2.12 I note that, in his letter of instructions, the Auditor General also asks me to advise in relation to a separate investment made by the NSWALC. This goes beyond the terms of the joint instructions so I am unable to advise on this issue at present.

3. Advice sought

3.1 The Auditor General asks for "my views" about whether the SEFA investment complies with the prudent person test. I have taken this to mean whether there is a legal basis for the preliminary view expressed in the Deputy Auditor General's letter of 17 October and his letter of instructions that the SEFA and the mining investments fail the prudent person test.

3.2 Aboriginal Affairs asks me to reconsider my earlier advice in light of Ms Pritchard SC's opinion.

4. Advice

4.1 I think that, as a matter of law, it was open to the Auditor General to have reached his preliminary view that the payment to SEFA was in breach of the prudent person rule. At the outset, I will set out some of the relevant legislative provisions.

Relevant legislation

4.2 The objects of the NSWALC include (s. 105):

"(a) to improve, protect and foster the best interests of Aboriginal persons within New South Wales, and

(b) to relieve poverty, sickness, suffering, distress, misfortune, destitution and helplessness of Aboriginal persons within New South Wales."

Section 106(8)(d) provides that one of the functions of the NSWALC is to "facilitate business enterprises, in accordance with this Act". Section 106A(2)(b) allows the NSWALC to "explore for and exploit, or cause to be explored for or exploited, mineral resources or other natural resources vested in it". Section 108(1)(a) provides that one of the functions of the NSWALC is "directly or indirectly, to provide community benefits under community benefits schemes",

4.3 Section 149 of the *ALR Act* relevantly provides:

> "(1) The New South Wales Aboriginal Land Council is to establish in an authorised deposit-taking institution an account named the 'New South Wales Aboriginal Land Council Account' (the ***Account***).
>
> ...
>
> (3) Subject to section 150, the following is to be paid from the Account:
>
> ...
>
> (b) amounts required to meet expenditure incurred by the New South Wales Aboriginal Land Council in the execution or administration of this Act,
>
> ...
>
> (5) Money to the credit of the Account may be invested in any manner authorised by the regulations."

Section 150(1) provides that the capital value of the account be maintained. Section 150(2) provides:

> "(2) Net realised investment income and net realised capital gains on money to the credit of the Account (being realised investment income and realised capital gains less any costs incurred in investing the money, including the cost of obtaining investment advice) after 31 December 1998 may be disbursed from the Account."

4.4 Clause 93(1) of the *Aboriginal Land Rights Regulation 2002* ("the *ALR Regulation*") provides:

> "(1) Money to the credit of the New South Wales Aboriginal Land Council Account may be invested in any manner for the time being authorised by law for the investment of trust funds."

4.5 Section 14A of the *Trustee Act* meets the description of a law "for the investment of Trust funds" for the purposes of the *ALR Regulation*. This section reflects the obligations owed by trustees as fiduciaries to their beneficiaries and provides:

> "(1) This section has effect subject to the instrument (if any) creating the trust.
>
> (2) A trustee must, in exercising a power of investment:

201203344 Advice 1 D2012/520297

> (a) if the trustee's profession, business or employment is or includes acting as a trustee or investing money on behalf of other persons, exercise the care, diligence and skill that a prudent person engaged in that profession, business or employment would exercise in managing the affairs of other persons, or
>
> (b) if the trustee is not engaged in such a profession, business or employment, exercise the care, diligence and skill that a prudent person would exercise in managing the affairs of other persons."

This is known as the "prudent person rule".

The prudent person test

4.6 The concept of the "prudent person" was first laid down in the United States decision of *Harvard College v Amory* 26 Mass 9 Pick 446 in which the Court said:

> "All that can be required of a trustee is that he shall conduct himself faithfully and exercise sound discretion. He is to observe how men of prudence, discretion and intelligence manage their own affairs, not in regard to speculation, but in regard to permanent disposition of their funds, considering the probable outcome, as well as the probable safety of the capital to be invested."

4.7 Section 14A(2) differs from this test by creating a special standard which applies to professional trustees (set out in s. 14A(2)(a)) and a standard which applies to all other trustees (set out in s. 14A(2)(b)). I think that the standard in s.14A(2)(a) will apply to the NSWALC. This is because the duties of the NSWALC include, pursuant to s. 149(5) of the *ALR Act*, investing the money in the account set up under that section. It appears that Ms Pritchard SC has made the same assumption at [63] of her opinion (although the reference to para. (a) appears inadvertently to have been omitted). Regardless, I would probably agree with Ms Pritchard SC that nothing likely turns on this.

4.8 The question is, therefore, whether, in investing in SEFA, the relevant members of the NSWALC exercised the care, diligence and skill a prudent person in that employment would have exercised in managing the affairs of other persons.

4.9 In Davis & Shaw's *Trustee Investment: The Prudent Person Approach* (Butterworths 1997), the following comment is made (at p37):

> "Prudence is a test of conduct and not of performance. Neither the overall performance of the portfolio, nor the performance of individual investments should be viewed as central to the inquiry. Prudence should be measured primarily by the process through which investment strategies and tactics are developed, adopted, implemented and monitored. Prudence is demonstrated by the process through which risk is managed, rather than by the labelling of specific investments as either prudent or imprudent."

201203344 Advice 1 D2012/520297

4.10 As Ms Pritchard SC notes at [66], the second reading speech for the *Trustee Amendment (Discretionary Investments) Bill 1997* (which introduced s. 14A) similarly recognises the importance of "flexibility and diversification" of investments.

4.11 That said, however, investment in schemes of an "inherently hazardous nature" will represent a breach by the trustee of his or her duties to the beneficiary (*Re Whiteley* (1886) 33 Ch D 347 at 356–357 per Lindley LJ; *Fouche v Superannuation Fund Board* (1952) 88 CLR 609 at 636–637 per Dixon, McTiernan and Fullagar JJ; *Wingecarribee Shire Council v Lehman Brothers Australia Ltd (in liq)* [2012] FCA 1028 at [901] per Rares J).

4.12 If the Auditor General is correct in the assessment he expressed in his letter of 17 October, namely, that SEFA was "a start-up venture with uncertainty over its likelihood to provide any return on investment for a number of years" and there was "a lack of marketability with investments of this nature", it was open for him to conclude that a prudent person would have made this investment. Provided there is at least some basis for this opinion in the materials considered by the Auditor General (*Australian Broadcasting Tribunal v Bond* (1990) 170 CLR 321) and the conclusion is not so unreasonable that no reasonable decision maker could have reached this conclusion (*Associated Provincial Picture Houses Ltd v Wednesbury Corporation* [1948] 1 KB 223), this assessment does not amount to an error of law. (I note that I am not considering procedural fairness questions at this point).

4.13 Whilst the Auditor General's letter is brief (which is something the NSWALC criticise in its letter of 6 November), the materials referred to by Ms Pritchard SC, reveal some basis for his assessment. For this reason, it seems unlikely to me that the Auditor General's assessment would be regarded by a court as unreasonable in the *Wednesbury* sense.

4.14 Further, in light of what Davis and Shaw have said, whilst it may be accepted that performance of the investment is not, itself, determinative of whether the prudent person would have made the investment, nor is it irrelevant. An inference may legitimately be drawn that investment in a company which was not expected to show returns for a number of years demonstrates that the process through which the risk of the investment was assessed was inadequate. More importantly, the minutes of the NSWALC meeting of 21 July 2011, particularly those that demonstrate that the investment was not analysed by the investment and finance committees of the NSWALC, could legitimately, in my view, be taken to demonstrate that the conduct of the NSWALC in assessing the risks of the investment was deficient.

4.15 Whether such conclusions should be drawn is a matter for the Auditor General. However, as there is some evidence available and the conclusion is not apparently unreasonable in the *Wednesbury* sense, I consider that he is legally entitled to take the view he has taken.

Ms Pritchard SC's opinion

4.16 Ms Pritchard SC's has expressed an apparently contradictory view. I say "apparently" because the conclusion which she ultimately reached was that it is unlikely that a *court* would find that an investment in SEFA was a breach of the *Trustee Act* (see at [5]). In part, this is because a court generally only interferes with the discretion of trustees on certain limited grounds (see at [61]). The present question for consideration is not whether a court would find there to have been a breach of trust. This is because there is no trust in the present situation, merely a statutory obligation under s. 149(5) which requires the NSWALC to invest as a trustee would and also because the Auditor General is not a court. Instead, the question is whether there is a lawful basis for the Auditor General's opinion that there has been a breach of the prudent person rule. In a sense, I think the position is almost the reverse of that considered by Ms Pritchard; the onus will be on anyone challenging the view of the Auditor General to demonstrate that he made legal error, which means that the grounds for challenging his view are greatly reduced.

4.17 Leaving this to one side, however, Ms Pritchard SC raises a number of arguments as to why the investment was not made in breach of s. 149(5) of the *ALR Act*. At [66], she notes that the point of s. 14A (as revealed by the second reading speech to the Bill which introduced that section) is to encourage greater flexibility and diversity in investments. I agree this was the point of inserting s. 14A; prior to that time, trustees were permitted to invest only in a specified list of investments. Beyond acknowledging that historical reality, however, the second reading speech does not, in my view, take the matter any further. It is one thing to accept that a trustee may invest in a broad and diverse range of portfolios; it is another to say that a trustee may invest in a scheme with little prospect of generating a return.

4.18 However, this analysis of the prudent person test is not Ms Pritchard SC's central focus. She accepts (and, indeed, the materials she refers to evidently make abundantly plain) that the investment in SEFA was not made purely in the interests of profit but so as to deliver services and foster beneficial economic conditions amongst Aboriginal individuals and communities. However, on her construction of the *ALR Act*, this was not a breach of s. 149(5) or of the prudent person rule as applied by that section.

4.19 In particular, Ms Pritchard SC considers that s. 149(5) permits the NSWALC to have regard to a broader range of matters than mere profit when deciding whether to make an investment. Her reasoning in this regard is set out at [67] as follows:

a. Section 14B(2) is concerned with the duties of a trustee in exercising the power of an investment;

201203344 Advice 1 D2012/520297

b. This requires consideration of the terms of the instrument creating the trust;

c. Here, as there is no instrument creating the trust, it is necessary to have regard to the terms and objects of the *ALR Act*;

d. The objects of the *ALR Act* in constituting the NSWALC, as set out in s. 105, include improving, protecting and fostering the best interests of Aboriginal persons in New South Wales. Specifically, its powers to achieve these objects include facilitating business enterprises (s. 106(8)(d)) and providing community benefits under community benefit schemes (s. 108(1)(a)).

e. Therefore, the power of investment in s. 149(5) can legitimately be exercised so as to promote those objects and the obligations imposed by s. 14A of the *Trustees Act* via s. 149 of the *ALR Act* should be read so as to be consistent with those objects.

4.20 I do not agree with this reasoning. This is because I do not think it is possible to regard the *ALR Act* as somehow analogous to an instrument creating a trust. They are clearly instruments of a very different character. The instrument creating a trust is a private instrument which sets out the obligations and powers of the trustees with respect to their beneficiaries. It is clear that the powers to invest must be exercised conformably with and subject to that instrument and, indeed, that much is expressly provided by s. 14A(1) of the *Trustee Act*. The *ALR Act* is, of course, a public Statute and does not create a relationship of trustee and beneficiary. All it does is to impose on the NSWALC the same obligations in investing moneys for the account that it would have had were it a trustee. For this reason, s. 14A(1) should not be construed as requiring s. 14A(2) to be read subject to the *ALR Act*.

4.21 Even if I am wrong, however, and the Act could be regarded as analogous to an instrument creating a trust, I would nevertheless still disagree with Ms Pritchard SC. This is because, for the reasons set out below, I do not think general considerations of the type Ms Pritchard SC refers to at [67] of her opinion are relevant to construing s. 149(5).

The proper construction of the ALR Act

4.22 I accept that the objects of the *ALR Act* are relevant to construing the investment power in s. 149(5). In *CIC Insurance v Bankstown Football Club* (1997) 187 CLR 384 Brennan CJ, Dawson, Toohey and Gummow JJ said;

> "the modern approach to statutory interpretation (a) insists that the context be considered in the first instance, not merely at some later stage when ambiguity might be thought to arise, and (b) uses "context" in its widest sense to include such things as the existing state of the law and the mischief which, by legitimate means such as those just mentioned, one may discern the statute was intended to remedy. Instances of

201203344 Advice 1 D2012/520297

> general words in a statute being so constrained by their context are numerous. In particular, as McHugh JA pointed out in *Isherwood v Butler Pollnow Pty Ltd* if the apparently plain words of a provision are read in the light of the mischief which the statute was designed to overcome and of the objects of the legislation, they may wear a very different appearance. Further, inconvenience or improbability of result may assist the court in preferring to the literal meaning an alternative construction which, by the steps identified above, is reasonably open and more closely conforms to the legislative intent."

Similarly, in *Wilson v State Rail Authority of New South Wales* [2010] NSWCA 198, Allsop P said (at [12]):

> "However, as is now beyond dispute, in construing an Act, a court is permitted to have regard to the words used by Parliament in their legal and historical context. Context is to be considered in the first instance, not merely when some ambiguity is discerned. Context is to be understood in its widest sense to include such things as the existing state of the law and the mischief or object to which the statute was directed. These are legitimate means of understanding the purpose of the Act and of the relevant provisions, against which the terms and structure of the provisions and the Act, and a whole, are to be understood."

4.23 Section 149(5) is concerned with the investing of money. The verb "to invest" means "[t]o employ (money) in the purchase of anything from which interest or profit is expected; now, esp. in the purchase of property, stocks, shares, etc., in order to hold these for the sake of the interest, dividends, or profits accruing from them" (Oxford Dictionary, Online Edition). Section 149 creates an account for the keeping of money; this makes it plain beyond argument that the word "invest" refers to payments made with the object of realising gains of a financial kind (as opposed to the realisation of various other benefits which could, in a different context, be regarded as "investments"). Therefore, in my view, s. 149(5) does not expressly authorise or contemplate the payment of moneys to achieve other ends.

4.24 In my view, a reading of s. 149(5) in its statutory context (including the objects of the *ALR Act*) does not alter its meaning or effect. The reason for this is that the Act elsewhere includes specific provisions designed to achieve the objects referred in s. 105. For example, as Ms Pritchard SC points out, s. 106(8)(d) and s. 108(1)(a) confer express powers on the NSWALC to facilitate Aboriginal business enterprises and deliver community and social benefits. The construction of s. 149(5) proposed by Ms Pritchard SC would duplicate and overlay these specific powers with a general power. In *Anthony Hordern & Sons Ltd v the Amalgated Clothing and Allied Trades Union of Australia* (1932) 47 CLR 1 the High Court held (at 7):

> "When the Legislature explicitly gives a power by a particular provision which prescribes the mode in which it shall be exercised and the conditions and restrictions which must be observed, it excludes the

> operation of general expressions in the same instrument which might otherwise have been relied on for the same power".

Sections 106(8)(d) and 108(1)(a) deal specifically with the facilitation of Aboriginal business enterprises and the providing of community benefits. On this subject matter, these sections are the specific powers. Section 149, by contrast, does not deal specifically with issues of the facilitation of business enterprises and community benefits and is, on this subject matter, the general power. Applying *Anthony Hordern*, therefore, the general power in s. 149 should not be construed as conferring the same power conferred specifically by ss. 108(8)(d) and s. 108(1)(a).

4.25 By contrast, ss. 149 and 150 relate specifically to financial matters (including, relevantly, investments). On this subject matter, they are the specific provisions and ss. 106(8)(d) and 108(1)(a) the general provisions. The maxim *generalia specialibus* provides that a specific provision will prevail over a general one (see *Purcell v Electricity Commission of New South Wales* (1985) 60 ALR 652 at 657). However, as a court will generally endeavour to avoid inconsistency, it will read down the general provision if possible (*Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 at 382 per McHugh, Gummow, Kirby and Hayne JJ). For these reasons, I do not think the Court would read s. 106(8)(d) and s. 108(1)(a) so as to enable the NSWALC to make investments or deal with money in a way which is inconsistent with ss. 149 and 150.

4.26 Similarly, Ms Pritchard SC's broad reading of s. 149(5) would cause the specific provisions in ss. 106(8)(d) and s. 108(1)(a) to be otiose. It is presumed that Parliament intended every word used by Parliament to have effect (*Commonwealth v Baume* (1905) 2 CLR 405 at 414 per Griffith CJ; *Project Blue Sky Inc v Australian Broadcasting Authority* (1998) 194 CLR 355 at 382 per McHugh, Gummow, Kirby and Hayne JJ).

4.27 My proposed construction is consistent with the objects of the Act set out in s. 105. The Act contains various specific provisions allowing the NSWALC to put money towards schemes intended to benefit Aboriginal persons and communities (s. 108(8)(d) and 108(1)(a) are examples of such provisions). Section 149(5) enables the objects to be met by maximising the moneys available in the fund. Under s. 150(2), these additional moneys may be disbursed from the account (including so as to meet the expenditure incurred in the administration and execution of the Act- see s. 149(3)). However, given that s. 150(1) requires the capital value of the account to be maintained, the greater the return on the investment, the more money is available to be disbursed in the administration and execution of the Act and so as to deliver the benefits contemplated by the Act. Thus, s. 149(5) achieves and furthers the Act's purpose by maximising the available funds.

4.28 Therefore, I think that the delivery of social services and economic benefits are irrelevant considerations to the exercise of the investment power in s. 149(5).

4.29 I note that I have approached the question principally as a matter of statutory construction. I have not considered whether the Auditor General's report could be successfully challenged judicially by the NSWALC. Other considerations might arise (for instance, whether the Auditor General complied with his obligations in procedural fairness). In this regard, I note particularly the matters raised on the last paragraph of p. 2 of the NSWALC letter to the Minister.

4.30 I note also that I have not had occasion to explore the options that might be available to the Minister (although I note that a direction under cl. 93(3) of the *ALR Regulation* might be a possibility).

4.31 I should note that, although I do not have a final view on the matter, I do not disagree with what Ms Pritchard SC has said at [50] of her advice as to whether the NSWALC would have been able to make payments to SEFA as part of its functions under s. 106(8)(d) or s. 108(1)(a). It seems to me to be at least possible that providing moneys to an organisation intended to provide loans so as to benefit Aboriginal individuals or businesses would be a payment to "facilitate business enterprises" and could also be to provide community benefits. If so, s. 149(3)(b) would have authorised a disbursement of the account for this purpose. However, I note that, according to the records Ms Pritchard SC has seen, this is not what occurred; instead, the payment was made under the investment power.

Signed:

John McDonnell
Assistant Crown Solicitor
for Crown Solicitor

201203344 Advice 1 D2012/520297

CROWN SOLICITOR
NEW SOUTH WALES

Advice

Notice to produce information and records to EPA re [redacted]

Contents

Prepared for: AUD018 Audit Office of NSW
Date: 29 July 2013
Client ref: Peter Achterstraat, NSW Auditor-General
CSO ref: 201301978 T08 Richard Kelly

 201301978 Advice 1 D2013/317621

1. Summary of advice

1.1 In general terms, the secrecy requirements of s.38(1) of the *Public Finance and Audit Act 1983* (the "*PFA Act*") operate as a lawful excuse (within the meaning of s.211 of the *Protection of the Environment Operations Act 1997* (the "*POEO Act*")) for non-compliance with a requirement to provide information and records under Chapter 7 of the *POEO Act*. In the present matter, to the extent that the Notice to Provide Information and/or Records dated 10 July 2013 (the "Notice") requires the Auditor-General to provide information or records which would reveal any matter or thing coming to his knowledge in the exercise of functions under the *PFA Act* (including the conduct of a performance audit under Division 2A of Part 3 of that Act), the Auditor-General may in my view decline to do so. Having regard to the terms of the Notice it would appear very likely (and possibly inevitable) that provision by the Auditor-General of the information and records sought in the Notice, would breach the secrecy requirements of s.38(1). Nevertheless, if it has not already occurred I suggest the Auditor-General should review the terms of the Notice and satisfy himself as to whether this is the case.

1.2 The secrecy requirements of s.38(1) of the *PFA Act* are subject to the exceptions contained in s.38(2) of that Act, including s.38(2)(b), which operates in respect of certain criminal and civil proceedings relating to money and property. On the basis of the information contained in the Notice, which essentially discloses that an investigation is taking place in respect of a possible offence under s.143 of the *POEO Act*, there are in my view no proceedings presently in existence for the purposes of s.38(2)(b) of the *PFA Act*, and the exception contained in that sub-section is therefore not engaged and does not provide a basis for the Auditor-General to be compelled to comply with the Notice.

1.3 Please note this is a summary of the central issues and conclusions in my advice. Other relevant or significant matters may be contained in the advice, which should be read in full.

2. Background

2.1 [redacted]

2.2 The Notice dated 10 July 2013 which has now been received by the Auditor-General seeks provision of a range of information and records (including names, contact details, diary notes, emails, correspondence, file notes and so on) in connection with [redacted]. The Notice, in the "Background" section at p. 2 of the document, states as follows:

[redacted]

2.3 (The reference to "the Act" in the above extract is a reference to the *POEO Act*.)

2.4 The Notice is issued on NSW Environment Protection Authority ("EPA") letterhead and is addressed to the Audit Office of NSW, to the attention of Mr Peter Achterstraat, and requests that the information and/or records sought in the Notice be provided to Mr Steven James, Investigator, Office of Environment and Heritage, by no later than 5:00pm on Wednesday 7 August 2013. The Notice states that Mr James is an authorised officer for the purposes of the *POEO Act*.

2.5 It is against the above background that my advice is sought.

3. Advice sought

3.1 My advice is sought as to whether s. 38 *PFA Act* precludes compliance with the Notice in relation to materials acquired during the relevant audit of [redacted] by the Auditor General.

201301978 Advice 1 D2013/317621

4. Advice - whether s. 38 *PFA Act* provides the Auditor-General with a lawful excuse for non-compliance with the Notice

4.1 As outlined in the terms of the Notice, [redacted]. Chapter 7 of the *POEO Act* is titled "Investigation" and includes provisions conferring powers in relation to investigation of offences. In the present matter the Notice states that it has been issued by an authorised officer pursuant to s. 193 of the *POEO Act*, which relevantly provides that an authorised officer may by notice in writing require a person "to furnish to the officer such information or records (or both) as the officer requires by the Notice in connection with any matter within the responsibilities and functions of the regulatory authority that appointed the officer".

4.2 Section 211(1) of the *POEO Act* provides as follows:

> "**211 Offences**
>
> (1) A person who, without lawful excuse, neglects or fails to comply with a requirement made of the person under this Chapter is guilty of an offence."

4.3 It will be noted that s. 211 provides a "lawful excuse" exception in respect of compliance with a requirement made under the *POEO Act*. Section 211(4) imposes a maximum penalty for individuals of $250,000 and in the case of a continuing offence, a further penalty of $60,000 for each day the offence continues.

4.4 As you are aware, s. 38 of the *PFA Act* is a secrecy provision which requires the Auditor-General, an Auditor or an authorised person to "preserve and aid in preserving secrecy with respect to all matters and things that come to the knowledge" of those persons in the exercise of functions under the *PFA Act* and the "prescribed requirements", and further provides that such persons "shall not communicate to any person any such matter or thing". Section 38(1) is qualified by exceptions specified in s. 38(2), and I shall consider this in more detail further in this advice. Section 62 of the *PFA Act* provides that a person who contravenes or fails to comply with any provision of the *PFA Act* or the prescribed requirements is guilty of an offence.

4.5 In light of the provisions outlined above, a question that arises in the present matter is whether s. 38 of the *PFA Act* provides a lawful excuse, for the purposes of s. 211 of the *POEO Act*, which excuses the Auditor-General from the requirement to provide information and/or records in compliance with the Notice.

4.6 The circumstances arising in the present matter are very similar to those considered in the case of *Re NSW Grains Board* [2002] NSWSC 913. That case concerned an application to the Supreme Court by the Administrator of the NSW Grains Board, for leave to issue summonses for the examination of six named persons, including two officers of the Audit Office of NSW, in relation to matters concerning the Board. The Audit Office parties sought to oppose the application on grounds which included the secrecy provisions contained in s. 38 of the *PFA Act*. At para. 96, his Honour Barrett J observed that

> "If either of the Audit Office parties were summoned by the court under s.596A or s.596B on the application of the plaintiff, that person would be required by s.597 to attend, to produce books and to answer questions as directed by the court, unless relieved of those obligations by aspects of s.597 which use the words "without reasonable excuse" (see ss.597(6) and (7)). The question to be determined is therefore whether the existence and effect of s.38 of the Public Finance and Audit Act, as it operates upon and in relation to the Audit Office parties, would constitute "reasonable excuse"."

4.7 It will be noted that the issue for consideration outlined above is very similar to that which arises in the present circumstances. His Honour went on to observe (at para. 99) as follows:

> "In a case such as the present, where one compulsory provision of New South Wales law would be asserted as justifying non-compliance with another expressed to operate subject to a "reasonable excuse" exception, I do not see that the question whether the exception was available would entail anything more than reconciliation of the respective requirements according to the proper construction of the provisions. This is not a case in which the objective reasonableness of countervailing conduct asserted as "reasonable excuse" can arise for consideration (cf *Taikato v The Queen* (1996) 186 CLR 454 and *Bank of Valletta plc v National Crime Authority* (1999) 90 FCR 565): obedience to a conflicting but specific statutory compulsion is, of its inherent nature, "reasonable". The prohibition imposed by s.38 of the *Public Finance and Audit Act* upon a person within the purview of that section, if applicable, is thus of its very nature a "reasonable excuse" when a provision of s.597 of the *Corporations Law* expressed to be subject to a "reasonable excuse" exception operates, on its face, to compel the person to do what s.38 prohibits. The present inquiry therefore resolves itself into the single question whether s.38 will operate as a prohibition upon the Audit Office parties. The immediate answer is that it will, unless, in the particular circumstances, a provision in s.38(2) causes the prohibition not to operate."

4.8 (For present purposes I do not believe that anything turns on the distinction between the term "reasonable excuse" examined above, and the term "lawful exercise" in s. 211 of the *POEO Act*.)

4.9 In my view the reasoning in *Re NSW Grains Board* outlined above applies equally in the present matter. In general terms, the secrecy requirements of s.38(1) of the *PFA Act* operate as a lawful excuse (within the meaning of s.211 of the "*POEO Act*) for non-compliance with a requirement to provide information and records under Chapter 7 of the *POEO Act*. In the present matter, to the extent that the Notice to Provide Information and/or Records dated 10 July 2013 requires the Auditor-General to provide information or records which would reveal any matter or thing coming to his knowledge in the exercise of functions under the *PFA Act* (including the conduct of a performance audit under Division 2A of Part 3 of that Act), the Auditor-General may in my view decline to do so. Having regard to the terms of the Notice it would appear very likely (and possibly inevitable) that provision by the Auditor-General of the information and records sought in the Notice, would breach the secrecy requirements of s.38(1). Nevertheless, if it has not already occurred I suggest the Auditor-General should review the terms of the Notice and satisfy himself as to whether this is the case.

4.10 Turning to exceptions contained in s. 38(2) of the *PFA Act*, of particular relevance in the present matter is s. 38(2)(b), which provides that nothing in subs. 38(1) applies "to or in respect of":

> "(b) proceedings for an offence relating to public money, other money, public property or other property or for the recovery of public money, other money, public property or other property."

4.11 I will put to one side the question of whether the proceedings foreshadowed in the Notice can be characterised as "proceedings for an offence relating to public money, other money, public property or other property". That question may arise for consideration in due course, but for present purposes I think it is sufficient to examine the question of whether any "proceedings" are in existence within the meaning of s. 38(2)(b). If there are no such proceedings then in my view the exception in s. 38(2)(b) could not be invoked by the issuer of the Notice in order to compel the Auditor-General to comply with the Notice.

4.12 In *Re NSW Grains Board* the applicant sought to invoke the exception contained in s. 38(2)(b) on the basis that the purpose of the proposed summons was to undertake examinations with a view to pursuing proceedings for recovery of public money. The applicant submitted that this was sufficient to satisfy the meaning of "proceedings" under s. 38(2)(b). At para. 106, Barrett J stated:

> "I do not accept this submission. Before the part of the exception in s.38(2)(b) concerned with civil actions can operate, it must be possible to identify actual or, at least, proposed proceedings and to see that they entail a claim for a remedy of the kind encompassed by the words "recovery of public money, or other money, public property or other property" against some identified person. While a Part 5.9 examination might have, as one of its purposes, investigation of the question whether there are grounds for instituting such proceedings against particular persons, the giving of answers at such an examination could not be said to bear to any proceedings, apart from the examination itself, any relationship of the kind envisaged by the words "to or in respect of". Unless and until some recovery proceeding is cogently formulated, it cannot be said to exist."

4.13 While Barrett J uses phrases such as "proposed proceedings" and "cogently formulated" in the above passage, I do not believe that those observations should necessarily be taken as a comprehensive statement as to the construction of the word "proceedings" in s. 38(2)(b) of the *PFA Act*. The *Encyclopaedic Australian Legal Dictionary* (*www.lexisnexis.com.au*, accessed 19 July 2013) provides the following definition of the word "proceeding":

> "An action commenced in a court, whether between parties or not, including an appeal: for example, (CTH) *Federal Court of Australia Act 1976* s 4. Historically, the term 'proceeding' was given a narrow interpretation to mean the invocation of jurisdiction of the court by process other than a writ (*Herbert Berry Associates Ltd v Inland Revenue Cmrs* [1978] 1 All ER 161 ; [1977] 1 WLR 1437), or an application by a suitor to a court in its civil jurisdiction for its intervention or action (*Cheney v Spooner* (1929) 41 CLR 532 ; [1929] ALR 173). This traditional legal meaning has been extended (for example, under (CTH) *Extradition Act 1988* s 19(1)) to mean the steps and procedures that take place before an investigating magistrate, even if the task of the magistrate is administrative as distinct from legal or judicial: *Forrest v Kelly* (1991) 32 FCR 558;105 ALR 397"

4.14 With regard to criminal proceedings, the various methods by which such proceedings could be commenced in New South Wales were outlined by Gleeson CJ in *R v Hull* (1989) 16 NSWLR 385 at 390, and included laying a charge, exhibiting an information, followed by the issue of a summons, or the issue of a warrant for arrest where an information had been sworn before a justice, usually by a police officer.

4.15 Under the present Local Court procedures in the *Criminal Procedure Act 1986*, proceedings are not commenced until a court attendance notice has been filed in the relevant court registry: s. 53(1) (committal proceedings); s. 178(1) (summary proceedings).

4.16 At present the information contained in the Notice discloses nothing to suggest that the jurisdiction of a court has been invoked or that any steps, whether judicial or administrative, in the nature of those outlined in the above paragraphs have been taken for the purpose of instituting proceedings. As I have indicated, the secrecy requirements of s.38(1) of the *PFA Act* are subject to the exceptions contained in s.38(2) of that Act, including s.38(2)(b), which operates in respect of certain criminal and civil proceedings relating to money and property. On the basis of the information contained in the Notice, which essentially discloses that an investigation is taking place in respect of a possible offence under s.143 of the *POEO Act*, there are in my view no proceedings presently in existence for the purposes of s.38(2)(b) of the *PFA Act*, and the exception contained in that sub-section is therefore not engaged and does not provide a basis for the Auditor-General to be compelled to comply with the Notice.

4.17 In the event the Auditor-General seeks to rely on s. 38 of the *PFA Act* as a basis for non-compliance with the Notice, I would suggest that any letter sent by him for this purpose should conclude with the words "I reserve my position with respect to any further grounds of objection which may be available with respect to the Notice". The purpose of this would be to preserve the Auditor-General's position in respect of other grounds of objection which may become apparent, in the event Mr James and/or the EPA seeks to pursue compliance with the Notice by the Auditor-General.

4.18 This concludes my advice, which I hope is of assistance. Should you wish to discuss any aspect of this advice, or seek my assistance with regard to the preparation of a letter to be sent by the Auditor-General in response to the Notice, please do not hesitate to contact Richard Kelly, Assistant Crown Solicitor on 9224 5102.

Signed:

Richard Kelly
Assistant Crown Solicitor
for Crown Solicitor

201301978 Advice 1 D2013/317621

Appendix 5: Prescribed Audits

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

The following were prescribed entities as at 30 June 2013:

Entity	Latest financial statements audited	Type of audit opinion issued
Agricultural Scientific Collections Trust	30 June 2011 [a]	Unmodified
Ambulance Service of NSW	30 June 2006 [c]	Unmodified
AustLII Foundation Limited	31 December 2012	Unmodified
The Australian Institute of Asian Culture and Visual Arts Limited	30 June 2013	Unmodified
Belgenny Farm Agricultural Heritage Centre Trust	30 June 2012 [b]	Unmodified
The Brett Whiteley Foundation	30 June 2013	Unmodified
Buroba Pty Ltd	30 June 2013	Unmodified
C. B. Alexander Foundation	30 June 2012 [b]	Unmodified
CCP Holdings Pty Limited	30 June 2012 [d]	Unmodified
Cobbora Coal Unit Trust	30 June 2012 [d]	Unmodified
Cobbora Management Company Pty Limited	30 June 2012 [d]	Unmodified
Cobbora Unincorporated Joint Venture	30 June 2010 [d]	Unmodified
Cowra Japanese Garden Maintenance Foundation Limited	31 March 2013	Unmodified
Cowra Japanese Garden Trust	31 March 2013	Unmodified
Dumaresq-Barwon Border Rivers Commission	30 June 2011 [e]	Unmodified
Eif Pty Limited	30 June 2013	Unmodified
Gosford City Council, being a water supply authority listed in Schedule 3 to the *Water Management Act 2000*	30 June 2012 [b]	Qualified
Illawarra Health and Medical Research Institute Limited	30 June 2012 [b]	Unmodified
Local health districts within the meaning of the *Health Services Act 1997*:		
Sydney Local Health District	30 June 2013	Unmodified
South Western Sydney Local Health District	30 June 2013	Unmodified
South Eastern Sydney Local Health District	30 June 2013	Unmodified
Illawarra Shoalhaven Local Health District	30 June 2013	Unmodified
Western Sydney Local Health District	30 June 2013	Unmodified
Nepean Blue Mountains Local Health District	30 June 2013	Unmodified
Northern Sydney Local Health District	30 June 2013	Unmodified
Central Coast Local Health District	30 June 2013	Unmodified
Hunter New England Local Health District	30 June 2013	Unmodified
Murrumbidgee Local Health District	30 June 2013	Unmodified
Southern NSW Local Health District	30 June 2013	Unmodified
Western NSW Local Health District	30 June 2013	Unmodified
Far West Local Health District	30 June 2013	Unmodified
Mid North Coast Local Health District	30 June 2013	Unmodified
Northern NSW Local Health District	30 June 2013	Unmodified

Entity	Latest financial statements audited	Type of audit opinion issued
Marine Parks Authority	30 June 2011 [(a)]	Unmodified
Minister administering the *Environmental Planning and Assessment Act 1979* (a corporation)	30 June 2013	Unmodified
Minister administering the *Heritage Act 1977* (a corporation)	30 June 2012 [(b)]	Unmodified
National Art School	30 December 2012	Unmodified
NSW Businesslink Pty Limited	30 June 2013	Unmodified
NSW Fire Brigades Superannuation Pty Limited	30 June 2013	Unmodified
State Super Financial Services Australia Limited	30 June 2013	Unmodified
Trustees of the Farrer Memorial Research Scholarship Fund	31 December 2011 [(f)]	Unmodified
The trustees for the time being of The Art Gallery of New South Wales Foundation	30 June 2013	Unmodified
Trustee of the Home Purchase Assistance Fund	30 June 2013	Unmodified
Each board of management, state conservation area trust and trust board established for a state conservation area within the meaning of the *National Parks and Wildlife Act 1974*	-- [(g)]	--
The trustees for the time being of each superannuation scheme established by a trust deed as referred to in section 127 of the *Superannuation Administration Act 1996*:		
Energy Industries Superannuation Scheme Pool A	30 June 2013	Unmodified
Energy Industries Superannuation Scheme Pool B	30 June 2013	Unmodified
Uniprojects Pty Limited	30 June 2012 [(b)]	Unmodified
United States Studies Centre Limited	31 December 2012	Unmodified
Universities Admissions Centre (NSW and ACT) Pty Limited	30 June 2012 [(b)]	Unmodified
Valley Commerce Pty Ltd	30 June 2013	Unmodified
Wyong Council, being a water supply authority listed in Schedule 3 to the *Water Management Act 2000*	30 June 2012 [(b)]	Unmodified
Crown Employees (NSW Fire Brigades Fire Fighting Staff Death and Disability) Superannuation Fund	30 June 2013	Unmodified
Energy Investment Fund	30 June 2013	Unmodified
Home Warranty Insurance Fund	30 June 2012 [(b)]	Unmodified
Macquarie University Professorial Superannuation Scheme	30 June 2012 [(b)]	Unmodified
Parliamentary Contributory Superannuation Fund	30 June 2013	Unmodified
State Super Allocated Pension Fund established by State Super Allocated Pension Fund Trust Deed dated 23 November 1993	30 June 2013	Unmodified
State Super Fixed Term Pension Plan established by State Super Fixed Term Pension Plan Trust Deed dated 14 July 1999	30 June 2013	Unmodified
State Super Personal Retirement Plan established by State Super Personal Retirement Plan Trust Deed dated 3 April 1990	30 June 2013	Unmodified
State Super Investment Fund established by State Super Investment Fund – Cash Fund Constitution dated 22 November 1991, State Super Investment Fund – Capital Stable Fund Constitution dated 22 November 1991, State Super Investment Fund – Balanced Fund Constitution dated 22 November 1991 and State Super Investment Fund – Growth Fund Constitution dated 24 April 1997	30 June 2013	Unmodified

Entity	Latest financial statements audited	Type of audit opinion issued
The superannuation fund amalgamated under the *Superannuation Administration Act 1991* and continued to be amalgamated under the *Superannuation Administration Act 1996*	30 June 2013	Unmodified
University of Sydney Professorial Superannuation System	31 December 2012	Unmodified

a 30 June 2012 financial statements have been submitted for audit. My audit is still in progress as at 18 October 2013.

b 30 June 2013 financial statements have been submitted for audit. My audit is still in progress as at 18 October 2013.

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

d These entities were removed from the list of prescribed entities on 30 August 2013.

e The Commission's financial statements are now audited by the Auditor-General for Queensland.

f 31 December 2012 financial statements have been submitted for audit. My audit is still in progress as at 18 October 2013.

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

OF NEW SOUTH WALES

Our vision

To make the people of New South Wales proud of the work we do.

Our mission

To perform high quality independent audits of government in New South Wales.

Our values

Purpose – we have an impact, are accountable, and work as a team.

People – we trust and respect others and have a balanced approach to work.

Professionalism – we are recognised for our independence and integrity and the value we deliver.

Professional people with purpose

audit.nsw.gov.au

Professional people with purpose
Making the people of New South Wales proud of the work we do.

Level 15, 1 Margaret Street
Sydney NSW 2000 Australia

t +61 2 9275 7100
f +61 2 9275 7200
e mail@audit.nsw.gov.au
office hours 8.30 am–5.00 pm

audit.nsw.gov.au

audit office
OF NEW SOUTH WALES